



# Morgan Stanley Global Macro Forum

## A Better Outlook for EM

November 28, 2022

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**Jonathan Garner**

*Chief Asia & EM Equity Strategist, Chairman of Asset  
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## MSCI EM Index (Red Lines Indicate Trough) – We Upgraded MSCI EM on October 4



## EM Bear Markets and Subsequent Bull Cycles Historical Peak-to-Trough-to-Peak Analysis – We Think a New Bull Market Is Beginning

Peak Date	Trough Date	Days to trough	%Fall from peak	Next Peak Date	Days to Next Peak	%Gain Trough to Next Peak
9-Jul-97	10-Sep-98	428	-58.6%	10-Feb-00	518	124.8%
10-Feb-00	21-Sep-01	589	-53.7%	18-Apr-02	209	48.2%
18-Apr-02	10-Oct-02	175	-30.0%	12-Apr-04	550	95.2%
12-Apr-04	17-May-04	35	-20.4%	8-May-06	721	122.6%
8-May-06	13-Jun-06	36	-24.5%	23-Jul-07	405	74.8%
29-Oct-07	27-Oct-08	364	-66.1%	11-Jan-10	441	126.3%
2-May-11	4-Oct-11	155	-31.1%	29-Feb-12	148	29.9%
3-Sep-14	21-Jan-16	505	-37.5%	26-Jan-18	736	84.9%
26-Jan-18	29-Oct-18	276	-26.6%	20-Jan-20	448	22.7%
20-Jan-20	23-Mar-20	63	-33.9%	17-Feb-21	331	90.6%
17-Feb-21	24-Oct-22	614	-41.7%	?	?	?
<b>Average 1997-2020</b>		<b>263</b>	<b>-38.2%</b>			

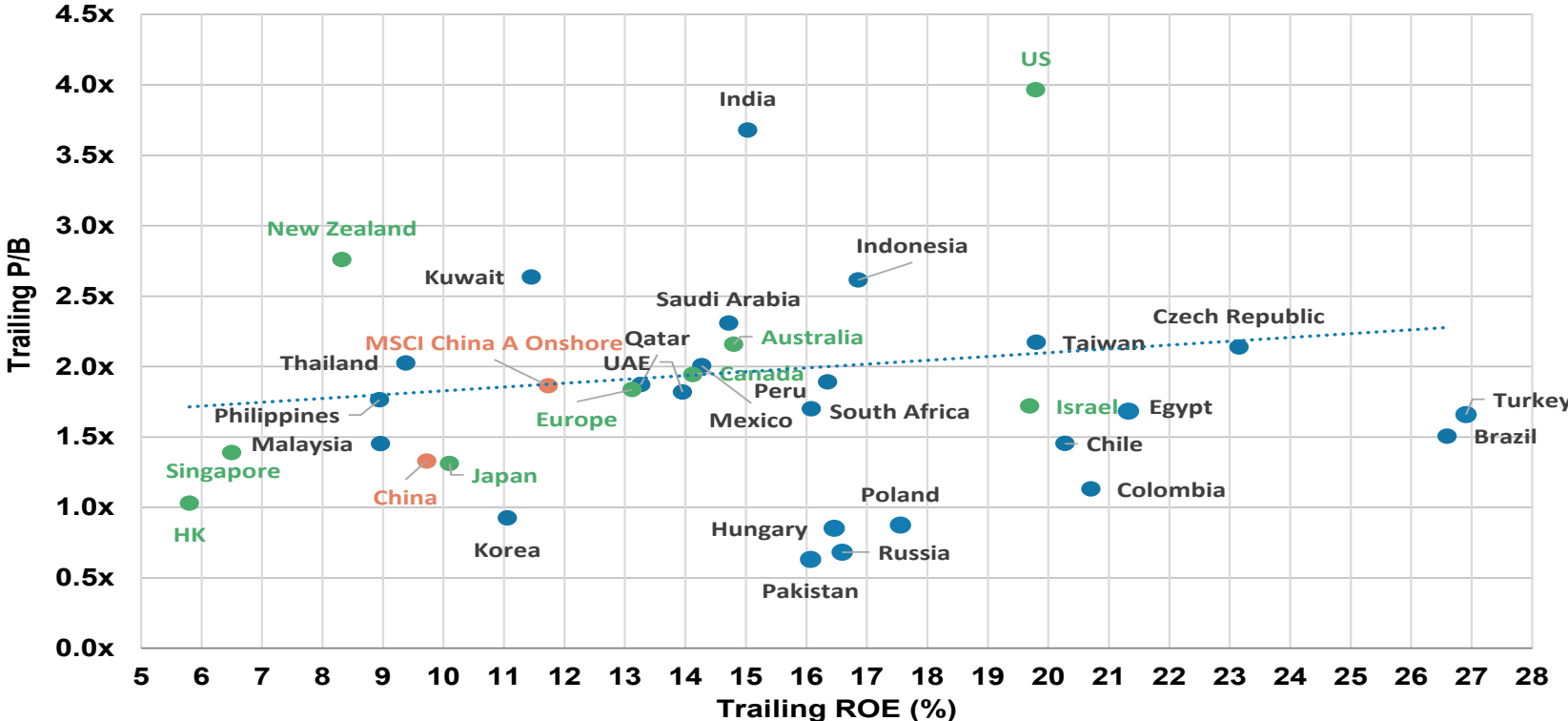
Source: MSCI, FactSet, Morgan Stanley Research; The most recent trough was recorded on October 24, 2022. The table only shows the EM bear markets with % fall from peak to be at least 20%.

