Domestic Growth: Worth A Premium?

In addition to examining the drivers of relative performance for the principal EM bourses in this report, we address two questions: the first is how to find sources of outperformance driven by the notion that global trade may well continue to languish, and the second is to re-examine the outlook for the largest EM equity sector, namely financials, in order to determine whether it is capable of outperforming its developed market (DM) counterpart.

The experience of the past three decades has consolidated the notion that EM equities generally outperform under conditions where global growth – in particular, the growth of merchandise trade – is thriving. So far this year, any such notion has been turned on its head: until very recently, EM equities have outperformed while global growth has been mediocre and trade data decidedly feeble. We have already outlined why we believe that the drivers of EM outperformance so far this year are transient and the case for EM in a global equity portfolio relies on a rotation of leadership away from commodity and liquidity plays (see the September 13, 2016 **MRB *EM Equities Report***[1]). And indeed, rising U.S. bond yields have already sent a chill through EM equity markets. In light of likely further downward pressure on some EM currencies, we are trimming our positions and refrain from taking an active bet in both Mexico (page 17) and South Africa (page 21).

MRB Emerging Market Equities Recommendations*

	-		N		+	Page
Brazil		■				7
China				■		9
India				■		11
Indonesia				■		13
Korea				■		15
Mexico			■			17
Russia		■				19
South Africa			■			21
Taiwan				■		23
Turkey		■				25
Emerging Markets**			■			

* 6-12 month horizon; relative to common currency emerging market equity benchmark
** 6-12 month horizon; relative to global common currency benchmark
Note: + = maximum overweight, N = neutral, – = maximum underweight

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- Commodity prices and easy liquidity have driven EM outperformance this year. Both drivers are fading.
- Anti-trade rhetoric from the U.S. and an overheating Chinese property market make it unlikely that global trade will accelerate or sustain EM outperformance.
- EM financial earnings are becalmed and conditions are not yet ripe for the China bank re-rating story to play out.
- China, India and Indonesia offer some protection because of the relatively closed nature of their economies and the domestic tilt of their equity earnings.

An Anti-Globalization EM Portfolio

Does the year ahead threaten the trade underpinnings of EM outperformance? We remain cautious, and are taking only selective long positions within the EM equity

[1] MRB *EM Equities Report*, "Nibbling In Asia", September 13, 2016

universe. There are two immediate risks to the momentum of global trade[2]: first, that the incoming Trump administration has alluded to increased protectionism (at least during the candidate's campaign); and secondly, the fact that China's economic cycle is showing signs of overheating[3].

President-elect Trump's immediate trade rhetoric will be hostile

In assessing the timing and scope of a Trump-led protectionist wave, it is difficult to gauge the impact of policies whose nature remains unknown, but it is safe to assume that President-elect Trump's immediate trade rhetoric will be hostile, for example, by targeting China either as currency manipulator or as a trade dumper. The impact of such rhetoric spreads well beyond the Trump campaign's twin bogeymen (China and Mexico) and risks shelving investment plans and cutting assumptions of future earnings growth from companies whose businesses are heavily trade-dependent.

On China's cyclical risk, we have been arguing for some time that the direct consequence of current attempts to rein in runaway house prices will be a slowdown in China's housing construction sometime in the first half of next year[4]. Such a slowdown would likely ricochet through China's rust belt and put commodity prices under renewed pressure. The trade implications are another downleg in the nominal value of commodity trade (as prices drop and demand softens), as well as renewed deflationary pressures in certain industries, in particular steel, where Chinese excess capacity could result in more dumping into export markets.

China's housing risk will ricochet through its rust belt and dampen commodity prices

Were these two developments to bear practical fruit, there are poor overall odds of EM earnings (and stock prices) outperforming in the year ahead. That said, the odds of outperformance would likely be highest in an "anti-globalization portfolio" comprised of countries and sectors whose growth is driven by domestic, rather than global factors. Unfortunately, for the most part, sectors and countries where earnings are primarily domestically-driven are the most expensive corners of the EM equity universe.

What would an anti-globalization EM equity portfolio look like? To construct such a portfolio, an investor would have to screen markets for being driven by domestic, rather than global factors, and then determine where the relative drivers of earnings are strongest and associated with reasonable valuations.

The odds of EM earnings and stock prices outperforming are poor

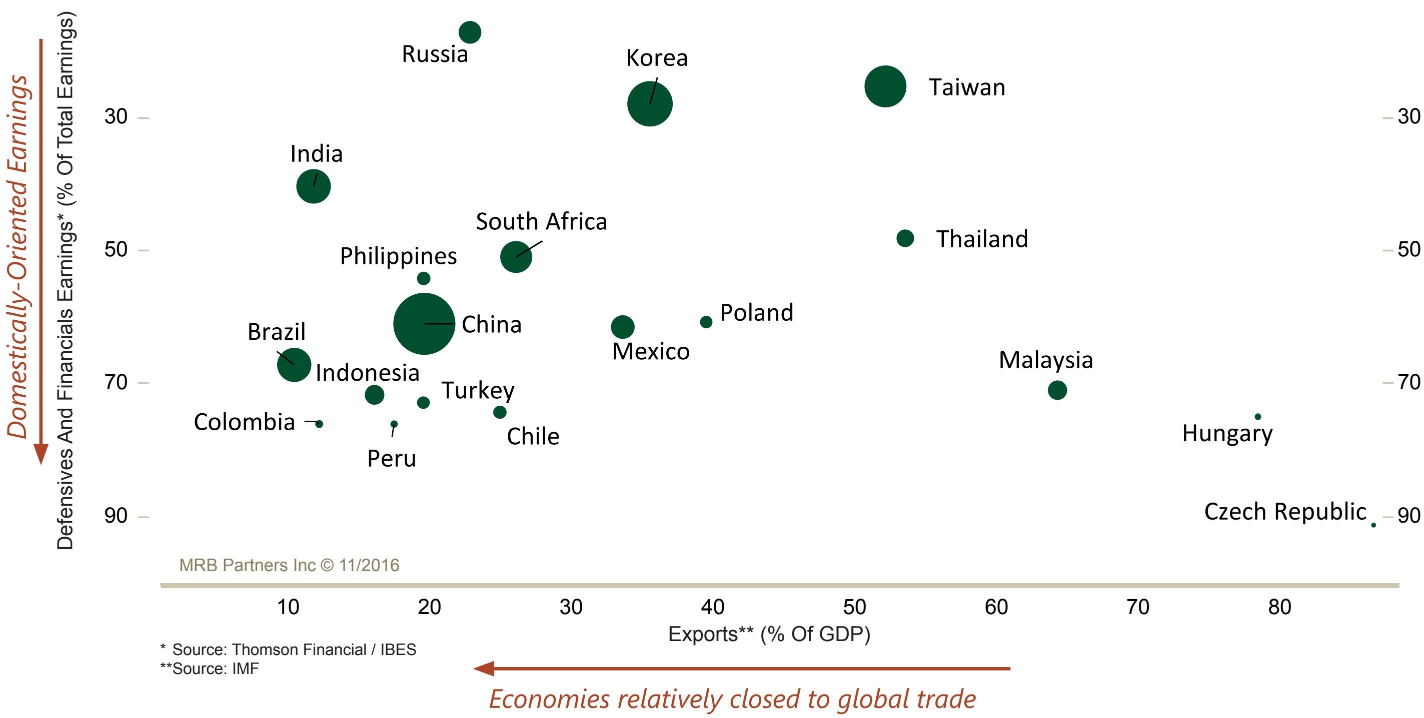
In the first instance such a portfolio would focus on economies which are ***relatively*** closed to global trade, for which the ratio of exports to GDP offers a simple proxy. Furthermore, in an EM context, financial and defensively-oriented sectors are typically

[2] Our longer term view on de-globalization is laid out in a two part **MRB *Theme Report***, "***Forced De-Globalization (Part I): Benefits And Costs Of Trade***", November 8, 2016 and "***Forced De-Globalization (Part II): Blame Technology Not Trade***", November 10 2016.

[3] Both aspects were addressed in greater detail in the **MRB EM *Research Highlight***, "***Will The Yuan Be Trumped?***", November 14, 2016.

[4] **MRB *China Research Highlight***, "***How China's Property Boom Goes Bust (Again)***", October 11, 2016

Chart 1 In Search Of Insulation: An "Anti-Globalization" Portfolio



domestically-oriented (there are some exceptions, including India's pharma industry). On the other hand, earnings for cyclical sectors, especially energy, materials, technology and consumer discretionary, tend to be dominated by global factors such as commodity demand and price, as well as global demand for manufactured goods. (Industrials can be an exception to this, depending on the makeup of the sector in each country; nevertheless we include industrials in the "externally-driven" sectors).

An anti-globalization tilt yields a rather idiosyncratic EM portfolio...

Such a screening approach yields a rather idiosyncratic portfolio dominated by Brazil, China and India (**chart 1**). Markets heavy in financials and defensive sectors, at the same time as being ***relatively*** closed to global trade include both commodity-exporters (Brazil, Colombia, Indonesia, Peru) and commodity-importers (China, India, Philippines, Turkey). At the other extreme, economies that are most open to global trade and are also heavy in cyclically-sensitive and externally-oriented sectors are Korea and Taiwan. That said, with a 6-12 month investment horizon, the earnings profile of Korea and Taiwan remain dominated by the positive fundamentals underpinning the technology sector.

...dominated by Brazil, China and India

Two corollaries are noteworthy. The first is that the more open the economy, the less the defensiveness of the market matters. Thus, in the case of Malaysia, Mexico or Central Europe, the overall macro-economic conditions that drive earnings in defensive sectors and financials are themselves heavily influenced by external trade. The second corollary is that the regional pattern of trade also matters. In the case of Central Europe, for example, trade is dominated by fellow-members of the European Union. An

Table 1 **Domestically-Driven Equities Are Generally Expensive**

	Financials		Defensives	
	Price/Book	12 m fwd P/E	Price/Book	12 m fwd P/E
DM	1.1	12.5	3.1	16.5
EM	1.2	9.1	2.3	16.4
China	0.9	6.7	1.7	14.4
India	2.7	16.8	4.5	23.7*
Indonesia	2.2	13.3	5.0	21.2*

*Greater than one standard deviation higher than historical mean.
Source: MSCI, IBES.
Financials include financials and real estate, defensives include consumer staples, health care, telecoms and utilities.

"anti-globalization" bet in this case would need to assume that Czechia, Hungary or Poland will undertake a unilateral exit from the EU, which seems highly improbable.

For as long as the growth momentum of China's "old economy" holds up, there is no immediate threat to commodity-related assets, but as soon as housing construction slows down, there will be stiffening headwinds to the earnings of resource sectors and, more generally, to those of commodity-exporting economies. On a 6-12 month view, therefore, the commodity-importer component of the "anti-globalization portfolio" should be favored based on growth drivers.

The crosscurrent of liquidity and capital flow is generally negative

But, there is also a crosscurrent of liquidity/capital flow to consider, in the context of the resumption of U.S. policy normalization (i.e. a Fed rate hike in December) and/or rising Treasury yields. This crosscurrent buffets the currencies of those economies which are most dependent on foreign portfolio capital in order to finance their current account deficits. There are three egregious hot money addicts in the EM universe, two of them – Colombia and Turkey – are also among those markets which might otherwise be beneficiaries of an "anti-globalization" play. These two should also be avoided. (The third hot money addict is South Africa).

This leaves China and India as the largest of the "anti-globalization" markets, with Indonesia as an honorary member of the group given the relative insulation offered to its earnings potential as a result of it successful structural reform program. We recommend overweights to all three markets, primarily driven by their earnings growth prospects. In most cases, however, the growth has been recognized and comes at a price.

Defensive sectors in India and Indonesia are particularly expensive

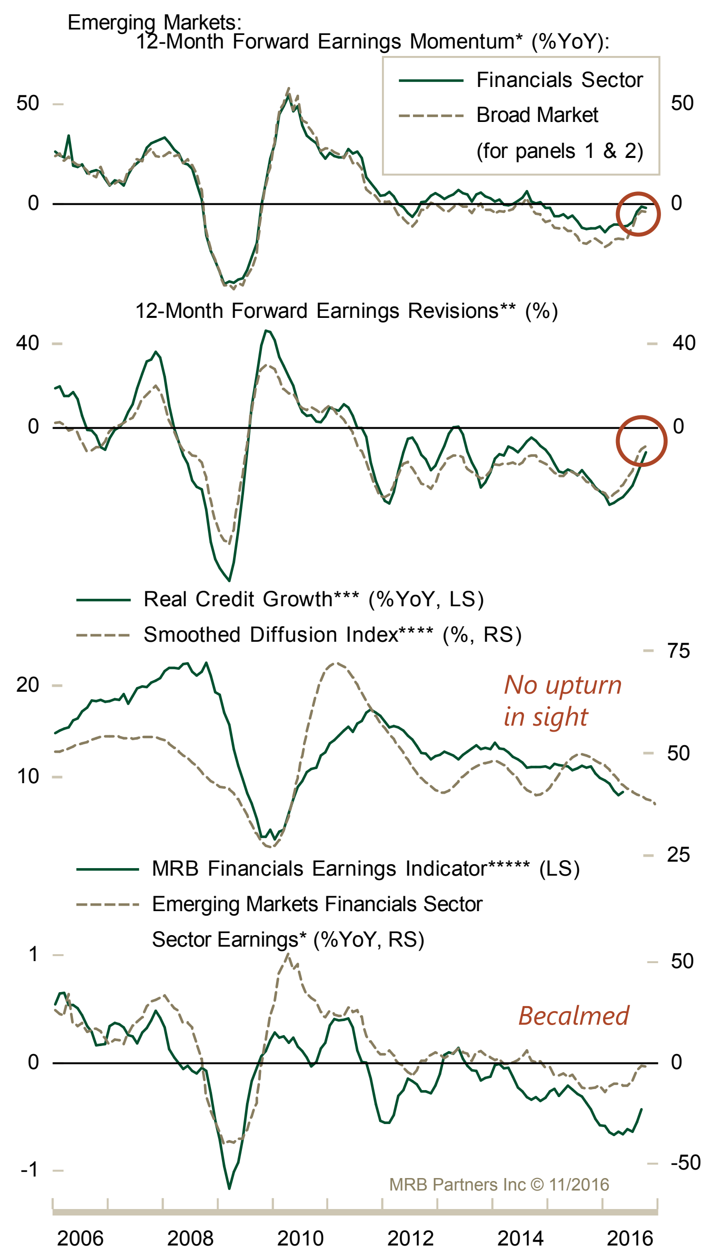
Defensive sectors in India and Indonesia are significantly more expensive than their EM and DM counterparts, and are both more than one standard deviation more expensive than their own historical experience when measured in P/E ratio terms (**Table 1**). Similarly, their financial sectors are also much pricier than those of their EM and DM counterparts. While such valuations are partially justified by relatively high return on equity (see pages 11 and 13), investors seeking this form of insurance against a poor backdrop for global trade will nevertheless face some sticker shock.

