EM Turbulence: A Correction, Not a Crisis

By BNY Mellon Investment Management

Recently, we asked emerging market portfolio managers and analysts from across BNY Mellon's investment boutiques to explain what's been driving the turmoil in emerging markets (EM), whether the worst is over, and what is likely to happen next.

Tom Higgins of Standish Mellon Asset Management, Colm McDonagh of Insight, Sean Fitzgibbon of The Boston Company and Rob Marshall-Lee of Newton all agree that EMs' troubles are unlikely to become a crisis such as the one that spread through east Asian economies beginning in 1997 and lasted for nearly two years. "What's been going on in EMs is a correction, not a crisis," says Fitzgibbon. Similarities to situations in the Asian crisis countries, such as structural imbalances, have appeared in some emerging markets. The catalysts for the Asian contagion, however, notes Tom Higgins, Chief Economist with Standish Mellon Investment Management, were massively overvalued currencies and the widespread practice of pegging government balance sheets to the U.S. dollar, neither of which is a prevalent issue in the vast majority of EMs today.

> Tighter money has also helped highlight a host of country-level issues.

McDonagh says that the correction has been triggered by individual countries' policy responses to the Federal Reserve's tapering of its asset purchases. "In the last year, a number of EM currencies have weakened and even more so since the start of the new year," he says. "The changes toward weaker currencies come as EM central banks seek the least fiscally costly ways to stimulate growth in a big election year. In some cases like Turkey, a weaker currency is due to risk aversion, while in other countries, such as Russia, currency weakness is a policy decision."

Higgins points out that tighter money has also helped highlight a host of idiosyncratic country-level issues in EMs. "As money's flowed out, a flashlight has been turned on EMs more broadly and now people see there are countries with some issues," he says. "Turkey has both a political corruption scandal and also an external balance of payments issue with a large trade deficit and interest rates that were too low. Turkey has been one of the worst performers this year as far as currency, but there are other EMs such as South Africa and Thailand with political issues. In China, we knew there were structural issues, but the potential default of

BNY MELLON

China Credit Trust, which has indirect links to one of China's larger banks makes people wonder whether it's the canary in the coal mine in terms of what's to come. China is the poster child for emerging markets, so when something isn't quite right in China, it gets people nervous."

> Indexes have been over-represented in places where things are not sustainable.

Several analysts pointed to the expectations and strategies employed by those nervous investors as helping to intensify the correction. "People were buying into EMs at a rate that didn't reflect the underlying risks," says McDonagh. "The EM central banks' policy responses to Fed tapering often have had greater consequences for those investing in EMs than for the countries themselves. That's because the vast flows into EMs over the past couple of years have largely gone into local-currency denominated long-only debt positions." Higgins points out that many investors' preference for index-based strategies have also prompted them to flee EMs en masse. "Investors have always looked at EMs as a homogenous entity and they buy broad EM index ETFs and when times get tough, they just dump the asset class. They don't distinguish between Turkey or Argentina and a country like Mexico which has much sounder fundamentals and has been implementing reforms in the banking and oil sectors and which has one of the most liquid currencies around, they just throw the baby out with the bath."

Rob Marshall-Lee of Newton echoes Higgins's concern that the flight from EM is an overreaction and that investors should not overlook the variegated nature of EMs. "Indexes have been over-represented in places where things are not sustainable," he says. He points out that risk remains in the putative safety of the developed markets toward which investment flows have shifted recently. "They're still on an unsustainable credit binge," he says. "While current accounts in most EM countries are shrinking and moving toward deficit, the fiscal imbalances in developed markets are far greater," he notes.

None of the portfolio managers and analysts we spoke to believes that the case for long-term investment in EMs (demographic-driven consumer market growth and relatively little debt) has been invalidated by recent events. However, they all emphasize the importance of employing actively managed investment strategies that recognize the variegated nature of the countries that wear the "EM" label.

While the fundamental investment thesis for EMs may remain intact, investors wonder when the turmoil will subside. BNY Mellon Chief Global Markets Strategist Jack Malvey notes, "The momentum for correction has been faltering without fresh negative catalysts."

Individual EMs already show signs of recovering, despite the ongoing normalization of developed markets' fiscal policy. "India shows signs of having come out the other side," says Fitzgibbon. He points to the successful stabilization of the rupee over the past year and the prospect that a new government may undertake much-needed reforms as reasons for optimism.

Newton's Rob Marshall-Lee sees current opportunities within EMs as well. Even as China's economy slows, active managers are spotting opportunities in specific niches such as China's internet sector. "It's much more a stock picker's market now, which for us is a big advantage," he says.