## MSCI EM 12-month Forward EPS and P/E De-rating versus Prior Recession Periods

	Peak Date	Trough Date	Peak Level	Trough Level	% Drawdown from Peak
1997/98 Asian/EM Crisis	Jun-97	Jan-99	26.7	14.2	-46.6%
2000/01 Tech Bubble Burst	May-00	Sep-01	27.1	21.5	-20.6%
2008/09 Global Financial Crisis	Jul-08	Mar-09	101.0	56.0	-44.5%
2015/16 Industrial Downturn	May-14	Feb-16	97.1	67.2	-30.8%
2020 Covid Recession	Jan-20	Jun-20	88.2	70.5	-20.1%
2022 Downturn*	Feb-22	Dec-22	101.8	75.0	-26.3%
<b>Average 1997-2020</b>			68.0	45.9	-32.5%

	Peak Date	Trough Date	Peak Level	Trough Level	% De-rating from Peak
1997/98 Asian/EM Crisis	Feb-98	Sep-98	17.4	9.6	-45%
2002/03 Corporate Defaults	Mar-02	Oct-02	11.8	8.2	-31%
2008/09 Global Financial Crisis	Oct-07	Oct-08	14.3	6.3	-56%
2015/16 Industrial Downturn	Apr-15	Aug-15	12.6	10.2	-19%
2020 Covid Recession	Dec-19	Mar-20	12.8	10.2	-21%
2021/22 Downturn*	Feb-21	Oct-22	16.3	10.2	-39%
<b>Average 1997-2020</b>			13.8	8.9	-34%

# P/B vs ROE for Global Equities – Korea and Offshore China Are Trading Cheap to the P/B vs. ROE Trendline Globally While Taiwan Is in Line



Source: FactSet, MSCI, RIMES, Morgan Stanley Research; Price index to compute P/B as of November 21, 2022. Other data as of end-October 2022. Numbers are based on MSCI indices for each economy. The line of fit does not take into account the six economies of Pakistan, Hungary, Russia, Turkey, Egypt and Poland.

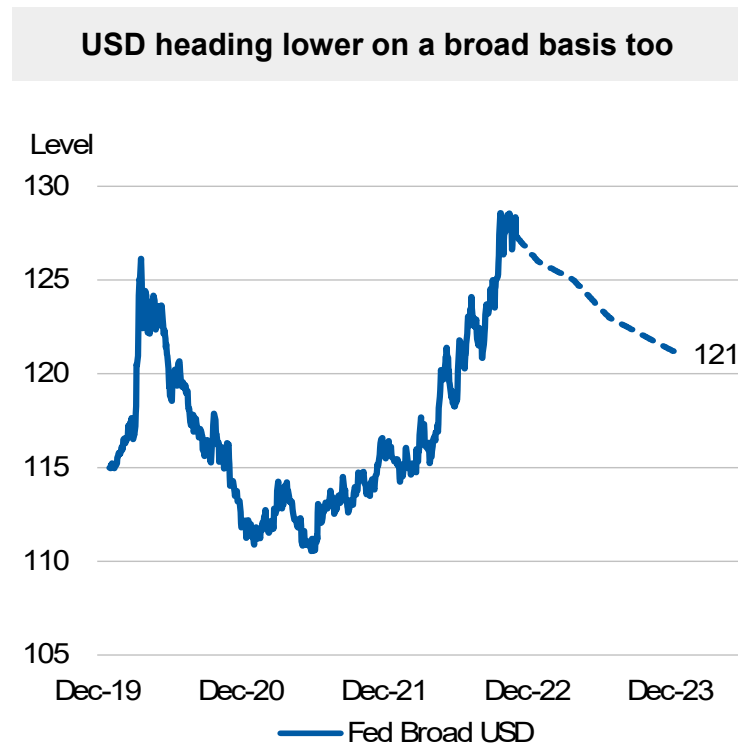
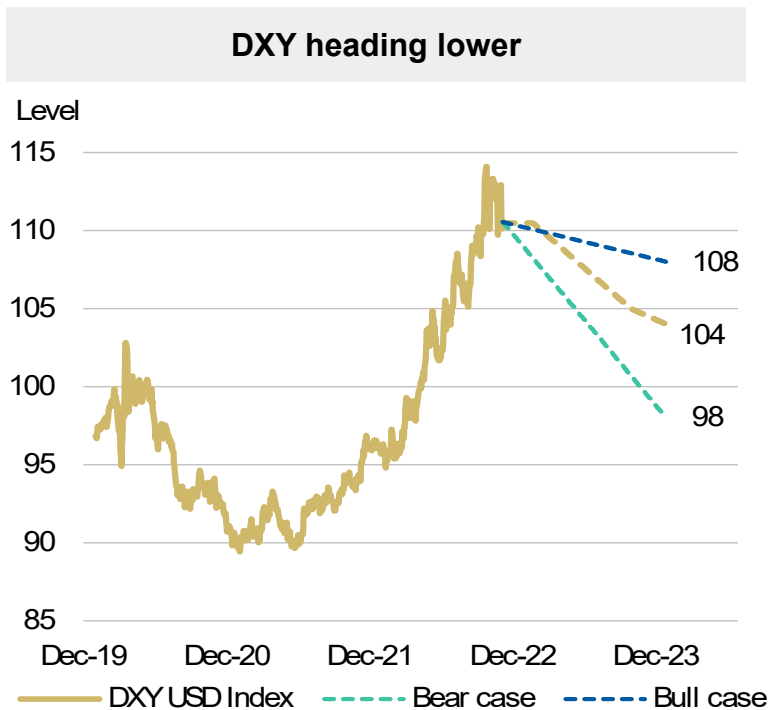
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**James Lord**

*Global Head of FXEM Strategy*

## We Expect to See a Dollar Decline

We expect to see DXY hitting 104, with risks skewed to the downside. This is consistent with EUR/USD hitting 1.08. USD should decline on a broad basis too.

