The Yield Search focused on Emerging Markets

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- **Firming of Eurozone and UK economies supports their respective equity markets**
- **Capital flows continue into emerging markets**
- **Dr. Patel, India's new RBI Governor should provide continuity – we see further upside in Indian debt markets**
- **KSA opens up IPO participation to Qualified Financial Investors from abroad**
- **Shenzhen/HK Stock Connect increases mainland access**

The post-Brexit world in Europe does not appear to be as bad as some commentators had forecast. **Recent data releases from Europe have shown some firming up in the eurozone and UK economies.** The eurozone July composite industrial confidence data rose slightly in July and is expected to hold at the improved level in this week's flash for August.

The effects of Brexit on the UK will take some time to work through, and there could still be some very difficult times ahead. However the market was pleased to see a 1.4% month-on-month broad-based jump in retail sales in July. Also, there was a small decline in claimants for unemployment benefits. Eurozone equities have nearly recovered all of their losses since the Brexit vote, while UK equities are up close to 7% from the pre-Brexit levels. **Yield support – with a 4% plus yield on both the Euro stoxx50 and FTSE100 indices are well supported.**

The S&P 5000 Dividend Aristocrats Index (an index of stocks that increased dividends in each of the past twenty years) has finally begun lagging the broader S&P 500 as utilities and telecom stocks halt their trajectory upwards. Telecom +19.3% and Utilities + 18.1% remain the best performing sectors in 2016, however, the worst this month. We see a rotation into technology and healthcare. The energy sector is responsible for the fourth consecutive quarter for a fall in earnings on the S&P 500, however, is showing signs of a rebound as expectations of a freeze in oil production has sent the commodity rallying back close to $50 levels.

The US Healthcare sector stands out as among the most exposed to the election outcome. Policies under Clinton or Trump could impact the pricing structure. M&A for the purpose of tax avoidance has already been frowned upon. H**istorical data, however, points to the Healthcare sector outperforming the market post-election.**

This week markets are likely to focus on the Jackson Hole conference, signifying a bias towards lower yields. Significant events for the rest of the year with a focus on policy rates include - The Italian referendum, US elections and the two FOMC meets in September and December.

The search for yield continues as investors take a cue from global central banks ongoing unprecedented monetary policy actions and venturing out into corporate bond purchases. Global Central banks are adding approximately close to $170-175B a month of liquidity to the global fixed income bond markets through various purchasing agenda. The substantial surge in total bonds on the developed markets that yield negative to zero is currently over US$13T. Together with improving EM dynamics both on fundamental and technical grounds, these are the main factors driving investor flows. FX volatility subsiding is also encouraging **investors to move to higher-yielding bonds within the emerging market asset class**

The option-adjusted spread (OAS) on US dollar-denominated EM Sovereign bonds is currently at 285bp. EM sovereign bonds when stripped between investment grade and high yielding Sovereign issuers, are currently trading at spreads of 173bp and 431bp respectively.

EM corporate bonds continue to offer attractive spreads of 213bp and 624bp on investment grade and high yield respectively. The average yield of 2.55% on UAE investment grade bonds is close to the record level lows last seen in May 2014. We await the next pipeline of deals from Sovereigns and corporates from the GCC region, particularly from the Kingdom of Saudi Arabia, Kuwait and Bahrain.

The 10-year Chinese Government bonds yield is at a near record lows at 2.68% from 2.61% as domestic investors brace for issuance of haven bonds including bonds issued by some of the big Chinese policy banks. We still believe the central bank (PBOC) will ease monetary policy, if and when required, to stimulate the economy.

Our focus remains on the Indian government bond yields where we expect to see further yield compression to levels seen post the financial crisis in 2008 to 2009, on the back of improving fundamentals and progress on reforms.

The Indian government has appointed Dr. Urjit Patel, a deputy governor in charge of monetary policy, to replace Mr. Raghuram Rajan as the next governor of the Reserve Bank of India "RBI.' His appointment implies a continuity of monetary policy at the RBI, as he worked closely with Mr. Rajan on key reforms, especially in controlling inflation. As Chairman of the Urjit Patel committee, he recommended moving to a CPI inflation target of 4% +/- 2% and towards positive real interest rates.

However, the fight against inflation continues in India as CPI inflation rose to 6.1 percent year on year in July, from 5.8 per cent in June, and just above the RBI's 6 percent ceiling. Wholesale prices rose 3.55 percent year-on-year in July, up from 1.62 percent in June and well ahead of the 2.84 percent rate economists were expecting. The new governor will also have to operate within the constraints of the new Monetary Policy Committee for decisions on rates.

From the Middle East to the Far East in Asia, countries are opening up their capital markets to foreign investors as they fear that their inward looking policy is stymieing volumes and capping gains.

In keeping with the aims of the National Transformation Plan, **Saudi Arabia relaxed its rules for Qualified Foreign Investors "QFI's" last week and is opening up its capital markets further by allowing QFI's participation in IPO's from January.** This seems a precursor to the listing of Aramco, which controls one-fifth of the world's petroleum reserves and could be valued at $2 trillion, making it the world's most valuable company. KSA intends to sell up to 5 percent of Aramco as early as next year.

Saudi markets have been sluggish this month. Not even the rebound in oil prices has helped the Index or volumes. The effects of fiscal prudence already commended by the IMF should trickle down to the economy and onwards to the markets eventually.

China's Shenzhen/HK Stock Connect Program will allow international investors to buy directly into the Shenzhen stock market and provide access to 880 stocks focused on technology, healthcare and also startups on the ChiNext. This follows the Shanghai-Hong Kong Connect launched two years ago that provided trading access to 567 Chinese companies. **The Combined Connect will provide accessibility to 70% of China mainland market cap.**

A-shares trade at a premium to H-shares and the Connect should bridge this gap. There are no quotas and more products such as ETF's would be available to foreign investors. The broadening of the investor base and increase of access could help China's A shares be considered in the next review by MSCI for its emerging market Index.

The Shenzhen Stock Connect may not trigger a sustainable rally in the A-share market as the Connect was expected and underlying economic data is not supportive. However, China has been lagging the broader EM Indices, and this could be the catalyst for Chinese Indices to play catch up in the short term.

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