In the case of China, valuations for financials are marginally more attractive than EM and DM counterparts in P/B terms, but look cheap in P/E ratio terms. Such bargains come with a caveat: in the case of financials it is credit quality, in the case of defensives it is the transient nature of current earnings growth momentum given our view that next year's growth momentum will stutter.

Final Word: *Three of our preferred markets within an EM equity portfolio – China, India and Indonesia – also have the advantage of having earnings cycles that are relatively protected from any downturn in global trade. The case for holding Korea and Taiwan at overweight relies on technology-specific drivers. In more general terms, earnings in both the latter two countries bear watching closely as they are vulnerable to any China or Trump-related hiccups to global trade. Other markets which appear relatively insulated to global drivers (e.g. Brazil, Colombia, Peru and Turkey) will either face headwinds as commodity exporters or because of their particular vulnerabilities to tightening global liquidity conditions.*

Financial Earnings Watch: Becalmed

Chart 2 Waiting...For Godot?



* Source: Thomson Financial / IBES
** Upward revisions minus downward revisions divided by total revisions; smoothed; source: Thomson Financial / IBES
*** Equally-weighted aggregate of 19 emerging markets
**** Percent of emerging markets with accelerating annual change; advanced 6 months; smoothed
***** Includes measures of credit, net interest margins & 12-month forward earnings revisions; standardized; MRB calculation

The financial sector is crucial to understanding the relative performance of overall EM equities, considering both the relative size and the cyclicality of its earnings[5]. We have long argued that a key indicator of the potential for EM equities to ***sustainably*** outperform their DM counterparts relates to the outlook for their financial earnings. In aggregate terms, the picture remains lacklustre (**chart 2**). Headwinds are easing, but there are no tailwinds. And as any sailor will confirm, the absence of wind is rarely associated with movement.

Forward earnings growth for EM financials is dead flat, and identical to the overall EM earnings outlook. Earnings revisions for EM financials closely follow the overall EM

[5] Financials account for 24% of EM market cap and 36% of its trailing earnings, compared with 17% of DM market cap and 26% of DM earnings. It is mathematically difficult for EM to outperform DM on a sustainable basis unless EM financials are also outperforming DM financials.

metric, and are still negative (albeit less negative than in the recent past). Real credit growth in EM economies remains negative, and a diffusion index which has been a useful leading indicator of aggregate credit growth also shows no sign of a revival. And finally, *MRB's Financial Earnings Indicator* also remains mired in negative territory, albeit with a positive second derivative.

It is still too early to bet on EM fianancials' outperformance...

Crucially, our assessment of earnings growth in the major EM economies confirms that it is still too early to take significant long positions in this sector. China accounts for 30% of the market cap of EM financials, with another five countries (in declining order of size: Brazil, Taiwan, Korea, India and South Africa) accounting for a further 40%. A bet on Chinese financials, in our view, is dependent on conditions ripening for a re-rating, based on market-friendly debt restructuring, rather than on earnings growth[6]. There was a mild re-rating earlier this year associated with a bank IPO but a comprehensive bailout has yet to materialize, so this driver of outperformance is still in the realm of conjecture rather than fact.

...and financials are unlikely to drive overall EM outperformance

For the other "big 5" of EM financials, it is hard to see sustainable earnings growth for the most part. Brazil is awakening from a deep recession but still far from any upturn in a credit cycle, and has a listed public banking sector heavily encumbered with bad debt. Korea and Taiwan have private sectors which are already heavily leveraged and it is therefore unlikely that a credit cycle will take hold here. Some of the headwinds to an Indian banking revival have been removed, and it is arguably best-placed to move into a positive earnings cycle, but our *Financial Earnings Indicator* has yet to confirm this positive transition. Finally, South African domestic demand and financial earnings face continuing pressure; the best that can be said being that higher bond yields are a positive for the earnings of its large insurance sector.

Final Word: *Conditions are becoming less hostile for EM financials to outperform, but they remain unsupportive. Until these conditions take a decisive turn for the better, EM financials are unlikely to drive overall EM outperformance in a global equity portfolio.*

Mehran Nakhjavani

Adam Wolfe

Amr Abdel Khalek

[6] **MRB *China Research Highlight***, "***Chinese Banks: Betting On A Bailout***", April 12, 2016

Brazil[7]: *Underweight*

Relative earnings momentum is already weakening and valuations are demanding.

Growth: Brazil's economy is recovering but momentum will stay muted on a 6-12 month view. Household finances remain stretched and high debt servicing will continue to weigh on retail sales over the coming year given that the monetary easing cycle will be gradual and there are no signs of improvement in employment. On the other hand, opening up infrastructure plans to the private sector is positive for future earnings of domestic industrial stocks, bank earnings have bottomed and the efficient private banks will benefit from any improvement in credit volumes and lower NPLs.

Policy: Domestic inflationary pressures have receded: inflation expectations are now close to the target and the MRB Policy Pressure Gauge shows that Brazil has the most potential for rate cuts on a 6-12 month view. That said, the easing cycle will be gradual and dependant on fiscal consolidation. Any dilution of fiscal reforms (themselves hostage to political developments) will limit the central bank.

Valuation: A premature re-rating has resulted in rich valuations on a 12-month forward P/E ratio and price-to-book ratio basis. Stocks are trading at levels not seen since last decade's commodity boom.

Technicals: Equities are still overbought and vulnerable to a near-term correction.

Final Word: *Valuations are demanding in most sectors and stock prices are unlikely to outperform without a meaningful pickup in earnings, which is difficult to envisage in the year ahead. Investors should avoid domestic consumer and resource stocks, and concentrate holdings in segments of the market that benefit from reforms, namely domestic industrial stocks and banks.*

Brazil Equities: Drivers Of Relative Performance*

	-		N		+
Growth			■		
Policy			■		
Valuation	■				
Technicals		■			
Net Impact		■			

* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, - = negative
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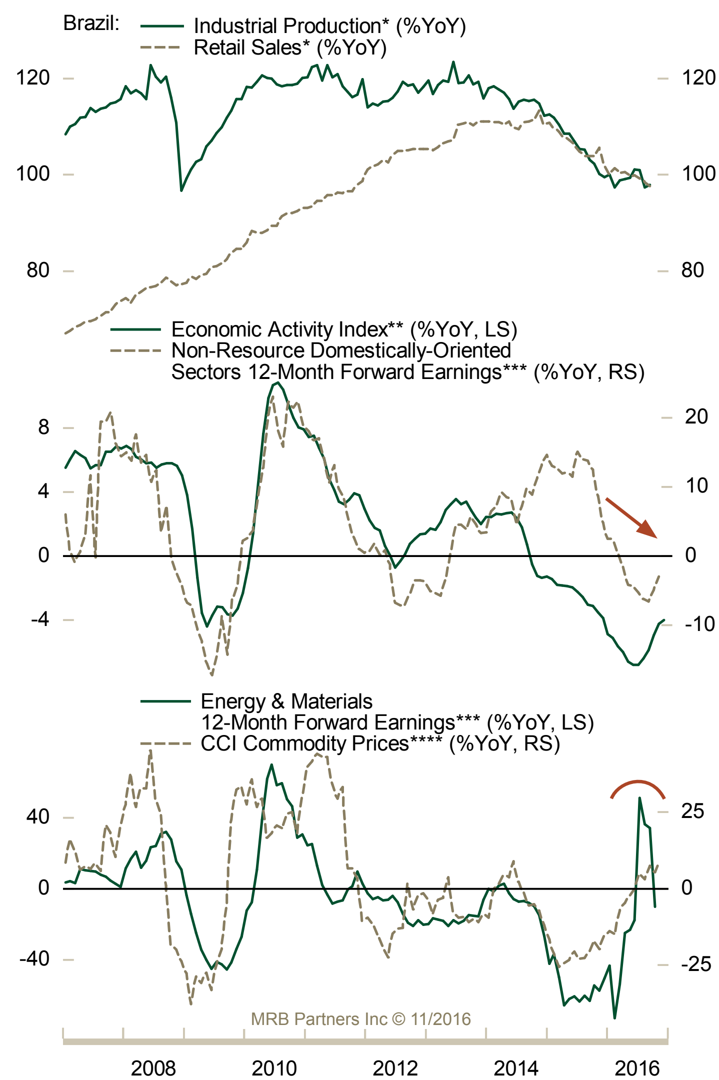
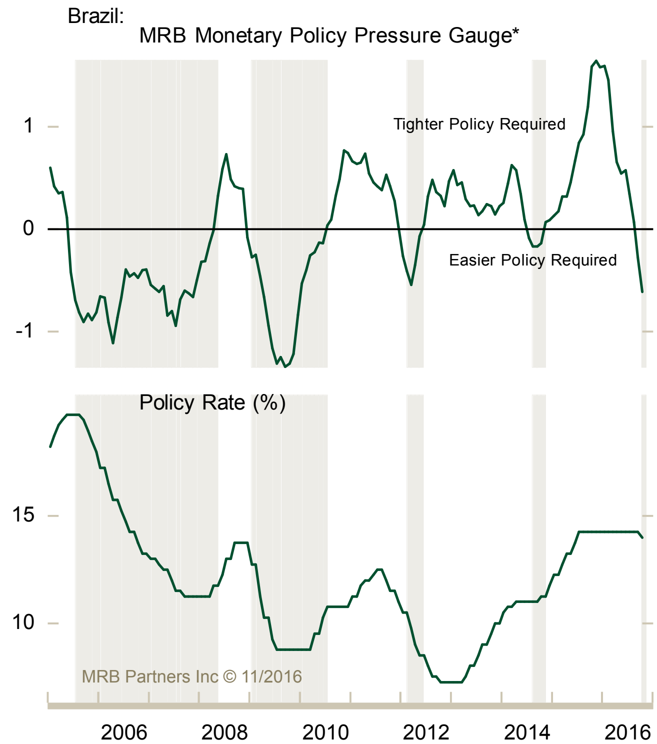
Still-Weak Growth/Earnings Will Limit Relative Upside



* Rebased to Janauary 2016 = 100; source: IBGE
** Advanced; source: Banco Central do Brasil
*** Local currency; source: Thomson Financial / IBES
**** Continuous Commodity Index; source: Commodity Research Bureau

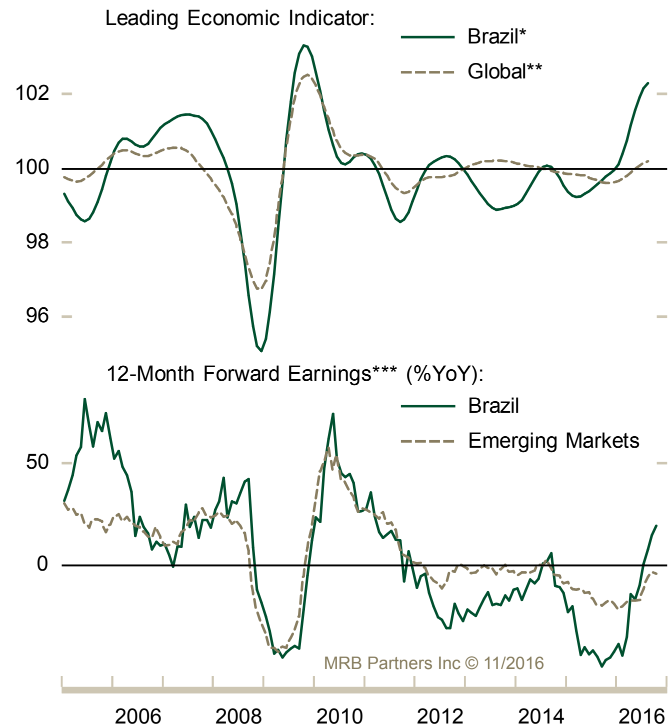
7 MRB *Weekly Macro Strategy Reports*, April 8, 2016, April 15, 2016, May 27, 2016 and July 29, 2016

Policy



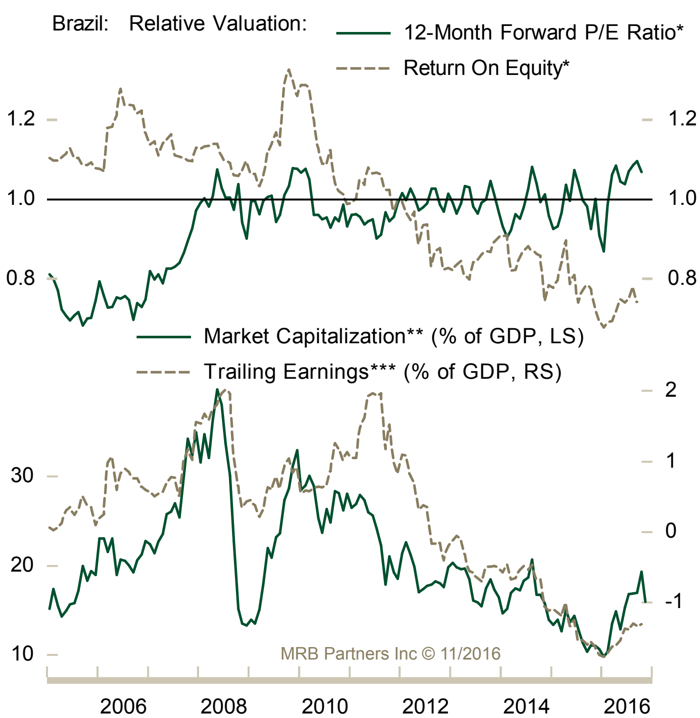
* Includes growth and inflation components; standardized
Note: Shaded for periods where the MRB Monetary Policy Pressure Gauge is below 0

Growth



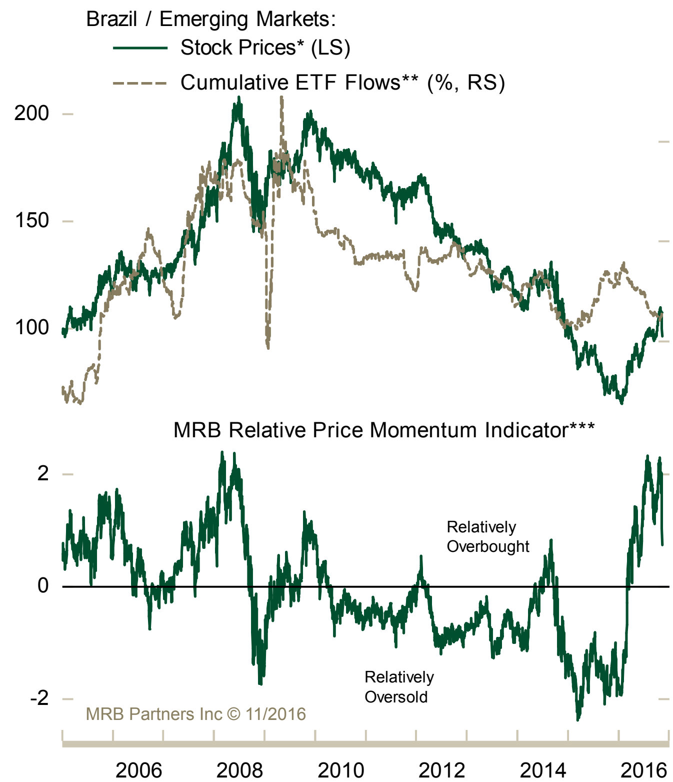
* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

Valuation



* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals



* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

China[8]: *Overweight*

Chinese earnings are largely domestically derived, and some sectors have strong tailwinds. However, a downturn in the property market is likely to prompt a downgrade in the next 6-12 months.