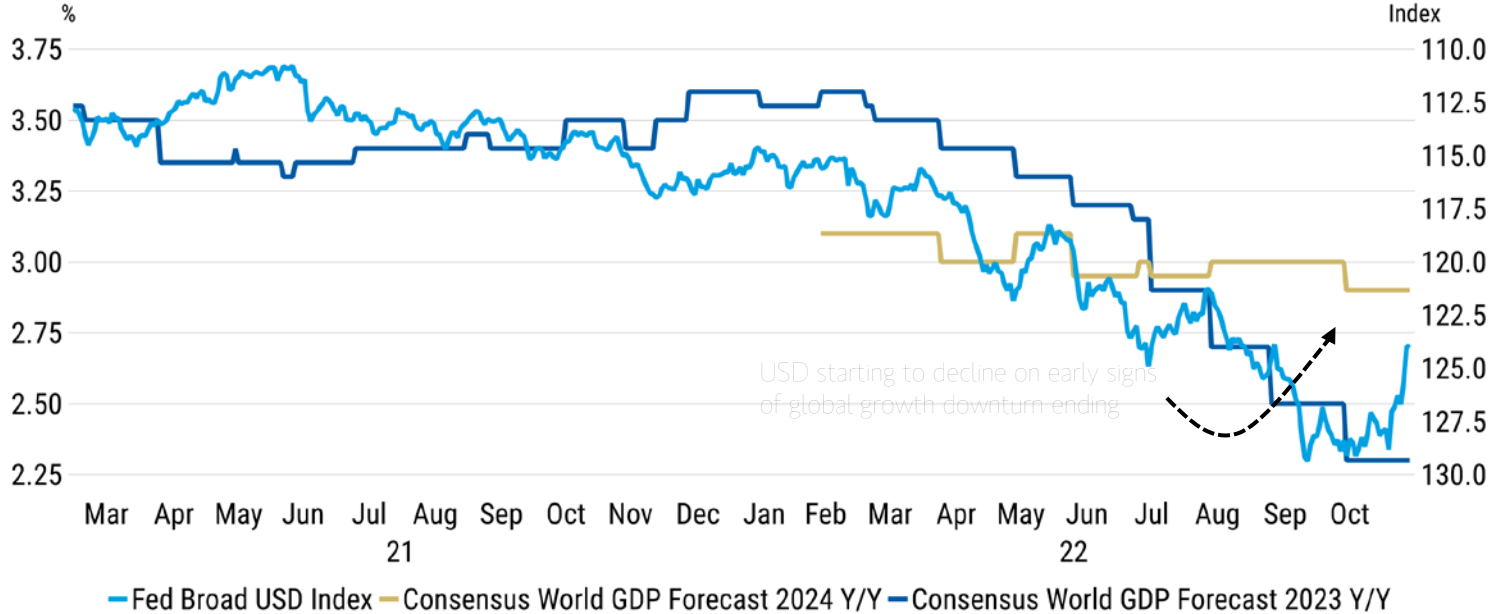




# Global Growth Downturn Ending Favours USD Weakness

Global growth upswings tend to result in USD weakness. China reopening and early signs of disinflation point to global recovery and USD weakness.

USD tends to be inversely correlated with global growth expectations

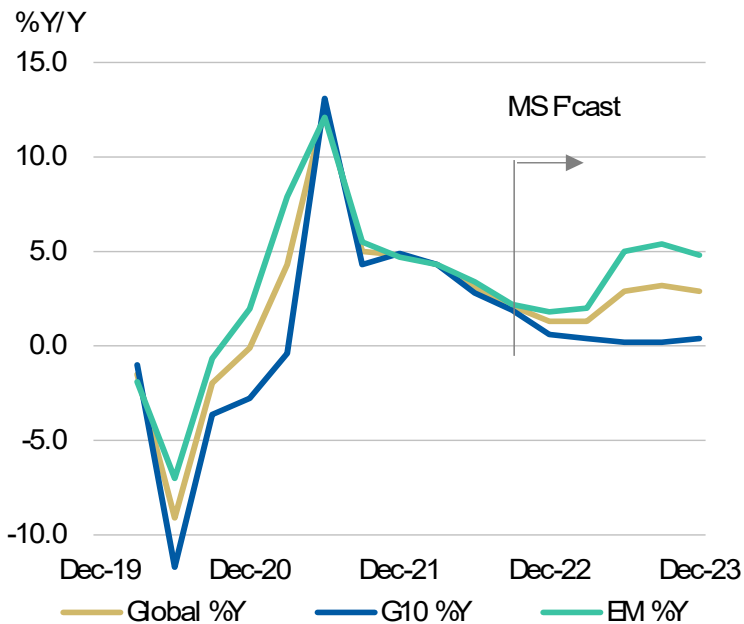


Source: Bloomberg, Morgan Stanley Research

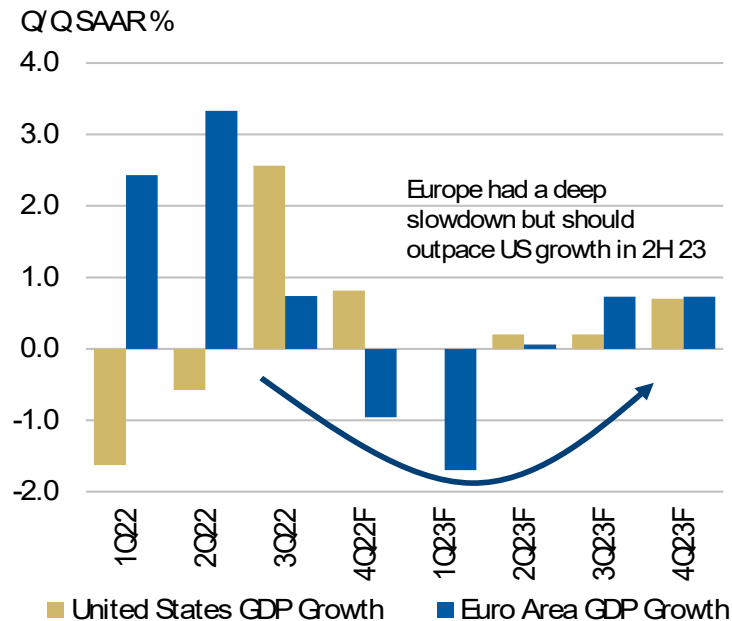
## Global Growth Composition Favours USD Weakness

Global growth upswings tend to result in USD weakness. When the composition leans towards RoW outperformance, the conviction on USD weakness grows

EM expected to lead modest global rebound



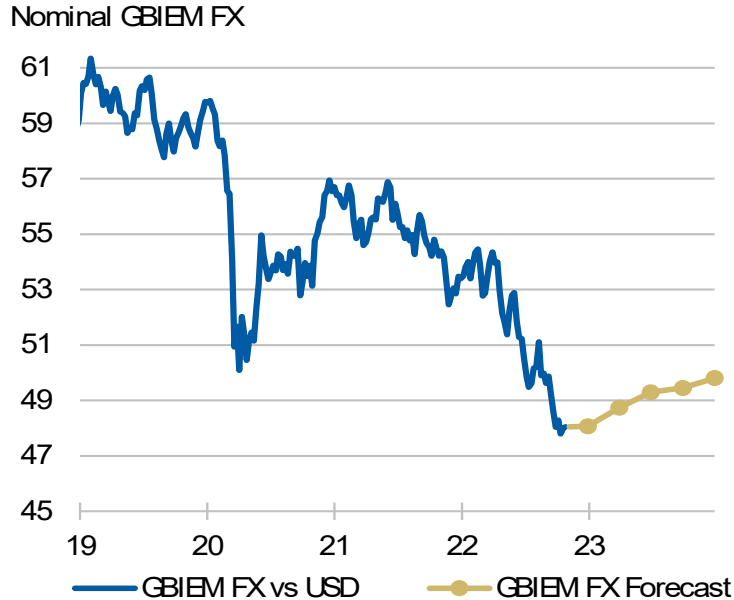
Eurozone to see a slightly stronger 2H23