While no one knows when indices that track the entire basket of emerging markets may reach bottom, all of our experts agree that EM allocations remain important for long-term strategic investors. Those investors should recognize the need to identify and manage the risks that continue to be a distinguishing feature of emerging market economies.

As McDonagh puts it, "Dedicated long-time EM investors recognize that political noise rises and falls in EMs, just as it does in developed markets, but no single country is big enough that its politics can create systemic risks."

Emerging markets allocations remain important for long-term strategic investors.

BNY Mellon Investment Management is one of the world's leading investment management organizations and one of the top U.S. wealth managers, encompassing BNY Mellon's affiliated investment management firms, wealth management organization and global distribution companies. BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may also be used as a generic term to reference the Corporation as a whole or its various subsidiaries generally. • The statements and opinions expressed in this document are those of the authors as of the date of the article, are subject to change as economic and market conditions dictate, and do not necessarily represent the views of BNY Mellon, BNY Mellon Investment Management EMEA Limited or any of their respective affiliates. This document is of general nature, does not constitute legal, tax, accounting or other professional counsel or investment advice, is not predictive of future performance, and should not be construed as an offer to sell or a solicitation to buy any security or make an offer where otherwise unlawful. The information has been provided without taking into account the investment objective, financial situation or needs of any particular person. BNY Mellon Investment Management EMEA Limited and its affiliates are not responsible for any subsequent investment advice given based on the information supplied.

Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and can fall as well as rise due to stock market and currency movements. When you sell your investment you may get back less than you originally invested. • While the information in this document is not intended to be investment advice, it may be deemed a financial promotion in non-U.S. jurisdictions. Accordingly, where this document is used or distributed in any non-U.S. jurisdiction, the information provided is for use by professional and wholesale investors only and not for onward distribution to, or to be relied upon by, retail investors. • Products or services described in this document are provided by BNY Mellon, its subsidiaries, affiliates or related companies and may be provided in various countries by one or more of these companies where authorized and regulated as required within each jurisdiction. Not all products and services are offered at all locations. This document may not be distributed or used for the purpose of offers or solicitations in any jurisdiction or in any circumstances in which such offers or solicitations are unlawful or not authorized, or where there would be, by virtue of such distribution, new or additional registration requirements. Persons into whose possession this document comes are required to inform themselves about and to observe any restrictions that apply to the distribution of this document in their jurisdiction. **The investment products and services mentioned here are not insured by the FDIC (or any other state or federal agency), are not deposits of or guaranteed by any bank, and may lose value.** • This document should not be published in hard copy, electronic form, via the web or in any other medium accessible to the public, unless authorized by BNY Mellon Investment Management EMEA Limited.

In **Australia**, this document is issued by BNY Mellon Investment Management Australia Ltd (ABN 56 102 482 815, AFS License No. 227865) located at Level 6, 7 Macquarie Place, Sydney, NSW 2000. Authorized and regulated by the Australian Securities & Investments Commission. • In **Brazil**, this document is issued by BNY Mellon Serviços Financeiros DTVM S.A., Av. Presidente Wilson, 231, 11th floor, Rio de Janeiro, RJ, Brazil, CEP 20030-905. BNY Mellon Serviços Financeiros DTVM S.A. is a Financial Institution, duly authorized by the Brazilian Central Bank to provide securities distribution and by the Brazilian Securities and Exchange Commission (CVM) to provide securities portfolio managing services under Declaratory Act No. 4.620, issued on December 19, 1997. • Securities in **Canada** are offered through BNY Mellon Asset Management Canada Ltd., registered as a Portfolio Manager and Exempt Market Dealer in all provinces and territories of Canada, and as an Investment Fund Manager and Commodity Trading Manager in Ontario. • In **Dubai, United Arab Emirates**, this document is issued by the Dubai branch of The Bank of New York Mellon, which is regulated by the Dubai Financial Services Authority. This material is intended for Professional Clients only and no other person should act upon it. • If this document is used or distributed in **Hong Kong**, it is issued by BNY Mellon Investment Management Hong Kong Limited, whose business address is Level 18, Three Pacific Place, 1 Queen's Road East, Hong Kong. BNY Mellon Investment Management Hong Kong Limited is regulated by the Hong Kong Securities and Futures Commission and its registered office is at 6th floor, Alexandra House, 18 Chater Road, Central, Hong Kong. • In **Japan**, this document is issued by BNY Mellon Asset Management Japan Limited, Marunouchi Trust Tower Main Building, 1-8-3 Marunouchi Chiyoda-ku, Tokyo 100-0005, Japan. BNY Mellon Asset Management Japan Limited is a Financial Instruments Business Operator with license no 406 (Kinsho) at the Commissioner of Kanto Local Finance Bureau and is a Member of the Investment Trusts Association, Japan and Japan Securities Investment Advisers Association. • In **Korea**, this document is issued by BNY Mellon AM Korea Limited for presentation to professional investors. BNY Mellon AM Korea Limited, 29F One IFC, 10 Gukegeumyung-ro, Yeongdeungpo-gu, Seoul, 150-945, Korea. Regulated by the Financial Supervisory Service. • In **Singapore**, this document is issued by BNY Mellon Investment Management Singapore Pte. Limited for presentation to accredited investors, institutional investors and family offices that are expert investors as defined under the Securities and Futures Act. BNY Mellon Investment Management Singapore Pte. Limited, One Temasek Avenue, #04-02 Millenia Tower, Singapore 039192. Co. Reg. 201230427E. Regulated by the Monetary Authority of Singapore. • This document is issued in the **UK** and in **mainland Europe**, by BNY Mellon Investment Management EMEA Limited, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No. 1118580. Authorized and regulated by the Financial Conduct Authority. • This document is issued in the **United States** by BNY Mellon Investment Management.