Growth: Non-resource cyclicals have structural tailwinds from the expansion of Internet retailing and a rebalancing of the economy toward private consumption. Financial earnings will continue to be weighed down by rising provisions in the banking sector, but state-owned enterprise (SOE) reforms appear to be gathering pace, which would reduce the risk from higher non-performing loans. Moreover, MSCI China's revenues are largely domestically-derived, reducing the risk from any Trumpian tariffs. That said, China's housing market poses the largest threat to relative earnings, primarily in the resource sectors, real estate and industrials.

Policy: The scope for monetary easing has closed, and we expect additional macroprudential measures targeted at housing price inflation in the coming months. Fiscal policy is likely to be more supportive in 2017, and may include some financing for SOE debt restructuring.

Valuation: Relative valuations have closed up somewhat, but China is still cheap. Return on equity in the consumer discretionary sector has declined, but this is largely due to problems in the index related to inclusion of the ADRs earlier this year.

Technicals: Neutral.

Final Word: *Maintain China at a modest overweight until signs of a housing downturn emerge. Consumer-facing sectors should see solid earnings growth, while financials still have re-rating potential.*

8 MRB *China Research Highlight*, "How China's Property Boom Goes Bust (Again)", October 11, 2016

China Equities:
Drivers Of Relative Performance*

	-		N		+
Growth	□	□	□	■	□
Policy	□	□	■	□	□
Valuation	□	□	□	■	□
Technicals	□	□	■	□	□
Net Impact	□	□	□	■	□

* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, - = negative

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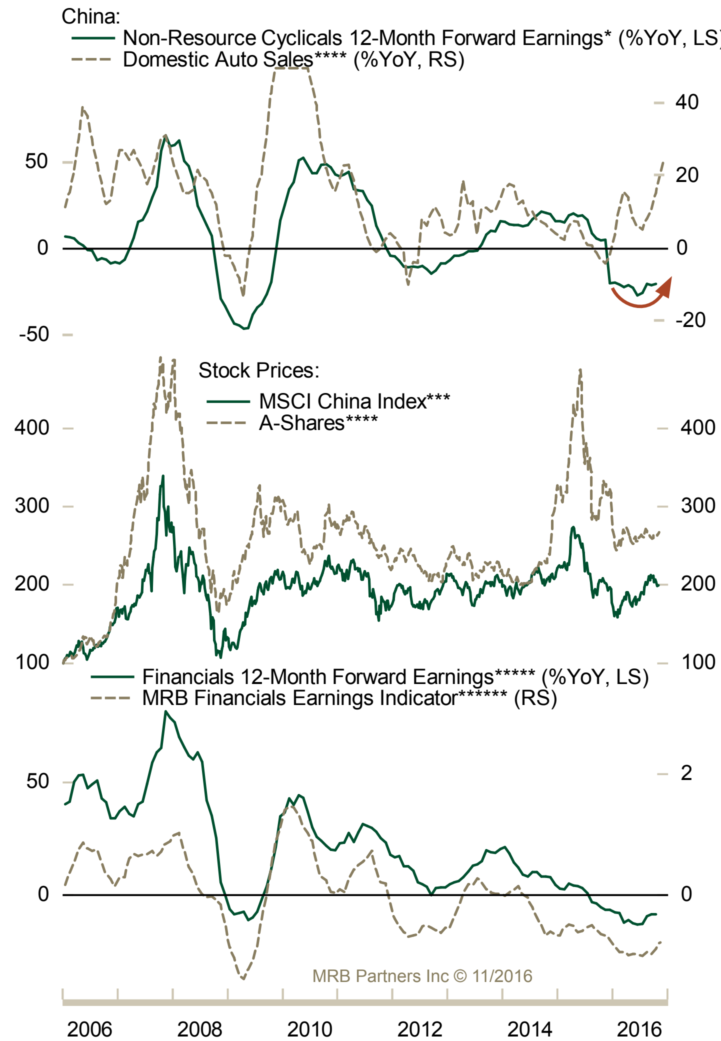
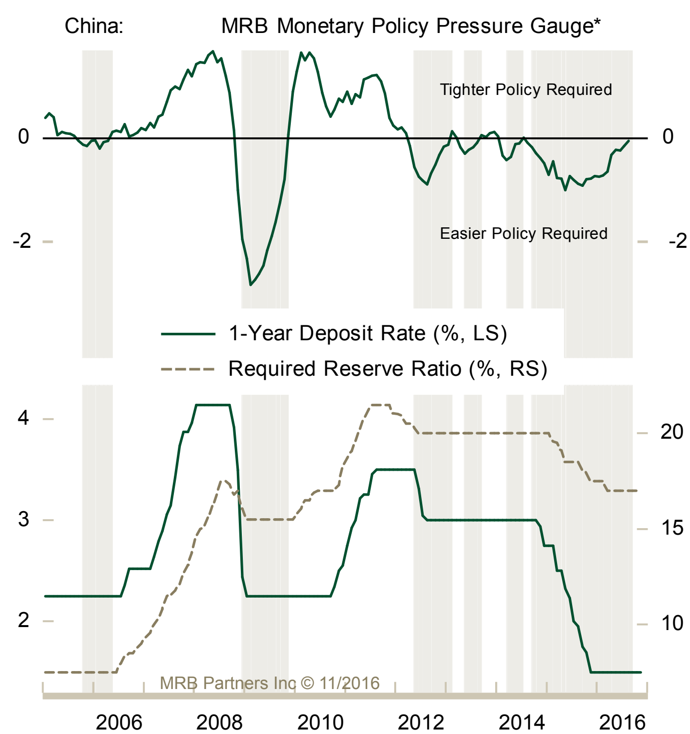
Risks To Earnings Are Declining



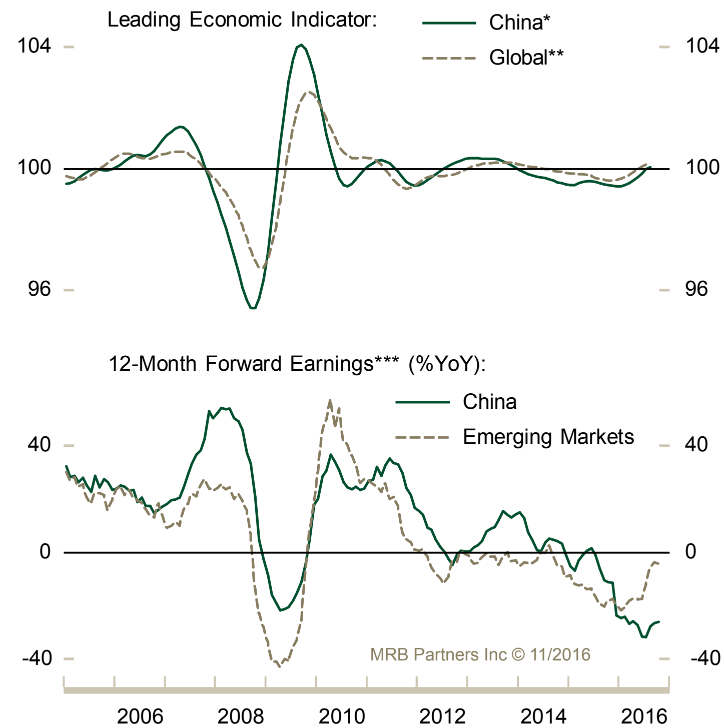
* Includes consumer discretionary, industrials and information technology; source: Thomson Financial / IBES
** Advanced; truncated above 50; smoothed; source: China Association for Automobile Manufacturers
*** U.S. dollars; rebased; source: MSCI
**** Rebased
***** Source: Thomson Financial / IBES
****** Advanced; includes measures of credit, net interest margins and 12-month forward earnings revisions; standardized

Policy



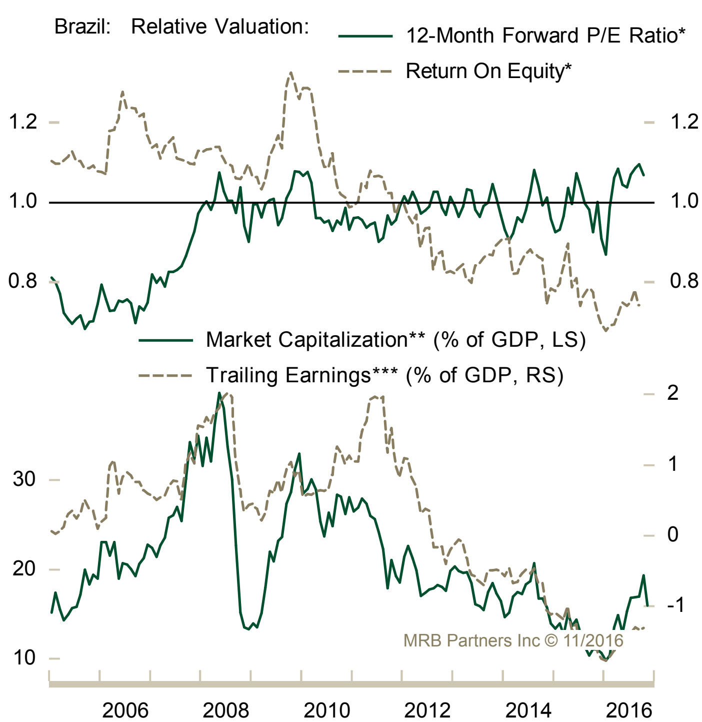
* Includes growth and inflation components; standardized
Note: Shaded for periods where the MRB Monetary Policy Pressure Gauge is below 0

Growth



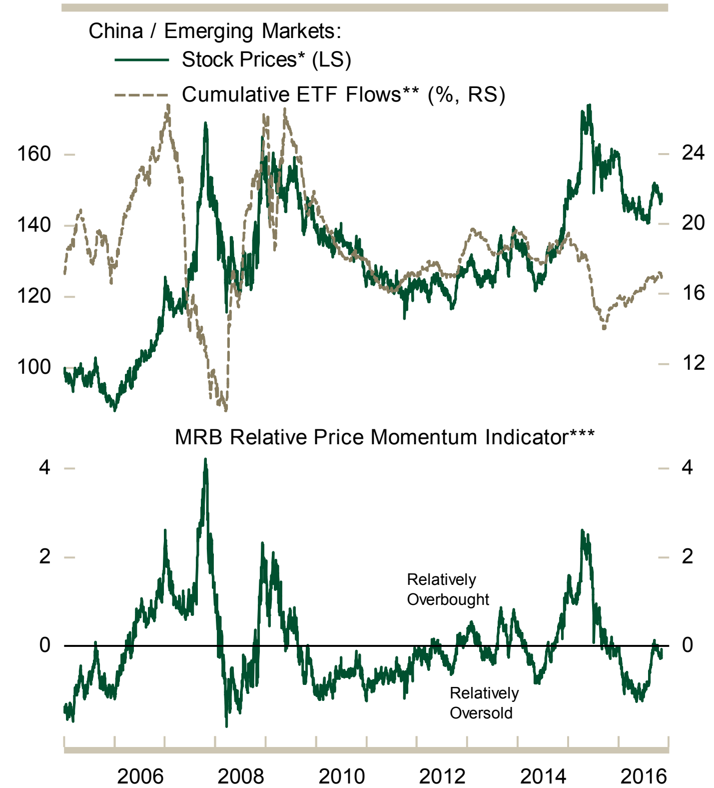
* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

Valuation



* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals



* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

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India[9]: *Overweight*

Relatively strong earnings momentum and structural reforms should drive outperformance. India's relatively closed economy and defensive sector tilt also provide protection in an EM selloff scenario.

Growth: Economic momentum appears to have rebounded in Q3, and this should continue into 2017. The withdrawal of larger denominated bills from the money supply may have a very short-term negative impact on growth, but the net impact over the next 12 months is likely to be positive, especially for financials and telecoms. Information technology stocks have earnings exposure to the U.S., but the vast majority of India's earnings are domestically-derived.

Policy: There is further room for the RBI to cut interest rates, though easing is likely to be gradual to ensure that inflation expectations remain anchored. The goods and service tax could now plausibly be implemented in April 2017, though that remains an ambitious target. The four-tiered structure is overly complicated, but still a major improvement from the current state-based system. Modi's government continues to push forward on structural reforms, as evidenced by last week's currency reforms.

Valuation: The market continues to trade in line with its historical premium to the EM benchmark on a sector-adjusted 12-month forward P/E ratio basis, but relative ROE is similarly high and rising.

Technicals: India is relatively oversold, which could provide near-term support.