## EM Currencies to Rebound and Local Bond Yields to Drop

We expect to see USD weakness filter through to EM, with currencies and bonds likely to recover

**We expect a recovery in EM FX versus USD**



**We see local currency bond yields falling**



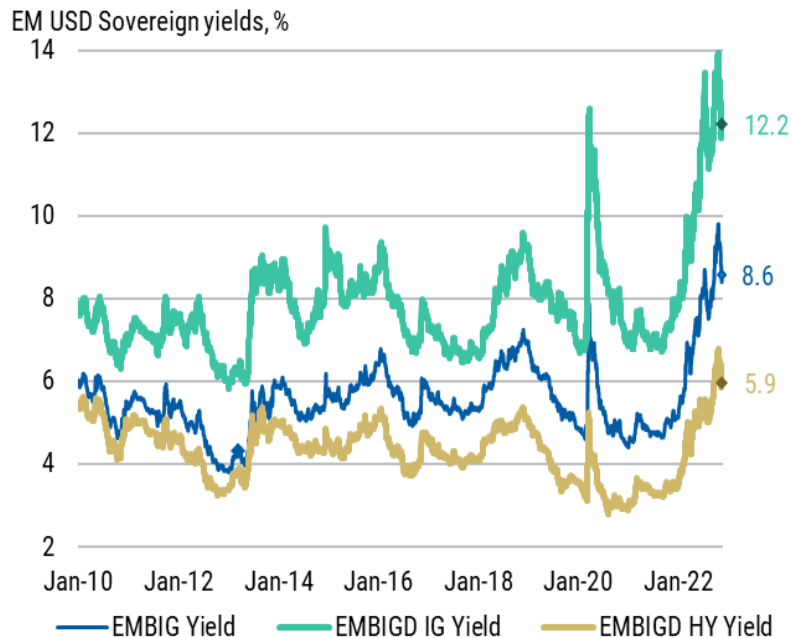
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**Simon Waever**

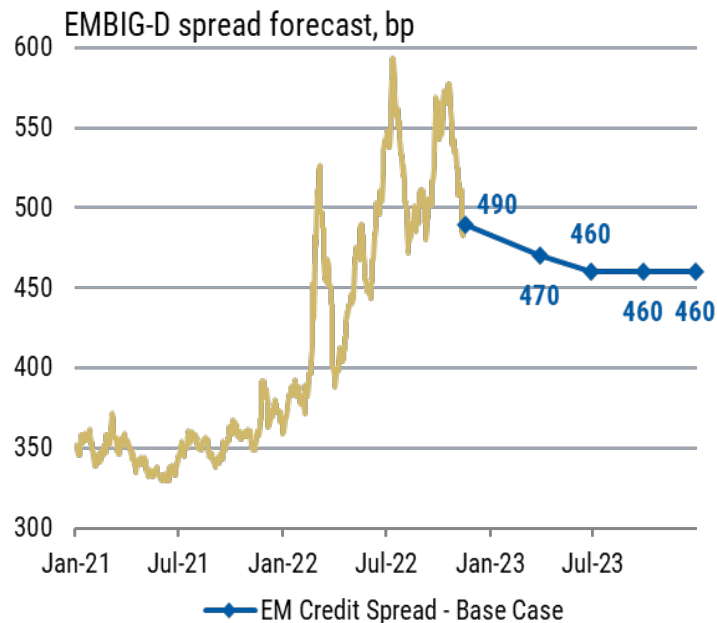
*Head of EM Sovereign Credit Strategy*

## EM Sovereign Credit Has Repriced Materially...

**EM sovereign USD bond yields have doubled since the lows at end-2020**

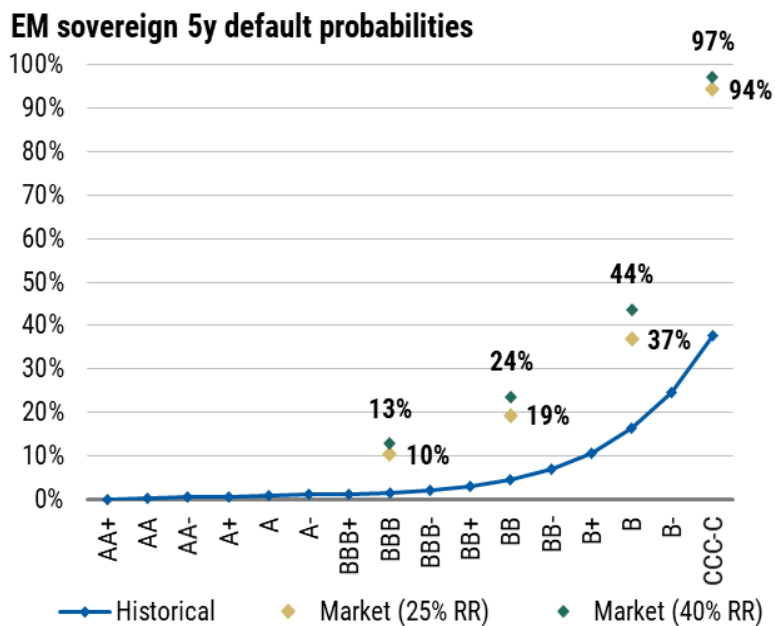


**EM sovereign credit spreads have room to tighten even while staying wide to history**



## ...with HY Sovereign in Particular Pricing in Significant Downside

Markets are already pricing much higher than historical default probabilities



EM funds have also de-risked throughout the year to leave their HY allocation very low versus history

