

Global Perspective

The Trump/ Jong-un show: should EM investors be worried?

Asset Management

August 2017

Tensions mount...tensions recede

Tensions between North Korea and the United States have increased since the start of the year as a result of the numerous missile tests conducted by North Korea.

In recent weeks the pressure gauge rose to new heights following the test on 28 June of an intercontinental ballistic missile capable of striking the US mainland. President Trump inflamed the situation, saying that any threat to the US would be responded to with "fire and fury," to which the North Korea leader, Kim Jong-un, replied by saying that he would strike the strategically important US island of Guam with multiple missiles.

Fortunately, tensions have been diffused somewhat by China voting in favour of a UN resolution to impose further economic sanctions on North Korea and putting pressure on both sides to dial down the aggressive rhetoric; this saw North Korea stepping back from its specific threats to launch missiles towards Guam.

Given China's role as North Korea's most important economic partner, its involvement is a positive for this highly tense situation. China's support for the UN resolution shows that the country is ready to play a more strategic role in global affairs, albeit while balancing that with its desire to preserve the status quo in the Korean peninsula.

If not nuclear war will it be trade war?

As evident in a number of tweets made by President Trump, he had been hoping for China to do more to help contain North Korea's nuclear ambitions. And this was one reason why the US decided not to name China as a currency manipulator or to tackle the 'unfair' trade relationship between the two countries. Such a move had been promised during the election campaign and was a key concern for markets following Trump's election win.

Trump's direction on this matter appears to be changing; he has asked US trade officials to determine whether the US should launch a trade complaint against China on the alleged basis that the country has been conducting a systematic theft of US intellectual property and forcing US companies doing business in China to share sensitive technology. This would amount to a first step for the US towards a more protectionist stance on trade.

Moreover, in a recent interview, Steve Bannon, former White House Chief Strategist, clearly stated that he viewed the US and China as being locked into an "economic war." And while it is not clear how widely this view is held, especially given Bannon's departure, the opening of the NAFTA renegotiation has made it clear that the US administration is gradually focusing in on trade, with the narrow aim of tackling the US trade deficit.

Salman Ahmed
Chief Investment Strategist

Charles St-Arnaud
Senior Investment Strategist

Risks are evolving but our outlook remains prudently positive

While the risks relating to the tensions in the North Korean peninsula should not be ignored (as likelihood of re-intensification remains fairly high), we believe that a risk that is relatively more likely to become a reality is a broader souring of the relationship between the US and China as a result of a wider trade dispute.

As we noted in a **recent piece**, we believe the broad outlook for emerging markets remains positive. Fundamentals have improved quite broadly and valuations have adjusted meaningfully since 2013. Note the calm with which these markets navigated the Fed rate hikes in 2015 and 2016

and volatility in oil prices (which were driven by supply side issues). We are confident that emerging markets have grown out of the tantrum phase. However, we are monitoring carefully the US/China trade situation as it is reappearing as a more important risk for our thesis.

Overall, we continue to believe the attractive positioning of the emerging market asset class is very real. However, given fractured bond market liquidity and the heterogeneity in emerging markets, the adoption of a low-turnover, quality-driven investment approach remains vital, in our view.

IMPORTANT INFORMATION

For professional investor use only. This material does not constitute an offer or solicitation in any jurisdiction where or to any person to whom it would be unauthorised or unlawful to do so.

This document is provided for information purposes only and does not constitute an offer or a recommendation to purchase or sell any security or service. It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful. This document does not contain personalized recommendations or advice and is not intended to substitute any professional advice on investment in financial products. Before entering into any transaction, an investor should consider carefully the suitability of a transaction to his/her particular circumstances and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences. This document is the property of LOIM and is addressed to its recipient exclusively for their personal use. It may not be reproduced (in whole or in part), transmitted, modified, or used for any other purpose without the

prior written permission of LOIM. This document contains the opinions of LOIM, as at the date of issue.

Past performance does not guarantee future results.

Emerging markets securities may be less liquid and more volatile and are subject to a number of additional risks including, but not limited to, currency fluctuations and political instability.

If investments are denominated in a currency other than that in which the majority of the investor's assets are held, the investor should be aware that changes in rates of exchange may affect the value of the funds' underlying assets. The portfolio risk management process includes an effort to monitor and manage risk, but does not imply low risk.

Issued by Lombard Odier Asset Management (Europe) Limited, authorised and regulated by the Financial Conduct Authority (the "FCA"), and entered on the FCA register with registration number 515393.

©2017 LOIM. All rights reserved.