Final Word: *Stay overweight India. Earnings momentum is improving, and structural reforms should continue to attract foreign inflows.*

India Equities: Drivers Of Relative Performance*

	-		N		+
Growth				■	
Policy				■	
Valuation			■		
Technicals				■	
Net Impact				■	

* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, - = negative

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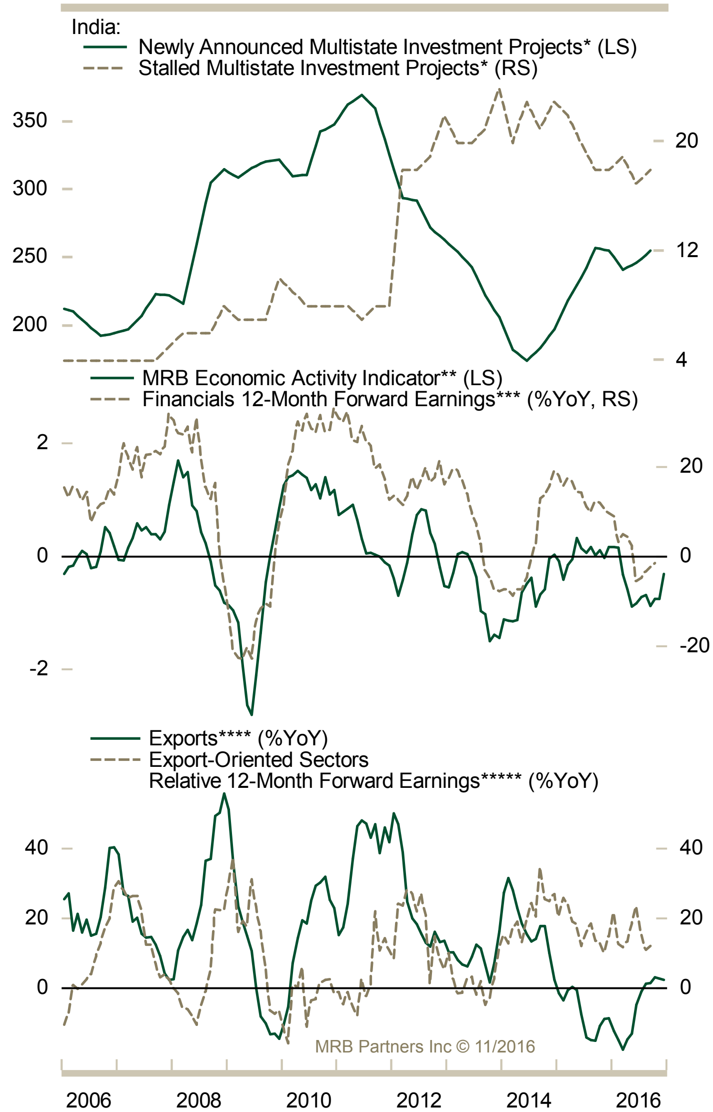
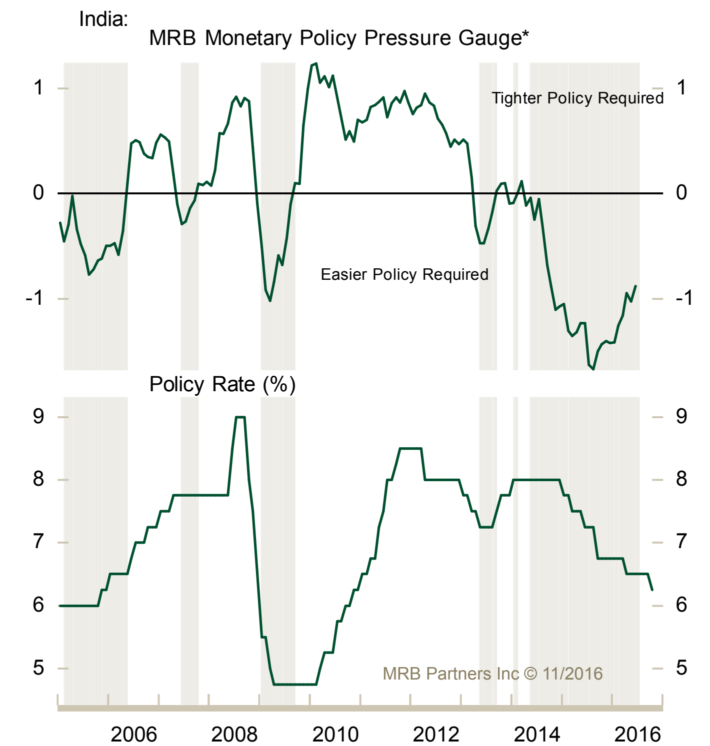
Financials Improve, Infrastructure Stalls



* Source: Centre for Monitoring Indian Economy
** Advanced; includes economic and financial components; standardized
*** Source: Thomson Financial / IBES
**** Advanced; smoothed; local currency; source: India Ministry of Commerce and Industry
***** Consumer discretionary, health care and information technology; relative to emerging markets equity benchmark; source: Thomson Financial / IBES

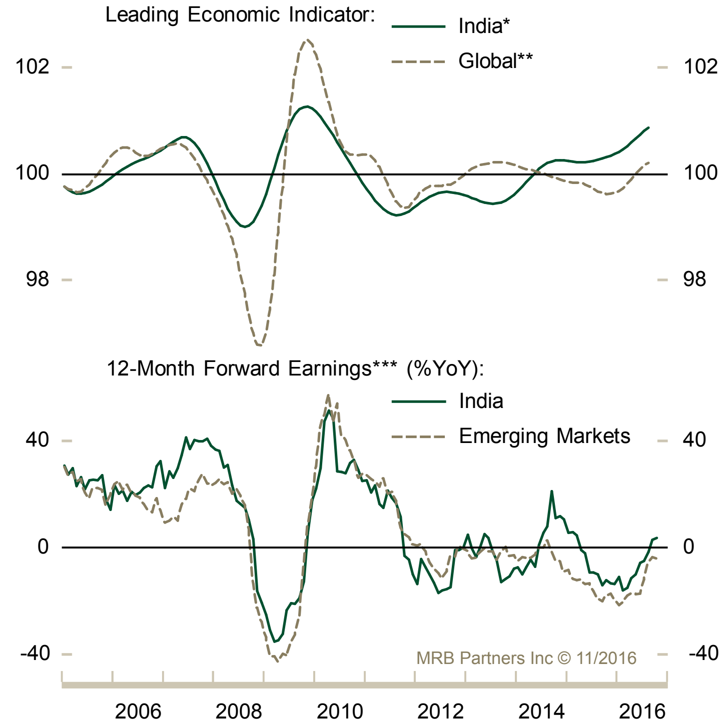
[9] MRB *Theme Report*, "Are India And Indonesia The Next China?", June 23, 2016

Policy



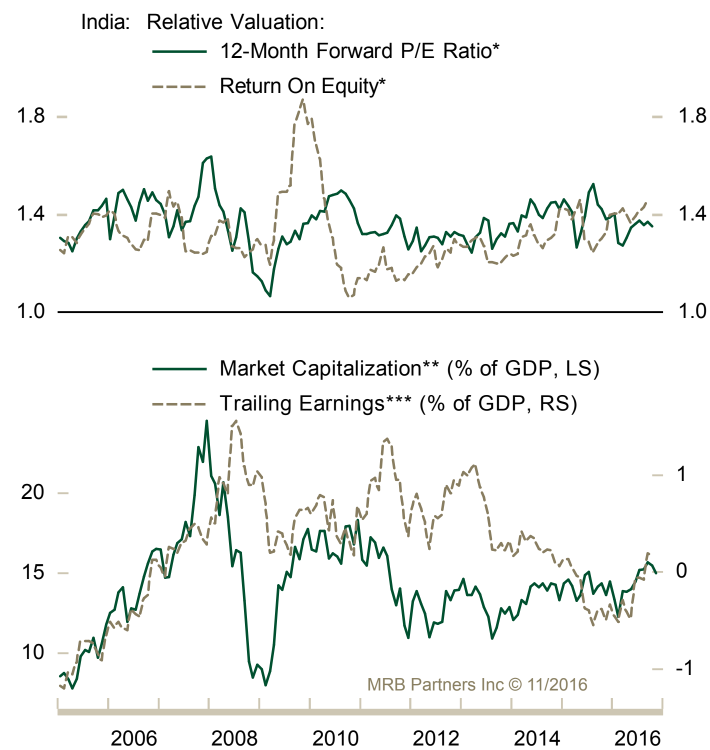
* Includes growth and inflation components; standardized
Note: Shaded for periods where the MRB Monetary Policy Pressure Gauge is below 0

Growth



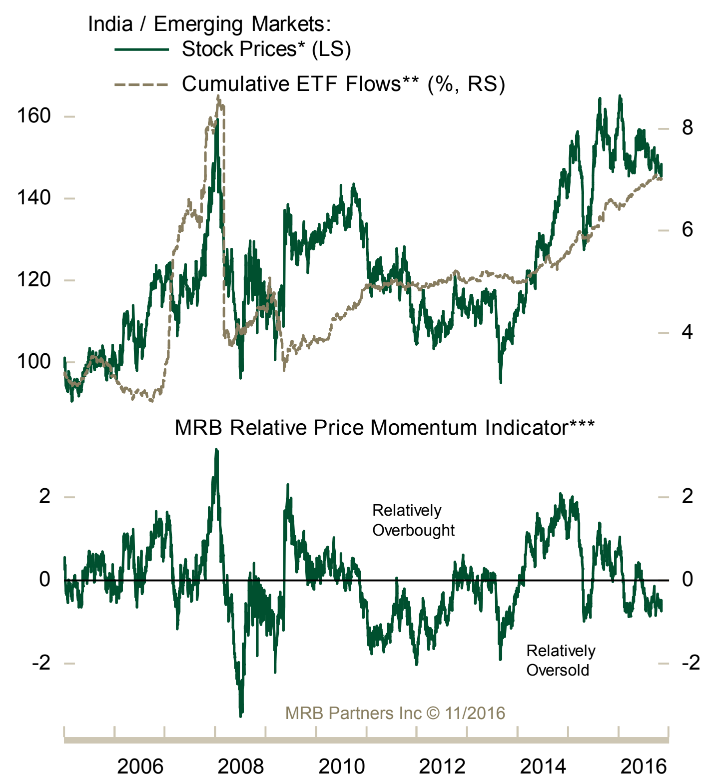
* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

Valuation



* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals



* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

Indonesia[10]: *Overweight*

Strong growth and structural reforms should drive outperformance. Indonesia is also a relatively closed economy with a defensive sector tilt, which should shield it from any further impairment of global trade.

Growth: Domestic economic momentum is accelerating on the back of improved consumer confidence and policy support. Corporate borrowing continues to be weak, but BI survey data suggest that credit access is improving, which should bolster private sector investment over the next 12 months. Moreover, policy easing has resulted in some yield curve steepening, which should encourage banks to lend.

Policy: There is plenty of room for the BI to ease policy rates further, with headline and core inflation hovering at the bottom of the target range and credit growth relatively moribund. Deregulation helped Indonesia jump 15 spots in the World Bank's Ease of Doing Business rankings this year, and further efforts are underway.

Valuation: Relative valuations are rich compared to their own history, but Indonesia still offers a premium ROE that can compensate for its higher 12-month forward P/E ratio on a sector-adjusted basis.

Technicals: Neutral.

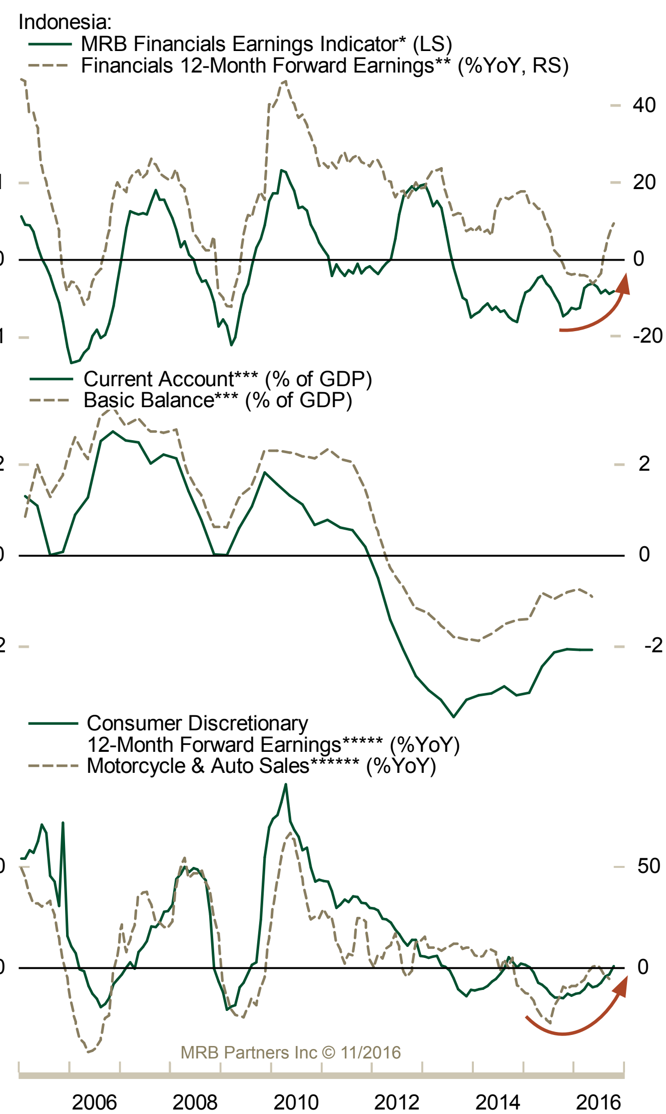
Final Word: *Earnings growth should remain strong on a relative basis, as policy support boosts domestic demand. Valuations may limit Indonesia's outperformance, but should not prevent it.*

Indonesia Equities: Drivers Of Relative Performance*

	-		N		+
Growth					■
Policy				■	
Valuation		■			
Technicals			■		
Net Impact				■	

* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, - = negative MRB Partners Inc © 11/2016

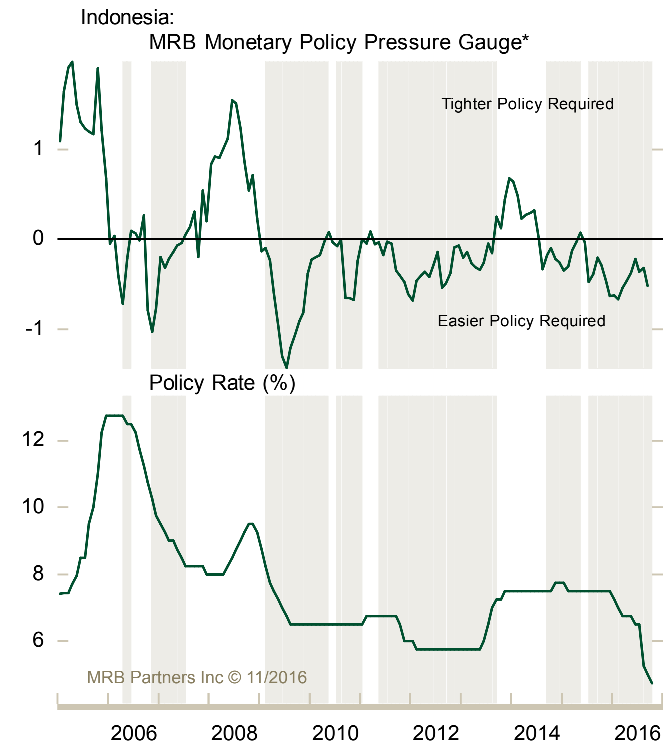
Domestic Fundamentals Are Solid



* Includes measures of credit volume, net interest margins and 12-month forward earnings revisions; standardized
** Local currency; source: Thomson Financial / IBES
*** Source: Statistics Indonesia
**** Source: Thomson Financial / IBES
***** MRB calculation