HY allocation vs. benchmark



## EM Sovereign Credit Strategy Implications

- **EM sovereign credit to outperform US credit in 2023.**
  - **Prefer HY over IG, bonds over CDS.**
  - **In IG, we like Panama, Saudi Arabia and Israel.**
  - **In the non-stressed HY space, our top picks are South Africa, Egypt and Mozambique.**
  - **In the distressed/low cash price bond space, we like Ecuador, Argentina, Ghana and Ukraine.**
  - **Finding value in quasi-sovereigns: PEMEX (Mexico), IDASAL (Indonesia), MUBAUH (Abu Dhabi), ABDPOC (Abu Dhabi) and Omani quasi-sovereigns.**
  - **Position for curve flatteners: 10s30s in Brazil and Mexico, 5s10s in Turkey.**
  - **CDS rich versus bonds: Buy CDS-bond basis in Panama, Qatar and Saudi Arabia.**
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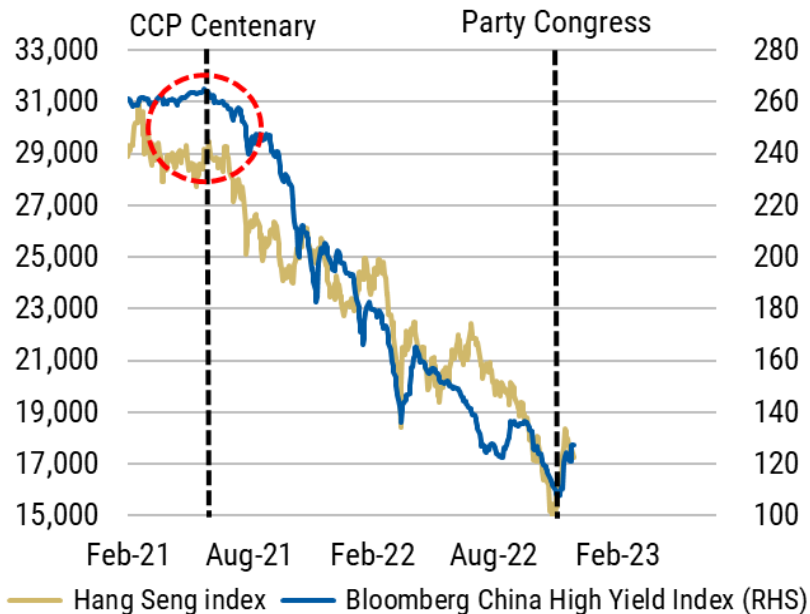
**Min Dai**