BNY Mellon owns over 95% of the parent holding company of The Alcentra Group, which is comprised of the following affiliated investment advisers: Alcentra, Ltd and Alcentra NY, LLC. • BNY Mellon Cash Investment Strategies is a division of The Dreyfus Corporation. • BNY Mellon Western FMC, Insight Investment Management Limited and Meriten Investment Management GmbH do not offer services in the U.S. This presentation does not constitute an offer to sell, or a solicitation of an offer to purchase, any of the firms' services or funds to any U.S. investor, or where otherwise unlawful. • BNY Mellon Western Fund Management Company Limited is a joint venture between BNY Mellon (49%) and China based Western Securities Company Ltd. (51%). The firm does not offer services outside of the People's Republic of China. • BNY Mellon owns 90% of The Boston Company Asset Management, LLC and the remainder is owned by employees of the firm. • BNY Mellon owns a 19.9% minority interest in The Hamon Investment Group Pte Limited, the parent company of Blackfriars Asset Management Limited and Hamon Asian Advisors Limited both of which offer investment services in the U.S. • Services offered in the US, Canada and Australia by Pareto Investment Management Limited under the Insight Pareto brand. • The Newton Group ("Newton") is comprised of the following affiliated companies: Newton Investment Management Limited, Newton Capital Management Limited (NCM Ltd) and Newton Capital Management LLC (NCM LLC). NCM LLC personnel are supervised persons of NCM Ltd and NCM LLC does not provide investment advice, all of which is conducted by NCM Ltd. Only NCM LLC and NCM Ltd offer services in the U.S. • BNY Mellon owns a 20% interest in Siguler Guff & Company, LP and certain related entities (including Siguler Guff Advisers LLC). • BNY Mellon Investment Management EMEA Limited and any other BNY Mellon entity mentioned above are all ultimately owned by BNY Mellon, unless otherwise noted.

The Alcentra Group
ARX Investimentos Ltda
BNY Mellon Cash Investment Strategies
BNY Mellon Western Fund Management Company Limited
The Boston Company Asset Management, LLC
CenterSquare Investment Management, Inc.
CenterSquare Investment Management Holdings, Inc.
The Dreyfus Corporation
EACM Advisors LLC
Hamon Investment Group
Insight Investment
Mellon Capital Management Corporation
Meriten Investment Management
The Newton Group
Siguler Guff & Company LP
Standish Mellon Asset Management Company LLC
Walter Scott & Partners Limited

BNY MELLON

©2014 The Bank of New York Mellon Corporation. 02/14

本情報提供資料は、BNY メロン・グループ（BNY メロンを最終親会社とするグループの総称です）の資産運用会社が提供する情報について、BNY メロン・アセット・マネジメント・ジャパン株式会社が審査の上、掲載したものです。当資料は情報の提供を目的としたもので、勧誘を目的としたものではありません。当資料は信頼できると思われる情報に基づき作成されていますが、その正確性、完全性を保証するものではありません。ここに示された意見などは、作成時点での見解であり、事前の連絡無しに変更される事もあります。

BNY メロン・アセット・マネジメント・ジャパン株式会社
BNY Mellon Asset Management Japan Limited

金融商品取引業者：関東財務局長（金商）第 406 号
〔加入協会〕一般社団法人　投資信託協会
　　　　　　一般社団法人　日本投資顧問業協会