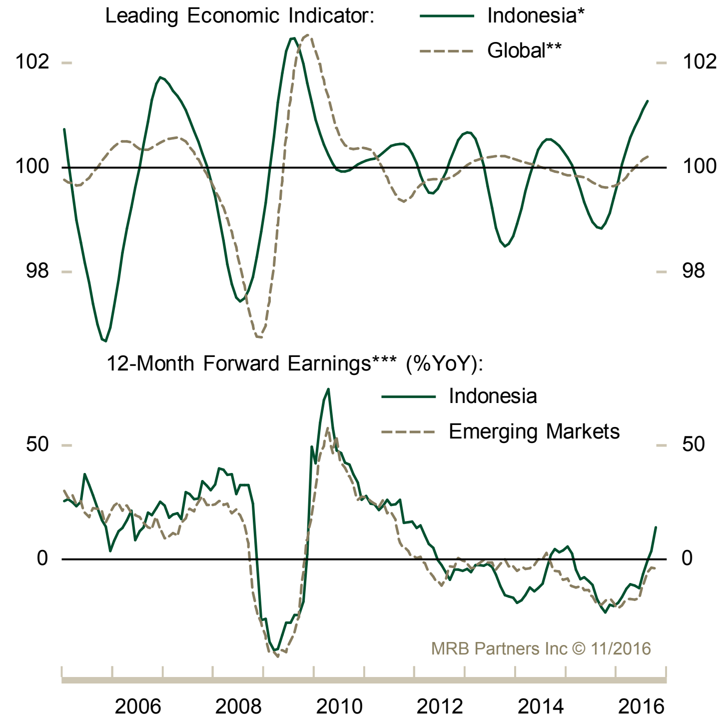
[10] MRB *Theme Report*, "Are India And Indonesia The Next China?", June 23, 2016

Policy



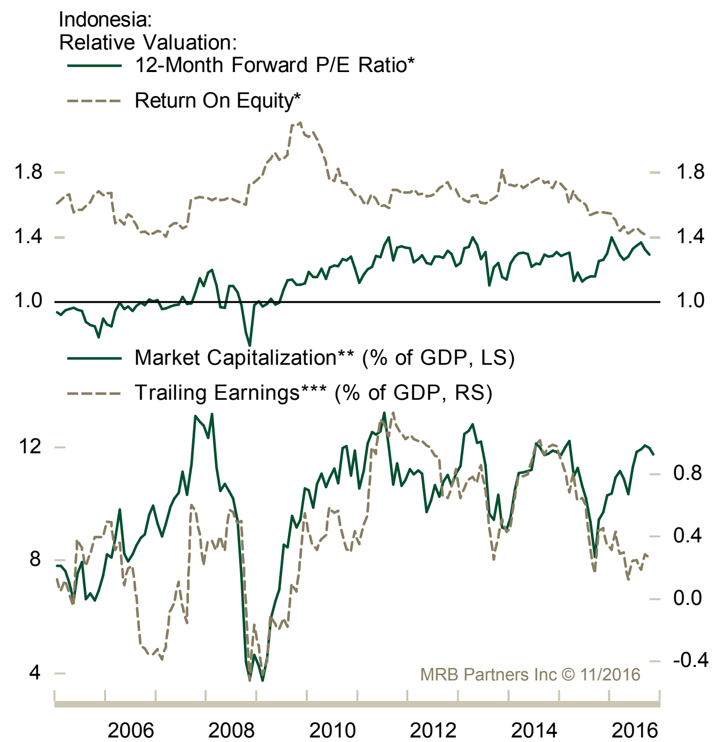
* Includes growth and inflation components; standardized
Note: Shaded for periods where the MRB Monetary Policy Pressure Gauge is below 0

Growth



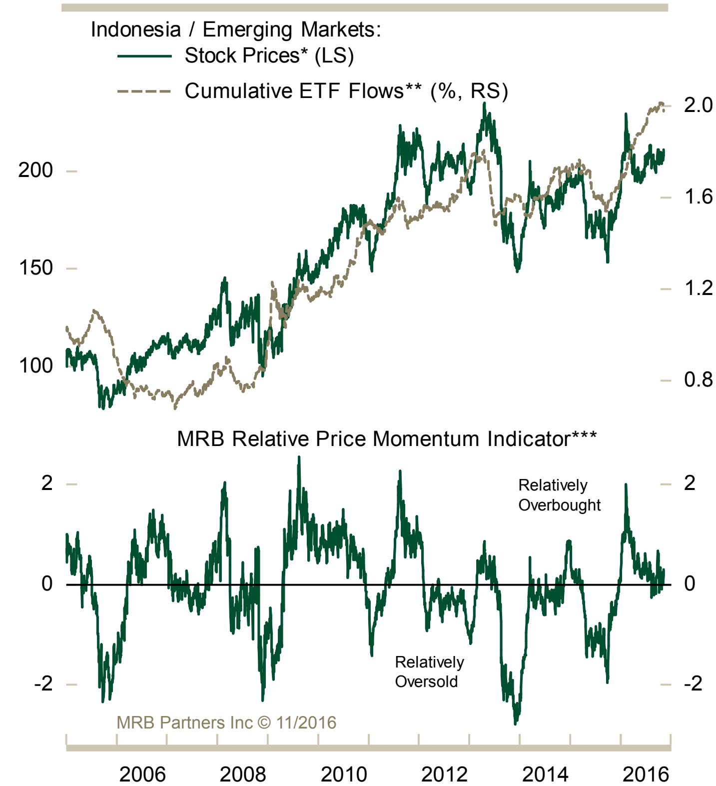
* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

Valuation



* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals



* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

Korea[11]: *Overweight*

Maintain an overweight stance as the leading indicators point toward further earnings outperformance. However, Korea is vulnerable to any disruption of the nascent global export recovery.

Growth: Improving external demand, particularly for information technology, should deliver relatively strong earnings growth over the next 12 months. Semiconductor sales are starting to rebound from cyclically-depressed levels, and the leading indicators point to further gains. Financial earnings should also improve on stronger credit demand and a slightly steeper yield curve. That said, Korea's trade agreement with the U.S. is one of the most vulnerable to the whims of President-elect Trump.

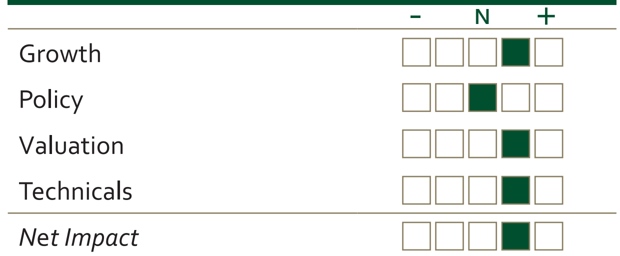
Policy: The BoK is likely done easing for now, though it will be in no hurry to hike interest rates. President Park's precarious political situation will impede any fiscal policy support in the near term, but the supplementary budget that kicked in at the end of Q3 will ensure a positive fiscal thrust.

Valuation: Korea trades at a relatively large discount to the EM benchmark on a sector-adjusted P/E ratio basis, while its relative ROE is rising. Valuations are attractive.

Technicals: Korea is slightly oversold on a relative basis.

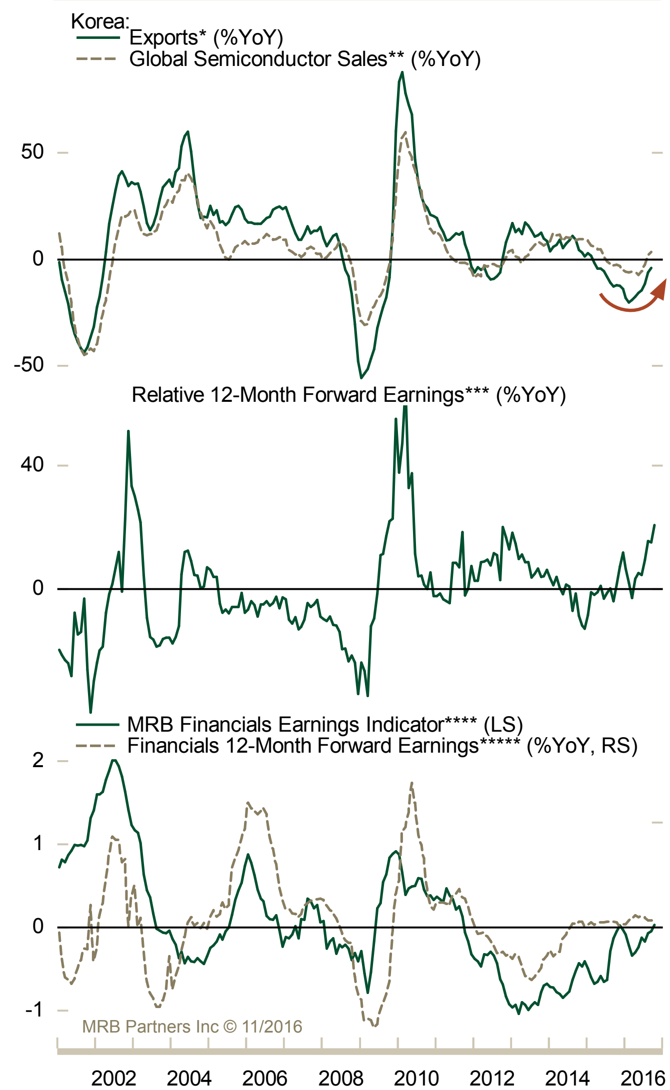
Final Word: *Continue to hold Korea at an overweight, as information technology earnings should have solid tailwinds. However, look to downgrade on evidence of anti-trade policies in the U.S. or a housing downturn in China.*

Korea Equities:
Drivers Of Relative Performance*



* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, – = negative MRB Partners Inc © 11/2016

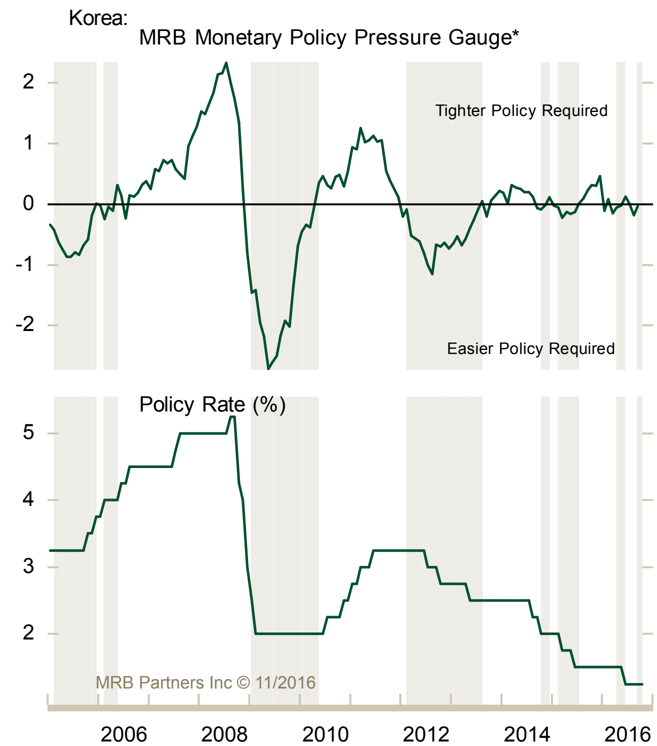
Semi Cycle To Boost Earnings



* U.S. dollars; source: Korea Customs Service
** U.S. dollars; smoothed; source: World Semiconductor Association
*** U.S. dollars; relative to emerging markets equity benchmark; source: Thomson Financial / IBES
**** Includes measures of credit volume, net interest margins and 12-month forward earnings revisions; standardized
***** Local currency; source: Thomson Financial / IBES

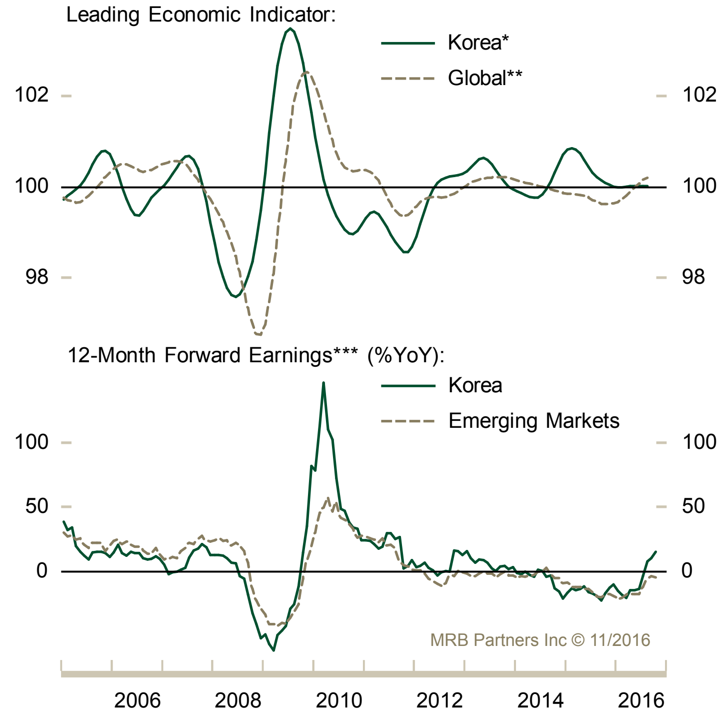
[11] MRB *Asia Ex-Japan Equities Report*, September 6, 2016

Policy



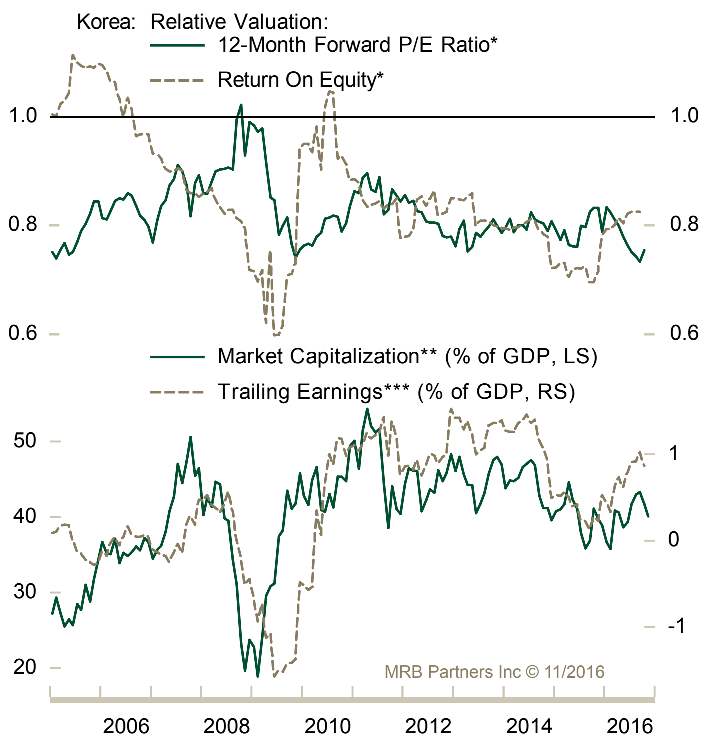
* Includes growth and inflation components; standardized
Note: Shaded for periods where the MRB Monetary Policy Pressure Gauge is below 0