*Head of Asia Macro Strategy*

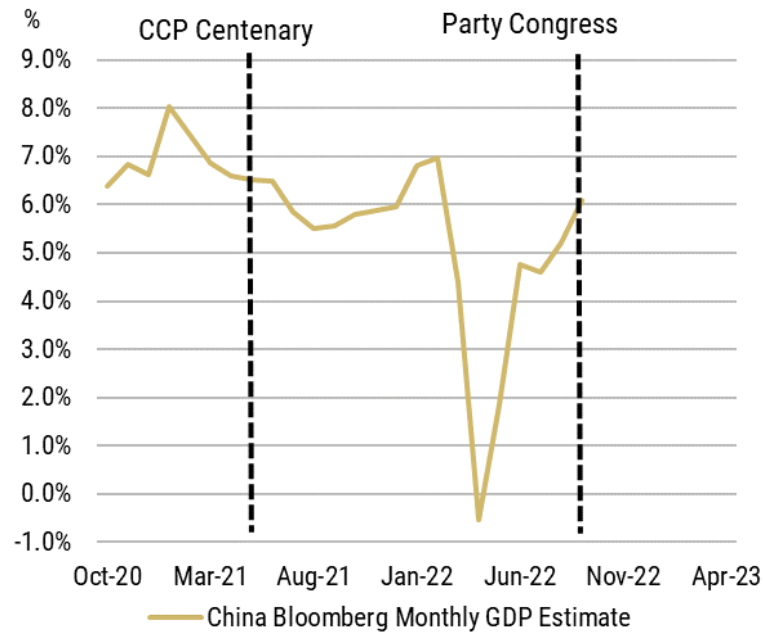


## Political Events Important for the Economic Cycle

**Risky assets sold off after July 2021**

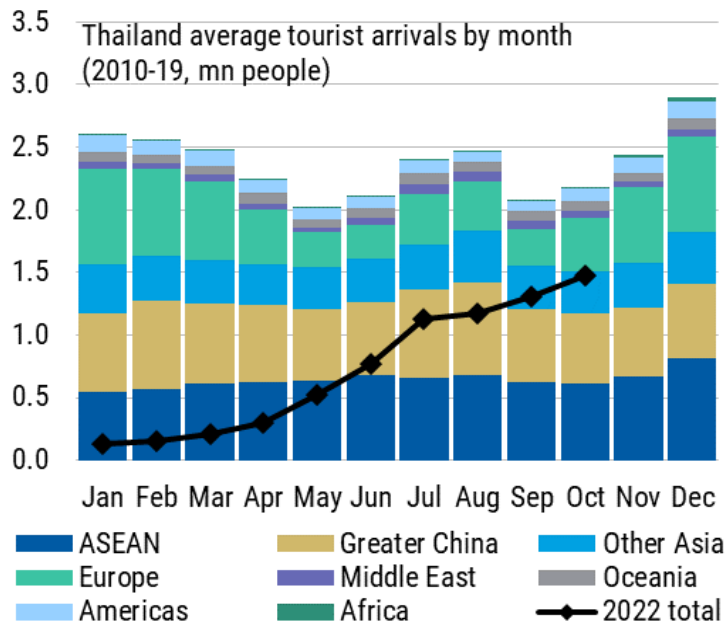


**Growth started to slow down at the same time**



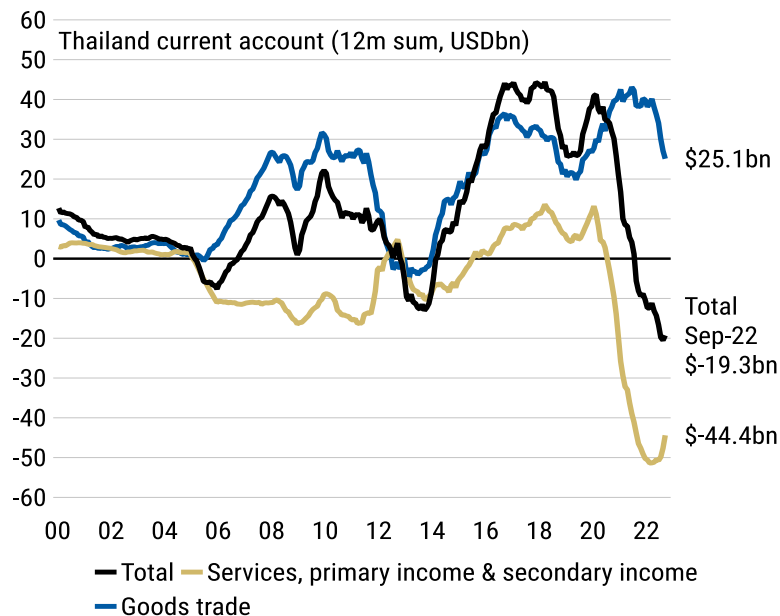
## Tourism in ASEAN Should Recover

### Seasonality in favour of a strong THB into winter



Source: Macrobond, Morgan Stanley Research

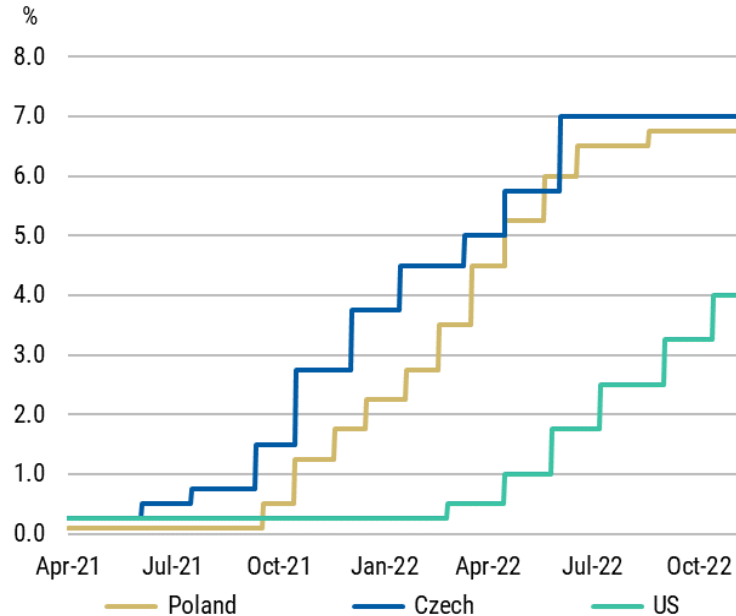
### The services deficit is finally starting to turn



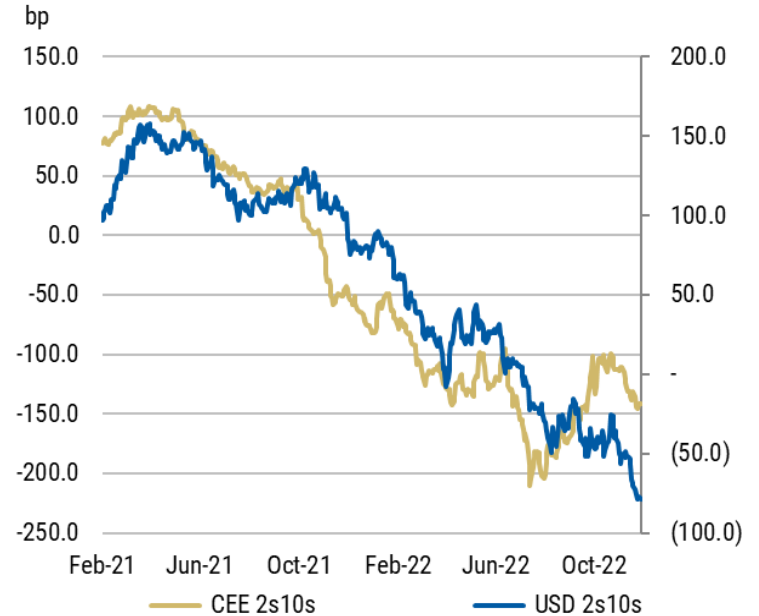
Source: Macrobond, Morgan Stanley Research

## CEE Could Lead the Asia Curve-Steepening Cycle

CEE is leading the US in terms of rate hikes

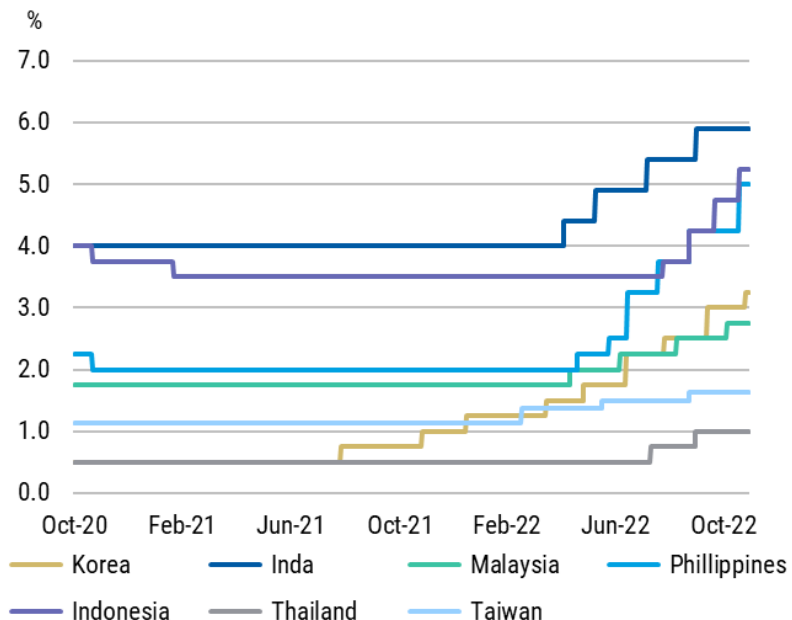


CEE rates started to steepen in July



## Korea and Singapore Are Leading the Hiking Cycle in Asia

Asia central banks' hiking path



Most Asian economies are lagging behind on rate hikes versus CEE economies

	First Hike Month	Month to CEE Avg
Czech	May-21	
Poland	Sep-21	
Korea	Aug-21	1
Singapore	Oct-21	3
Taiwan	Mar-22	8
India	Apr-22	9
Malaysia	May-22	10
Philippines	May-22	10
Thailand	Aug-22	13
Indonesia	Aug-22	13

