

Markets Update: Emerging Markets in 2021

Jake Siewert: Welcome to our Exchanges at Goldman Sachs Markets Update for Friday, January 15th. Each week we check in with a leader across the firm to get a quick take on what they're watching in markets. I'm Jake Siewert, global head of corporate communications here at the firm. And today I'm delighted to be joined by Jen Roth of our global markets division, who's going to talk about, as she always does, the investing landscape for emerging markets. Jen, welcome back to the program. Happy new year.

Jen Roth: Thank you, Jake. Happy new year. Good to see you. Hopefully next time we do this we'll be in person.

Jake Siewert: Yeah, we could do it at least once in person hopefully sometime soon. So for those watching emerging markets, the MSCI Index has rallied back to record highs. What's driving all the enthusiasm amongst investors?

Jen Roth: So, yeah, you're absolutely right. In the past two months there really has been a significant amount of enthusiasm around emerging markets as an asset class. We've now had for over ten months very easy monetary policy conditions globally that have really flushed the market with liquidity. On top of the monetary impulse, you also have the fiscal impulse that is perceived to be even stronger with the Democratic wins in Georgia last week. So you have a monetary anchor, you have a fiscal anchor, and then a vaccine which doesn't necessarily help us on a spot basis but very positive for the forward.

You also have the world forecasting stronger global growth of 5.2% with GS in particular well above consensus at 6.4%. EM is effectively a beta play on growth and is the quintessential reflation and pro cyclical trade, so we should continue to benefit from the macro environment we're finding ourselves in.

I'd be remiss not to mention valuations, which also play an important role here. EM always trades at a discount to developed market equities for obvious reasons, but it's the cheapest it has been on a relative basis, which makes it look particularly attractive. Valuations look similar on the external debt side where EM bonds look to track debt versus US high-yield bonds, which continue to drive inflows and interest into the space.

Jake Siewert: So Jen, do the fundamentals of the emerging

market economies really match the asset prices we're seeing? Or is there a bit of a disconnect?

Jen Roth: So right now the market's really trading on a forward basis. The price section is largely ignoring the somewhat challenging EM fundamentals like the large fiscal debts and little room on the monetary policy side because of the extremely supportive macro backdrop for the asset class that we just discussed. If we fast forward, EM will most likely come to an inflection point in the next 6-9 months. Fundamentals will either have improved significantly if we have the sustained growth we are forecasting, but if this doesn't materialize many of the EM countries will be in a difficult situation. They'll have no more room on the fiscal or monetary policy side, and we'll have to deal with the high debt load which could become an issue for the credit.

Prices are prone to run ahead of fundamentals, which is what we're seeing now with the positive price action and bullishness around the asset class.

Jake Siewert: So emerging markets is obviously a very broad category. Within emerging markets, are there particular areas where you're seeing a lot of investor interest?

Jen Roth: Generally speaking, investor interest has been in the high yielders. People are really looking to generate carry, so places like Mexico, Indonesia, Russia, South Africa or in the laggards like Brazil. In the rates space, given the rally we saw last year, more interest has been in the [UNINTEL] trades. And in credit, our investors are really waiting for what we anticipate being a robust new issue pipelines put their money to work.

Jake Siewert: You're talking to a lot of clients. Do you get the sense from talking to them that this kind of more aggressive investing style will continue throughout the year?

Jen Roth: Even with the volatility to start the year, people aren't really budging from their core positive view on the asset class. Most of the portfolio managers really think 2021 will be the year for EM. You know, once the treasury sell-off stabilizes, they're ready to reload longs with a continued preference for high yield over IG. The only issue is this is a really consensus playbook at this point, which can be a little bit worrying when everyone has the same view.

Jake Siewert: Okay. What are the risks that could shift people away from EM assets? Which asset class is most vulnerable?

Jen Roth: The most obvious risk right now is really a renewed COVID-induced shutdown or anything that will affect global growth. You know, beyond that, if everything goes well - - and you're going to have a lot of central banks that will need to hike interest rates later in the year, which will put pressure on these economies. We should also keep an eye on commodities and the dollar. If there's a change in the bullish commodity narrative in the dollar bid of the past few weeks remains, that will definitely put the asset class under pressure. To be clear, neither of these are our base cases, but regardless it's a risk to keep an eye on.

Jake Siewert: All right, Jen. Well thanks for joining us. That was a quick overview of where we are today, and we'll check back later in the year and see how emerging markets are holding up.

Jen Roth: Sounds great. Thanks for the time, Jake.

Jake Siewert: That concludes this episode of Exchanges at Goldman Sachs. Thank you very much for listening, and if you enjoyed this show we hope you subscribe on Apple Podcasts and leave a rating or a comment. And in case you missed it, check out our other episode this week with Olympia McNerney of our investment banking division on the continued momentum behind SPACs is an alternative path for companies to raise money in the public markets.

This podcast was recorded on Wednesday, January 13th, in the year 2020. Thank you for listening.

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