Growth



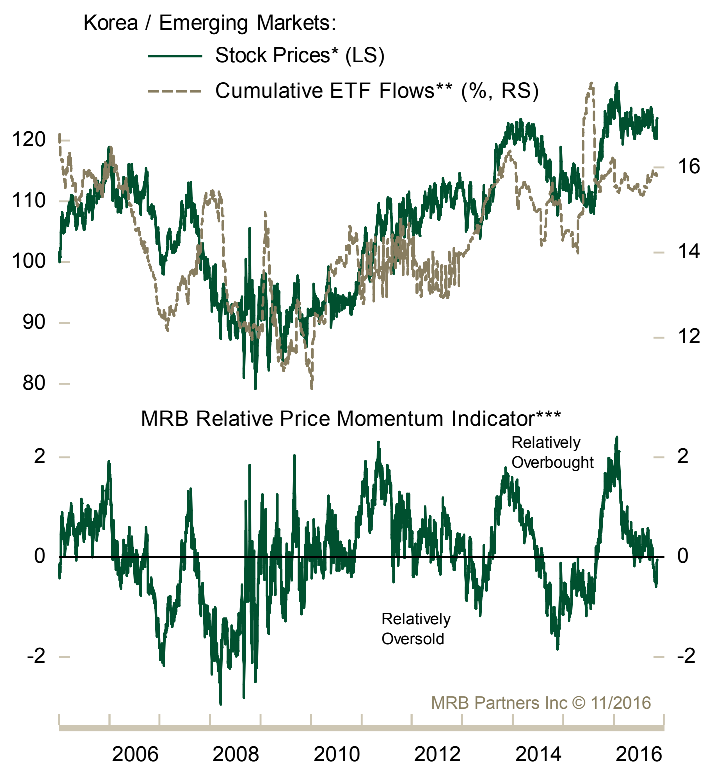
* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

Valuation



* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals



* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

Mexico[12]: Downgrade To *Neutral*

Mexico is in the crossfire during this phase of uncertainty surrounding U.S. trade policies. Given the difficulty of forecasting the latter, we are refrain from taking a bet.

Growth: Domestic activity remains resilient despite the modesty of external demand. Retail sales are mildly decelerating, albeit from very high growth rates and labor market indicators continue to point to solid household consumption. The possibility of U.S. protectionism is a significant long-term risk to growth, but Mexico will also benefit from any fiscally-driven U.S. growth upside. The peso is deeply undervalued, and will benefit from any potential trade friction between the U.S. and China. Still, a prolonged period of uncertainty surrounding trade agreements will weigh on business confidence, employment, and, overall equity earnings.

Policy: Recent currency depreciation implies that policy rate hikes are now in the cards and fiscal consolidation is likely to garner momentum to preserve favorable ratings by credit rating agencies and limit capital outflows. The relative policy impulse is thus negative for equity earnings.

Valuation: Valuations are attractive with the sector-adjusted 12-month forward P/E ratio premium falling from 33% to 15% since the start of the year, while return on equity is 10% higher than EM peers. In addition, the valuation argument is much more appealing for foreign investors given the peso's sharp weakness and undervaluation.

Technicals: Equities are extremely oversold relative to the EM benchmark and a countertrend rally is likely.

Final Word: *Domestic demand and earnings are holding up in the face of weak U.S. imports. That said, a prolonged period of uncertainty surrounding U.S. trade policies will likely weigh on the near-term growth outlook.*

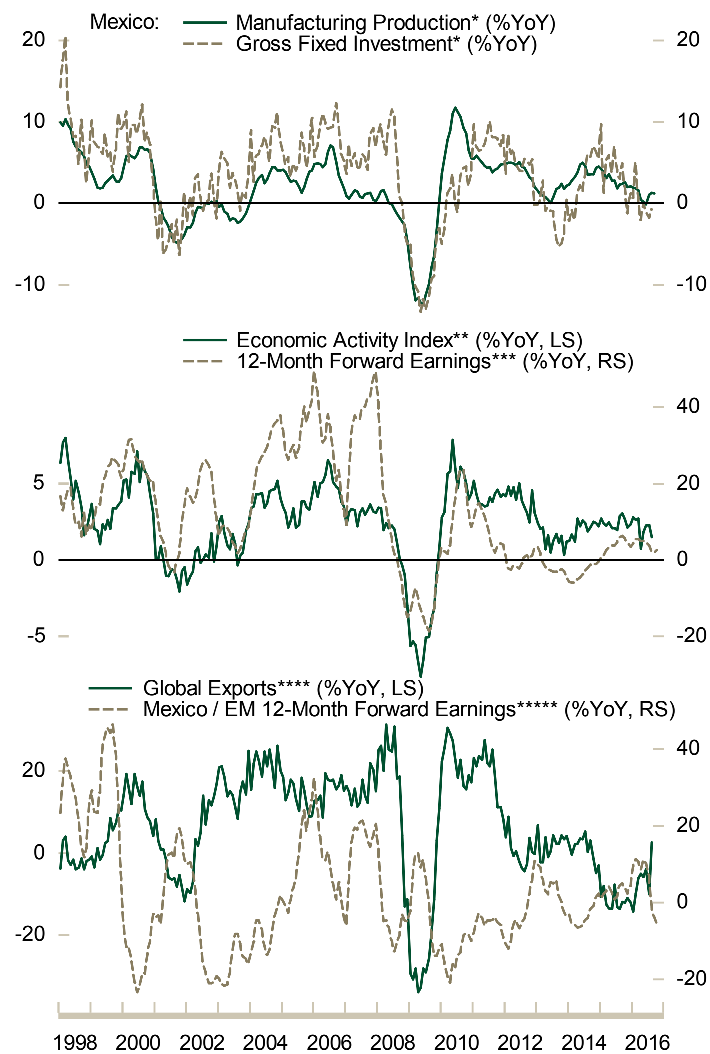
[12] MRB ***EM Research Highlight***, "Myth Busting The Mexican Peso", and September 20, 2016
MRB ***Weekly Macro Strategy***, July 8, 2016

Mexico Equities:
Drivers Of Relative Performance*

	-		N		+
Growth	□	□	■	□	□
Policy	□	■	□	□	□
Valuation	□	□	□	■	□
Technicals	□	□	□	■	□
Net Impact	□	□	■	□	□

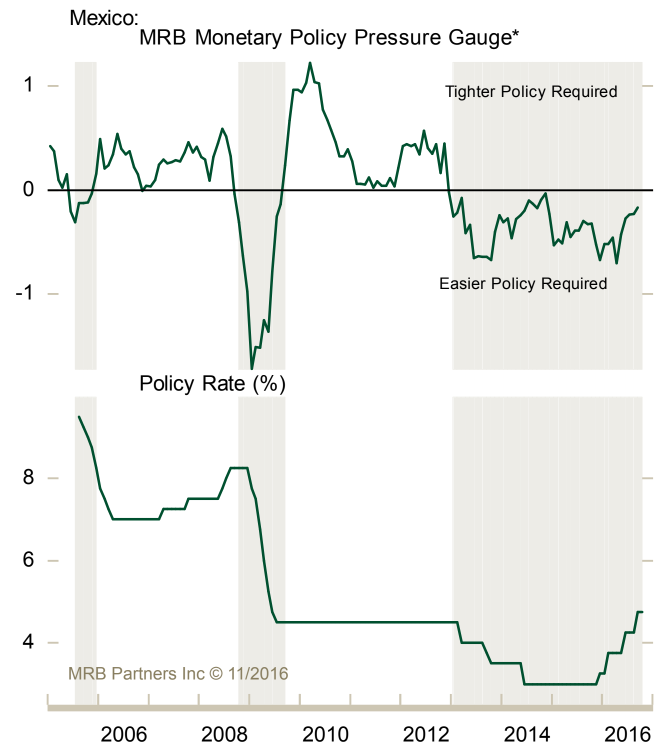
* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, - = negative   MRB Partners Inc © 11/2016

In Trump's Crosshairs



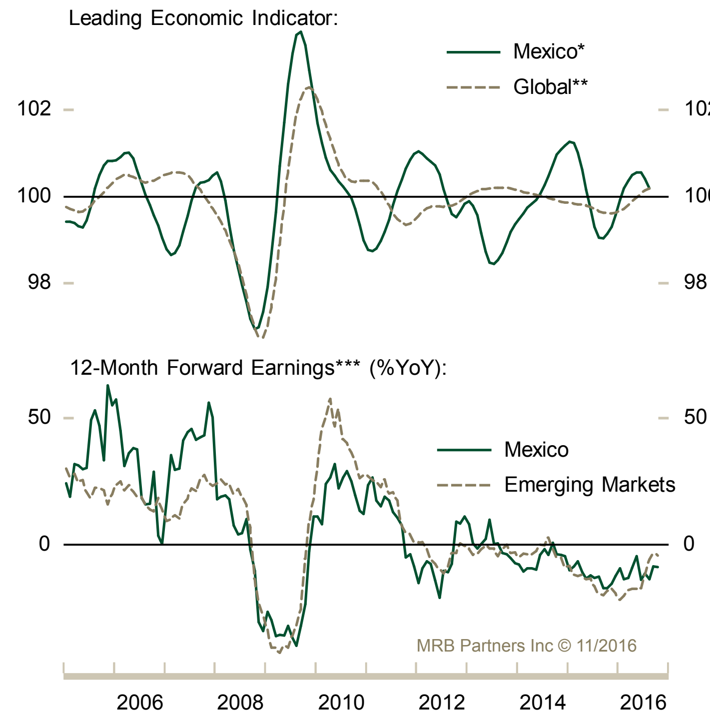
* Source: INEGI   MRB Partners Inc © 11/2016
** Source: Banco de Mexico
*** Local currency; source: Thomson Financial / IBES
**** U.S. dollars; source: IMF
***** U.S. dollars; source: Thomson Financial / IBES

Policy



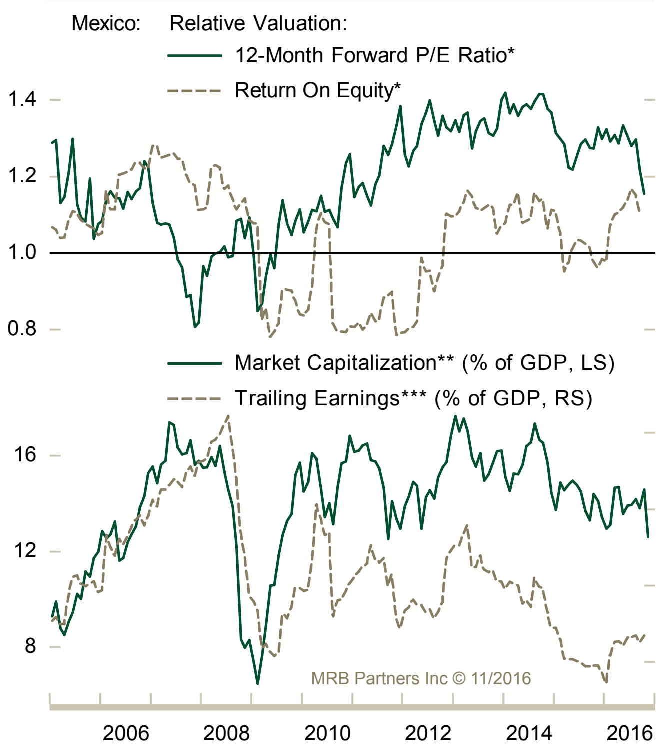
* Includes growth and inflation components; standardized
Note: Shaded for periods where the MRB Monetary Policy Pressure Gauge is below 0

Growth



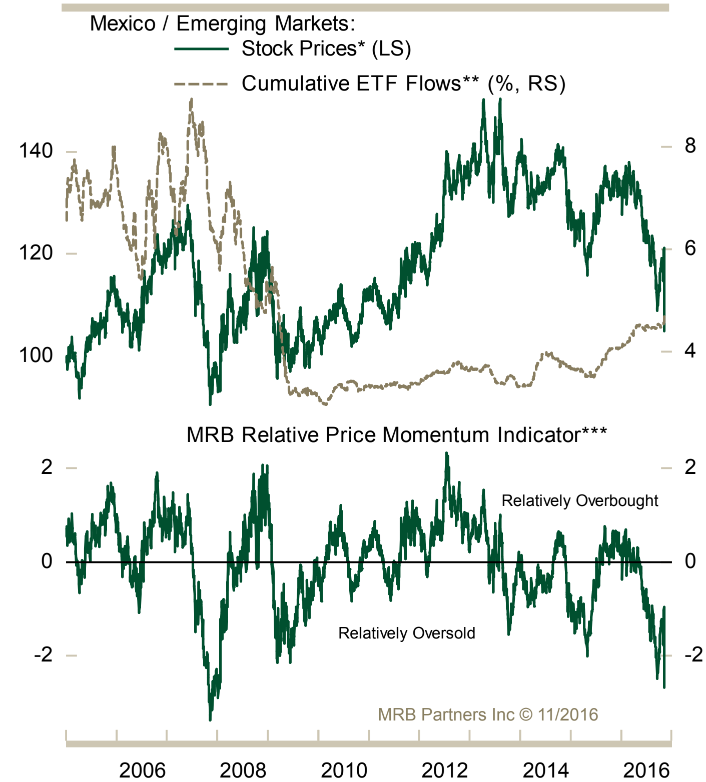
* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

Valuation



* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals



* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

Russia[13]: *Underweight*

President-elect Trump's ability and willingness to meaningfully improve relations with Russia is unknown at least in the near term. Meanwhile, our view on range-bound oil prices implies underperformance on a 6-12 month view.

Growth: Domestic activity will continue to recover with business confidence and industrial production showing signs of sustained improvement. In addition, private consumption has bottomed and employment, real wages and consumer credit suggest that retail sales will likely accelerate on a 6-12 month view. Bank earnings are likely to benefit from the improvement in credit volumes but the sector accounts for a small share of the market and is unlikely to drive overall earnings outperformance. Oil prices are the dominant driver of profits, and the absence of upside (which is our view) implies that Russian earnings will underperform on a one-year horizon.

Policy: Inflation will mildly decline from current levels and the BoR will cut rates further. However, the pace and scope of rate cuts will be limited as oil prices and the ruble decline anew. In addition, domestic demand plays are limited and thus policy rate cuts have only a mild effect on overall earnings.

Valuation: Valuations are still highly attractive, but the catalyst of rising oil prices and/or lifting sanctions are absent.

Technicals: Neutral.