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**Andrew Sheets**

*Chief Cross-Asset Strategist*

## Key Takeaways

- **EM equities – we think that a new bull market is beginning:** We upgraded EM equities to OW on October 4 and believe that a new bull market has begun. The de-rating of P/E and EPS is close to prior recessionary periods, a much larger adjustment than in DM (especially the US).
  - **EM fixed income:** We think that a final Fed hike in January 2023 means that both US 10-year yields and the DXY have peaked. Combined with better EM versus DM growth in 2023, this creates a better backdrop for EM fixed income markets that suffered significantly in 2022. Policy divergence means that there is also opportunity in relative value (a hiking cycle in Asia versus an easing cycle in LatAm and CEE).
  - **EM credit:** We were overweight EM hard currency debt prior to our 2023 outlook, and maintain that view. A more favourable macro backdrop should help (see above), while we also see ‘micro’ support, with a view that risk premiums in the sub-IG parts of the market remain high.
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## Valuation Methodology and Risks

Stance/Trade	Date	Entry Level	Target	Stop	Rationale	Risks
Like Israel Hard Currency Bonds	18-Nov-22	NA	NA	NA	Israel has underperformed the A rated complex substantially and now is among the cheapest credits for this ratings category. While election outcomes create some uncertainty around the fiscal trajectory, specifically whether expenditure restraint will loosen, fiscals are still benefiting from strong tax collection while domestic gas production should also help to offset some of the rise in commodity prices.	Issuance.
Like Egypt Hard Currency Bonds	11-Nov-22	NA	NA	NA	Valuations have cheapened while fiscal risks have abated. The IMF agreement has helped in this regard.	An unexpected issuance.
Like Panama Hard Currency Bonds	31-Oct-22	NA	NA	NA	It is now trading almost 40bp wide versus BBB peers, which we think is too much. We have a more constructive view on the country's macro picture with fiscals that should manage amid uncertainty around negotiations with protesting organisations.	Large issuance in the long end of the curve.
Like Saudi Arabia Hard Currency Bonds	25-Oct-22	NA	NA	NA	Saudi Arabia spreads have adjusted following a month of heavy issuance in October, leaving spreads looking cheap not only versus the GCC but also versus LatAm and Asia peers. We think valuations at these levels are cheap enough for investors to look beyond fiscal slippage, instead focusing on the Saudi sovereign as a cheap way to add oil exposure.	Oil prices heading towards US\$70/bbl.
Like Ecuador Hard Currency Bonds	17-Oct-22	NA	NA	NA	Valuations are cheap. We expect policy continuity. Oil prices are still supportive, leaving fiscals on an improving trend. The IMF is set to remain onboard. The broader macro situation is strong, including the external balance. There are few upcoming eurobond payments.	Still OW EM fund positioning and risks of renewed protests.
Like South Africa Hard Currency Bonds	5-Oct-22	NA	NA	NA	Fiscal numbers are holding up well while valuations have cheapened in anticipation of the MTBPS.	A rise in expenditure during the MTBPS will be negative for the curve. Moreover, heightened uncertainty leading up to the ANC Elective conference will cause the curve to underperform.
Like Ghana Hard Currency Bonds	20-Sep-22	NA	NA	NA	With the long end now trading below 40, we think that valuations have cheapened enough to warrant a like stance. With recent developments eroding the case for restructuring, we think that the risk/reward justifies this stance.	If the IMF insists on restructuring of bonds, we could see some weakness.
Like Ukraine Hard Currency Bonds	10-Aug-22	NA	NA	NA	In a scenario where the bond consent solicitation has passed, avoiding drawn-out disputes, and inflows return to EM, we think Ukraine certainly benefits given its low cash prices. Indeed, from current levels around 18, risk/reward is attractive compared to nearly all our restructuring scenarios.	Geopolitical risks.
Like Mozambique Hard Currency Bonds	30-Mar-22	NA	NA	NA	Improving debt/GDP and broader fiscal metrics. Oil and gas developments are a catalyst.	Delay in the gas projections in addition to increased insurgency activity.
Like Argentina Hard Currency Bonds	24-Aug-21	NA	NA	NA	With bonds still in the mid-30s we see risk/reward as attractive despite near-term vol. Assume IMF deal signed by early 2Q22. ARGENT 2041 favoured bond.	Deterioration in macro, including inflation expectations, wide fiscal deficit and low FX reserves, outweigh election impact.

Source: Morgan Stanley Research

## Valuation Methodology and Risks

Stance/Trade	Date	Entry Level	Target	Stop	Rationale	Risks
Buy PANAMA 33 and PANAMA 5Y CDS	18-Nov-22	At publication	90	130	Panama's recent issuance caused underperformance, especially in the curve's belly but also the front end of the curve. Its 5Y CDS held up well and actually outperformed peers during the recent market rally. The spread between PANAMA 33 and PANAMA 5Y CDS is now near year-long wids.	Higher-than-expected government spending.
Buy IDASAL 30 vs. INDON 02/30	18-Nov-22	At publication	140	210	IDASAL is a good proxy for INDON with a cheaper valuation. We expect prices of commodities such as copper, coal and aluminium, to stay high in 2023. China reopening in spring, as our economists expect, would also benefit Indonesia.	Lower commodity prices such as copper, coal, aluminium and tin.
Buy MUBALUH 31 vs. TAQAUH 30 (proceeds-neutral)	18-Nov-22	At publication	5	75	The Abu Dhabi quasi-sovereign space is starting to offer more value, with MUBUAH and ABDPOC especially looking cheap versus the sovereign curve. However, TAQA spreads have moved against general quasi-sovereign-to-sovereign decompression over the past month. This is incongruous with issuance risks from TAQA given the upcoming US\$1 billion maturity in January.	MUBALUH issuance.
Buy TURKEY 31 vs. TURKEY 26	8-Nov-22	114	65	144	The curve has steepened to one-year highs, representing 1.8 standard deviations. We think that this should flatten in the near term.	A disorderly election period.
Buy QATAR 04/28 (Treasury-hedged), buy QATAR 5Y CDS	3-Oct-22	-41	-5	-65	We like Qatar hard currency bonds, not only on a relative basis to GCC IG but also versus CDS, which has barely adjusted into the latest sell-off. Front-end bonds should rally back fast as investors pick up cheap valuations.	Slowdown in front-end demand from locals.
Buy KSA 51 (Treasury-hedged), buy KSA 5Y CDS	3-Oct-22	-175	-135	-205	The KSA curve has steepened substantially into the latest sell-off, making a package of CDS and low cash price bonds attractive on a Treasury-hedged basis. We do not expect Saudi Arabia to issue in the long end given curve steepness.	Long-end issuance.
Buy PEMEX Mar2027	20-Sep-22	88	95	84	At 10% yield, Pemex front-end bonds look very cheap. At current oil prices the Pemex curve should be much steeper, while the pick-up over sovereign is now the same in the 5-year sector as it is in the longer maturities.	New 5-year issuance.
Buy BRAZIL 50 vs. BRAZIL 31	6-Sep-22	130	100	150	The curve is steep versus history, peers and our curve model. New issuance should impact the 10-year sector more negatively. We expect the curve to bear flatten into elections.	New issuance in the long end.
Buy MEX 61 vs. MEX 32	10-Jan-22	106	70	140	The long end of the curve has underperformed materially year-to-date and now stands out as significantly steep versus history. Given that fiscals are only deteriorating slowly and we don't expect any long-end USD issuance in the coming months, this looks unjustified.	Long-end issuance.