Final Word: *The improvement is domestic demand is positive for bank earnings but the overall market will underperform EM peers on a 6-12 month view given our negative view on oil prices. Investors should continue to favor financials over energy stocks.*

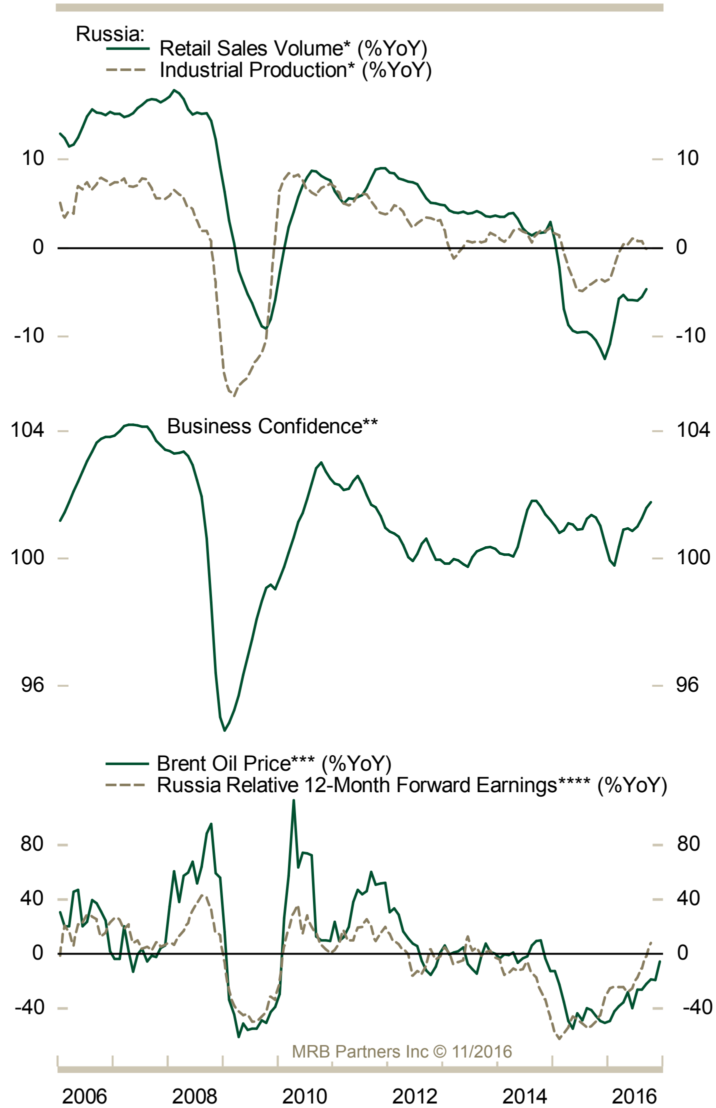
[13]MRB *Russia Research Highlight*, "Are Any Russian Assets Uncontaminated By Oil?", *August 12, 2016*
MRB *Weekly Macro Strategy Reports*, May 13, 2016

Russia Equities: Drivers Of Relative Performance*

	-		N		+
Growth		■			
Policy			■		
Valuation				■	
Technicals			■		
Net Impact		■			

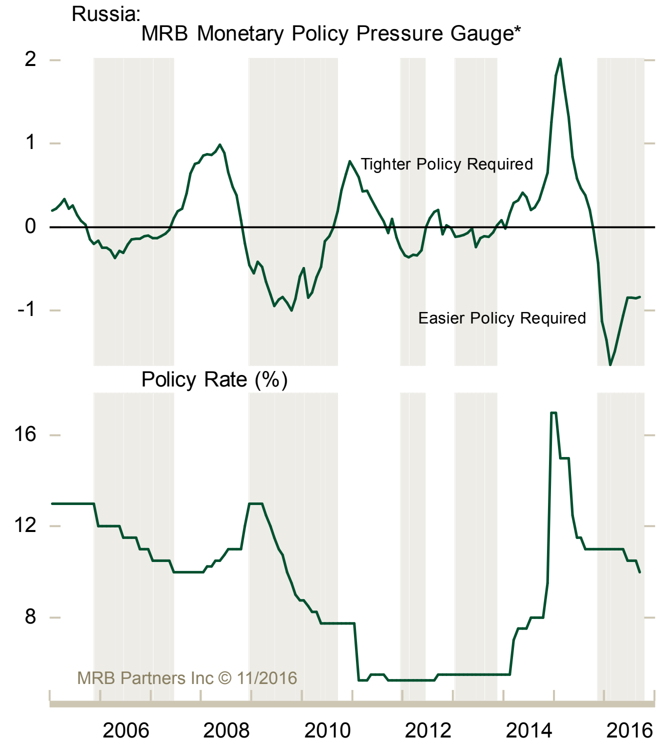
* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, - = negative MRB Partners Inc © 11/2016

Oil Price Weakness Will Weigh On Relative Earnings



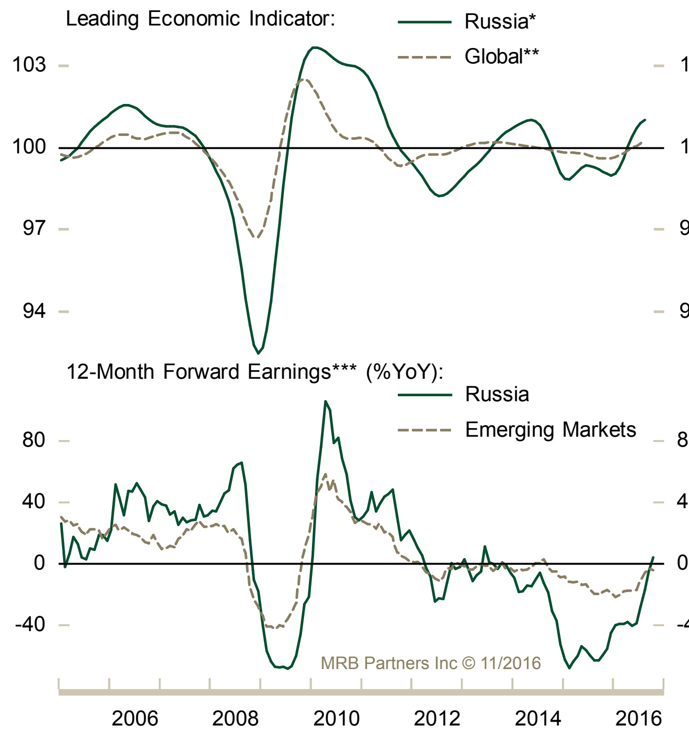
* Source: Russia Federal State Statistics Service
** Source: OECD
*** Advanced
**** U.S. dollars; relative to emerging markets equity benchmark; source: Thomson Financial / IBES

Policy



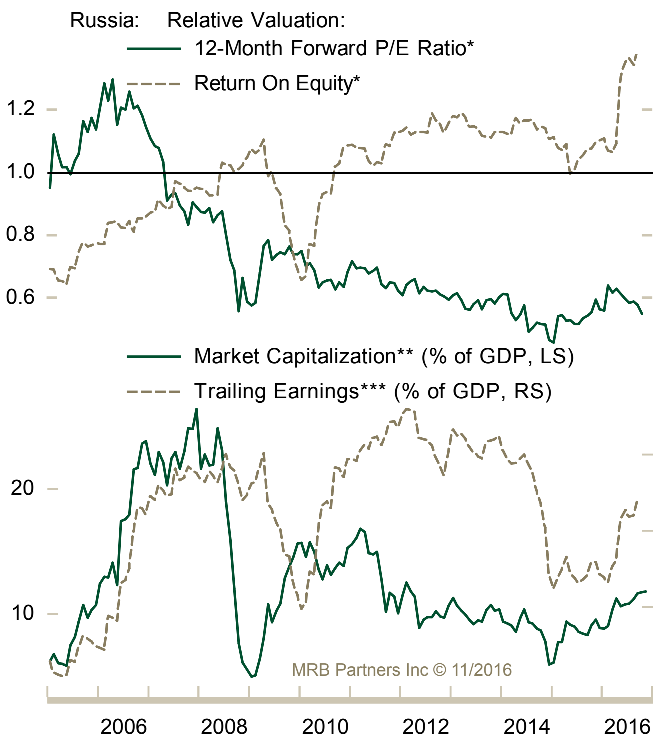
* Includes growth and inflation components; standardized
Note: Shaded for periods where the MRB Monetary Policy Pressure Gauge is below 0

Growth



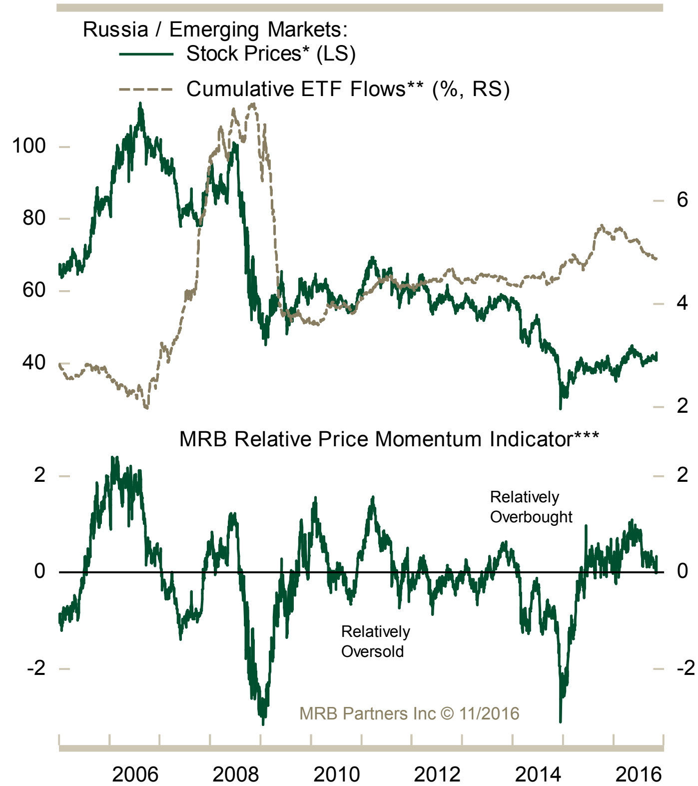
* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

Valuation



* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals



* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

South Africa[14]: *Downgrade To Neutral*

Our expectations of rand weakness will lift the large foreign currency-dependent segment of the market, but it will also undermine returns in common currency terms.

Growth: Industrial production is weakening and low business confidence will keep private investment weak. In addition, the recent mining-driven bounce will fade as commodity prices come under pressure once fears of a Chinese 'hard landing' re-emerge in 2017. Meanwhile, the poor outlook for employment coupled with high debt servicing will keep retail sales on its decelerating trend. Investors should continue to underweight domestically-oriented sectors and favor segments with exposure to foreign markets that are shielded, at least for now, from weak domestic growth and benefit from rand weakness.

Policy: Inflation has mildly declined but as the rand weakens anew, imported inflation will rise and the growth/inflation outlook will deteriorate. The central bank will remain on hold in the near term, but more rate hikes are likely on a 6-12 month view as the U.S. dollars firms and global bond yields rise.

Valuation: South Africa is no longer trading at a large premium on a sector-adjusted 12-month forward P/E ratio basis, but this is justified by the sharp decline in relative ROE.

Technicals: Neutral.

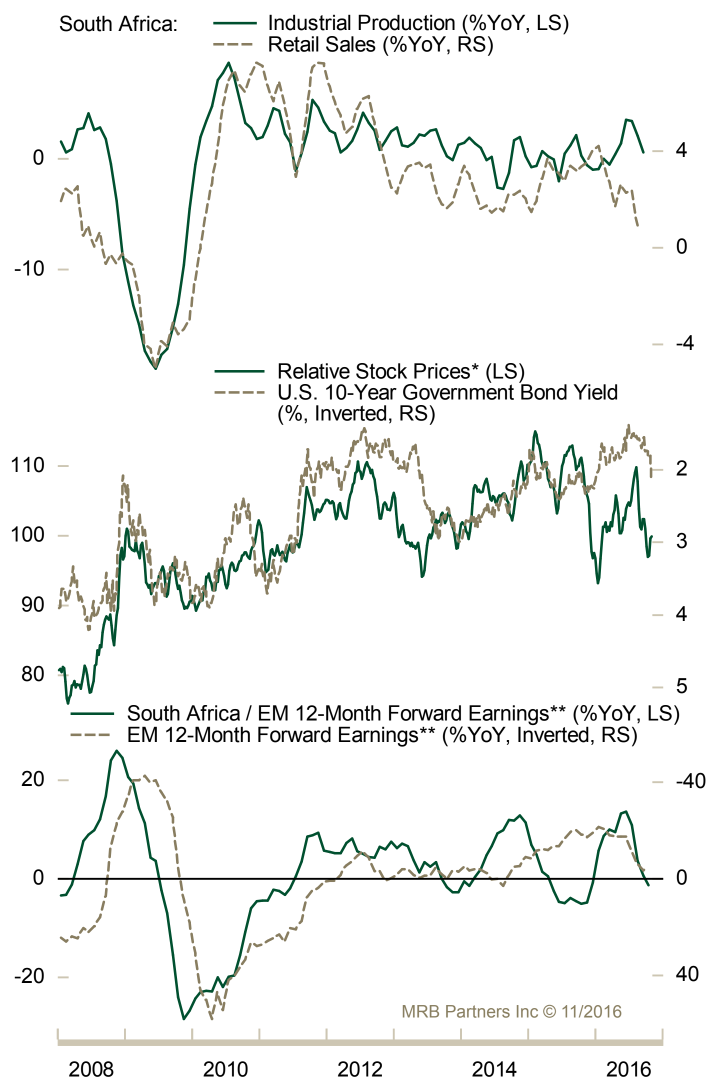
Final Word: *Dual-listed stocks, which account for the larger share of the market, will benefit from rand weakness. However, currency risk implies that foreign investors will miss out on the upside.*

South Africa Equities: Drivers Of Relative Performance*

	–		N		+
Growth			■		
Policy		■			
Valuation			■		
Technicals			■		
Net Impact			■		

* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, – = negative MRB Partners Inc © 11/2016