Source: Morgan Stanley Research



## History of Recommendations

### Buy BRAZIL 50 versus BRAZIL 31

Instrument	Maturity	Trade	Entry Date	Entry Level	Exit Date	Exit Level	Target/ Objective	Stop/Re-assess	Size of Trade or Unit/Notional	CUSIP/ISIN/ BLOOMBERG
SOAF 5 7/8 04/20/32 Corp	15-Feb-32	Buy SOAF 2032 vs BRAZIL 2031	13-May-22	113	08-Jul-22	170.0	60.00	170.00	9.7x10	US836205BC70
BRAZIL 3 3/4 09/12/31 Corp	12-Sep-31	Buy SOAF 2032 vs BRAZIL 2031	13-May-22	113	08-Jul-22	170.0	60.00	170.00	9.7x10	US105756CE88

### Buy PANAMA 33 and PANAMA 5Y CDS

Instrument	Maturity	Trade	Entry Date	Entry Level	Exit Date	Exit Level	Target/ Objective	Stop/Re-assess	Size of Trade or Unit/Notional	CUSIP/ISIN/ BLOOMBERG
PANAMA CDS USD SR 5Y D14	N/A	Sell Panama 5Y CDS vs Peru 5Y CDS	06-Sep-22	28	14-Sep-22	15	12	35	10x10	PANAMA CDS USD SR 5Y D14
PERU CDS USD SR 5Y D14	N/A	Sell Panama 5Y CDS vs Peru 5Y CDS	06-Sep-22	28	14-Sep-22	15	12	35	10x10	PERU CDS USD SR 5Y D14
PANAMA 3.87 07/23/2060 Govt	23-Jul-60	Buy PANAMA 60 versus PANAMA 2033	17-Oct-22	121.00	14-Nov-22	95	95.0	140.0	10x10	US698299BL70
PANAMA 3.298 01/19/2033 Govt	19-Jan-33	Buy PANAMA 60 versus PANAMA 2033	17-Oct-22	121.00	14-Nov-22	95	95.0	140.0	10x10	US698299BR41

### History of recommendations for Ecuador Hard Currency Bonds

Trade	Entry Date	Exit Date
Like Ecuador Hard Currency Bonds	01-Nov-21	08-Aug-22

### History of recommendations for Egypt Hard Currency Bonds

Trade	Entry Date	Exit Date
Like Egypt Hard Currency Bonds	10-Aug-22	20-Sep-22

### History of recommendations for Ghana Hard Currency Bonds

Trade	Entry Date	Exit Date
Dislike Ghana Hard Currency bonds	2-Mar-22	25-Apr-22

### History of recommendations for Israel Hard Currency Bonds

Trade	Entry Date	Exit Date
Dislike Israel Hard Currency Bonds	19-Nov-21	22-Feb-22
Dislike Israel Hard Currency Bonds	11-Jul-22	18-Nov-22

### History of recommendations for Panama Hard Currency Bonds

Trade	Entry Date	Exit Date
Like Panama Hard Currency Bonds	29-Nov-21	10-Jan-22
Like Panama Hard Currency Bonds	08-Aug-22	06-Sep-22

### History of recommendations for Saudi Arabia Hard Currency Bonds

Trade	Entry Date	Exit Date
Dislike Saudi Arabia Hard Currency Bonds	01-Nov-21	19-Nov-21
Like Saudi Arabia Hard Currency Bonds	24-Jan-22	10-May-22

### History of recommendations for South Africa Hard Currency Bonds

Trade	Entry Date	Exit Date
Dislike South Africa Hard Currency Bonds	19-Nov-21	02-Mar-22
Like South Africa Hard Currency Bonds	13-May-22	27-Jun-22

### History of recommendations for Ukraine Hard Currency Bonds

Trade	Entry Date	Exit Date
Like Ukraine Hard Currency Bonds	19-Nov-21	18-Jan-22

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**Buy/Long:** The analyst expects the total or excess return (depending on the nature of the recommendation) of the instrument or issuer that is the subject of the investment recommendation to be positive over the relevant time period.

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**Selling protection or Buying Risk:** The analyst expects that the price of protection against the event occurring will decrease over the relevant time period.

**Buying protection or Selling Risk:** The analyst expects the price of protection against the event occurring will increase over the relevant time period.

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)			Other Material Investment Services Clients (MISC)	
	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
<b>Overweight/Buy</b>	<b>1353</b>	<b>38%</b>	<b>288</b>	<b>41%</b>	<b>21%</b>	<b>597</b>	<b>39%</b>
<b>Equal-weight/Hold</b>	<b>1599</b>	<b>45%</b>	<b>326</b>	<b>47%</b>	<b>20%</b>	<b>709</b>	<b>46%</b>
<b>Not-Rated/Hold</b>	<b>1</b>	<b>0%</b>	<b>0</b>	<b>0%</b>	<b>0%</b>	<b>0</b>	<b>0%</b>
<b>Underweight/Sell</b>	<b>624</b>	<b>17%</b>	<b>80</b>	<b>12%</b>	<b>13%</b>	<b>220</b>	<b>14%</b>
<b>Total</b>	<b>3,577</b>		<b>694</b>			<b>1526</b>	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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