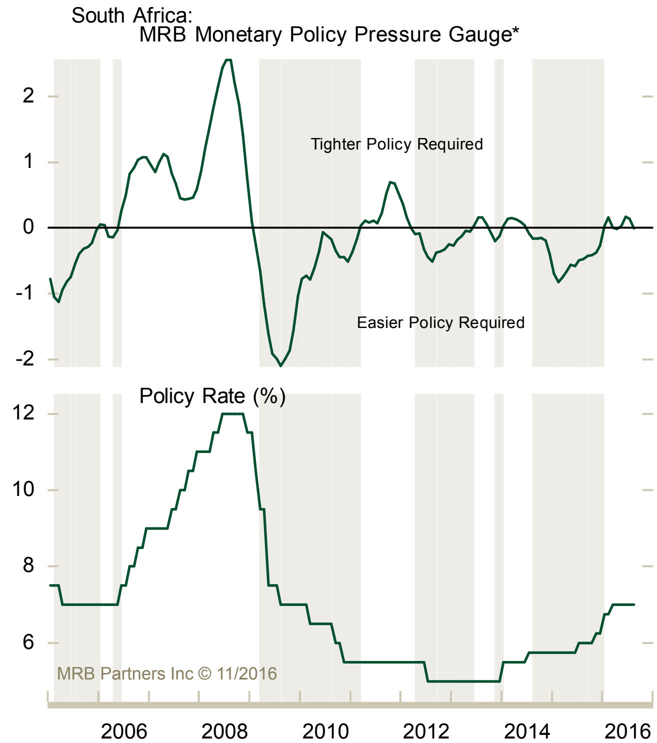
Weak Rand Offsets 'Rand Hedge' Gains



* U.S. dollars; relative to emerging markets; rebased; source: MSCI
** U.S. dollars; source: Thomson Financial / IBES

[14] MRB *Weekly Macro Strategy Report*, October 28, 2016, MRB *South Africa Reports*, "*Watch For China, Not The Fed*", August 30, 2016 and "*Fade The Rand Rally*", May 5, 2016

Policy

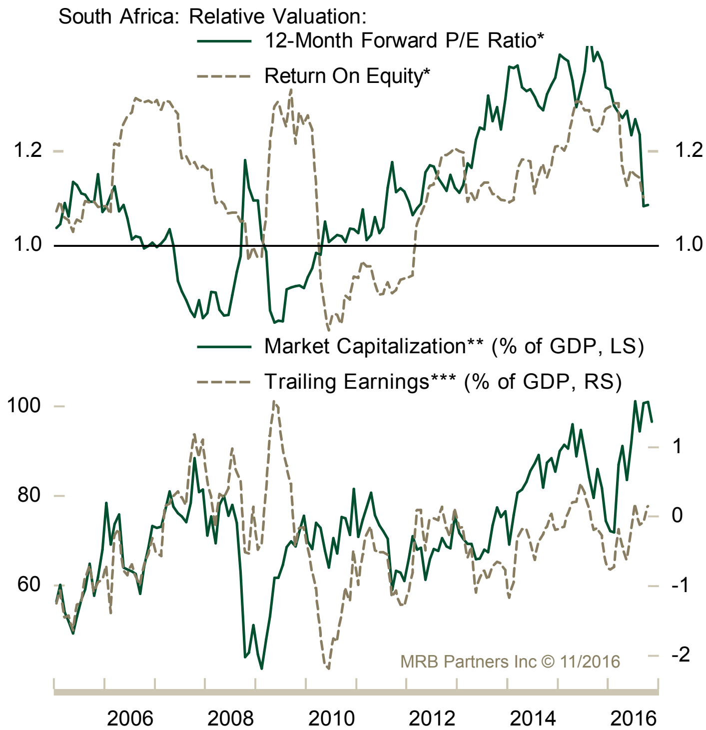


* Includes growth and inflation components; standardized
Note: Shaded for periods where the MRB Monetary Policy Pressure Gauge is below 0

Growth

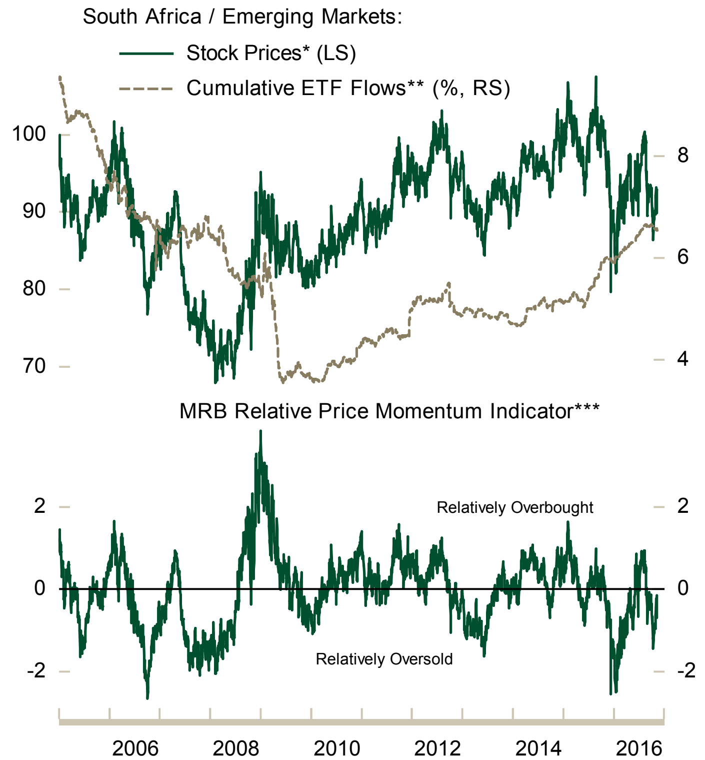
* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

Valuation



* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals



* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

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Taiwan[15]: *Overweight*

Stronger global semiconductor sales should deliver earnings outperformance over the next 12 months. However, U.S. trade policy and China's housing market pose credible threats to Taiwan's export-led recovery.

Growth: Taiwan's heavy weighting in information technology should benefit from rising global semiconductor sales over the next 12 months. Export orders of electronic products and the manufacturing PMI point to stronger demand in the near-term. This will have positive spillover effects for domestic-facing sectors. Financials' earnings should also benefit from rising property prices and improved credit demand.

Policy: There is little scope for further monetary easing, and fiscal policy looks set to be overly timid according to the 2017 budget. However, Taiwan's lack of bilateral trade agreements does protect it somewhat from the risk of an inward turn in the U.S. during the Trump administration.

Valuation: Taiwanese stocks are cheap relative to their own history and are fairly valued compared to other EMs. On a sector-adjusted basis, Taiwan trades at a similar 12-month forward P/E ratio as the EM benchmark and offers a similar ROE. However, a rebound in global semiconductor demand would push ROE higher, given Taiwan's operating leverage and sector profile.

Technicals: Recent outperformance has left the market somewhat overbought.

Final Word: *Continue to hold Taiwan at overweight, as information technology earnings have solid tailwinds. Anti-trade policies in the U.S. or a housing downturn in China would reasons to downgrade.*

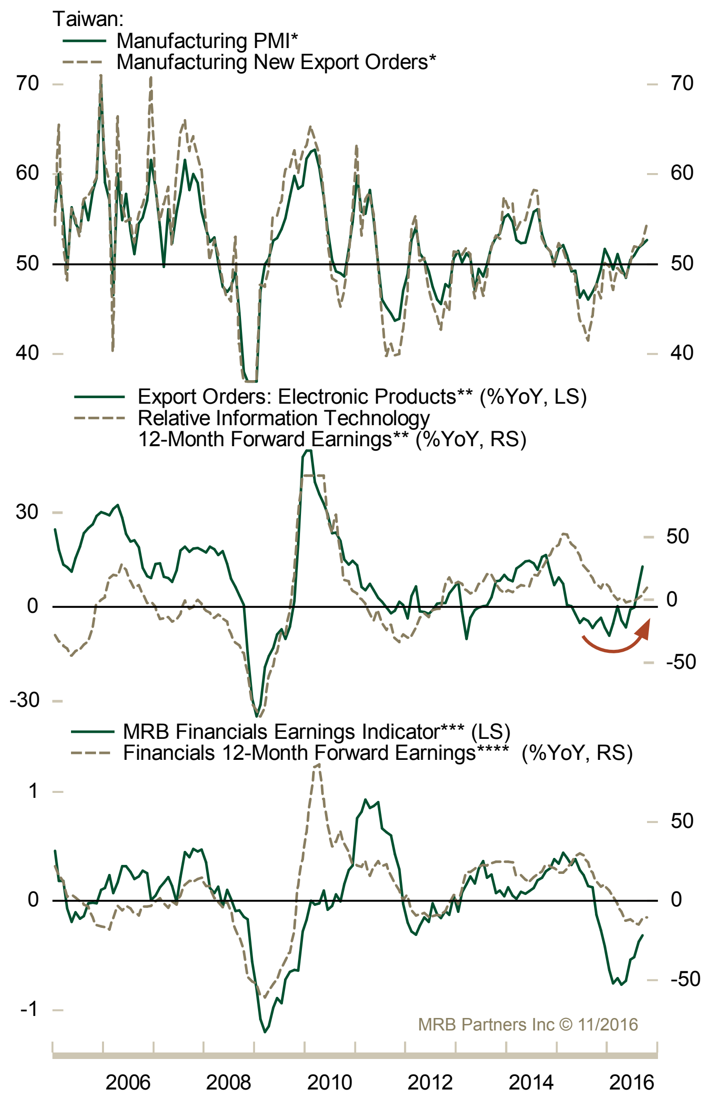
[15] MRB *Asia Ex-Japan Equities Report*, March 3, 2016

**Taiwan Equities:
Drivers Of Relative Performance***

	-		N		+
Growth	□	□	□	□	■
Policy	□	□	■	□	□
Valuation	□	□	■	□	□
Technicals	□	■	□	□	□
Net Impact	□	□	□	■	□

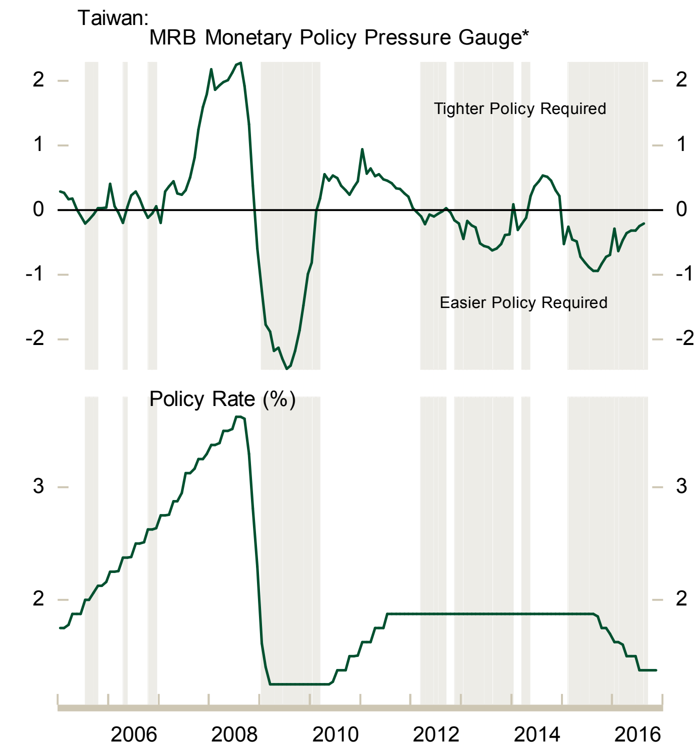
* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, - = negative MRB Partners Inc © 11/2016

Tech Demand Drives Rebound



* Truncated below 38 and above 71; source: Markit Economics
** Smoothed; U.S. dollars; source: Ministry of Economic Affairs
*** Includes measures of credit volume, net interest margins and 12-month forward earnings revisions; standardized
**** Local currency; source: Thomson Financial / IBES
Note: Relative earnings in panel 2 truncated above 100

Policy



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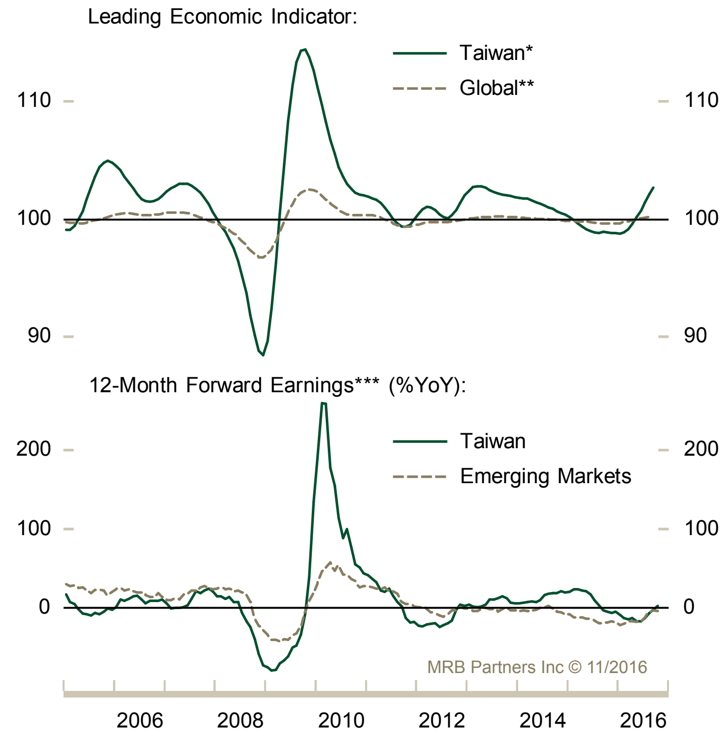
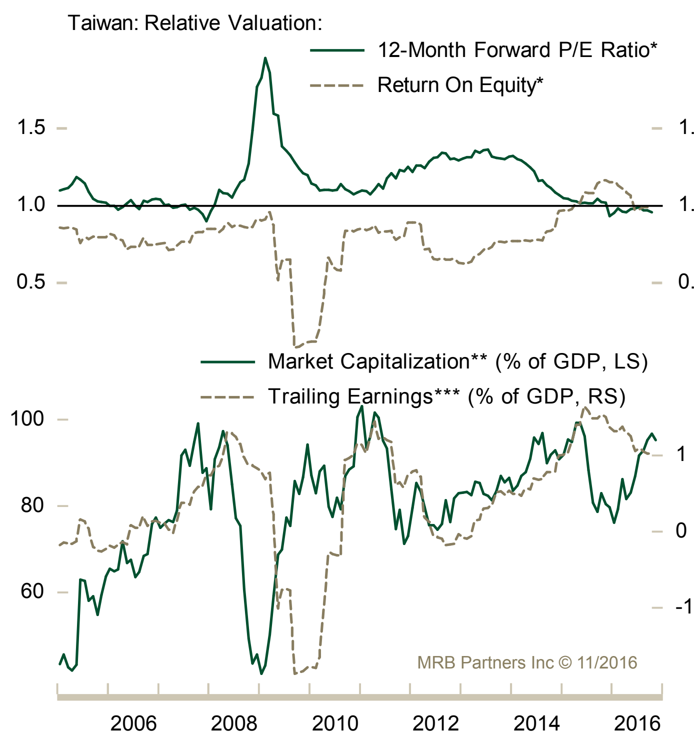
Growth



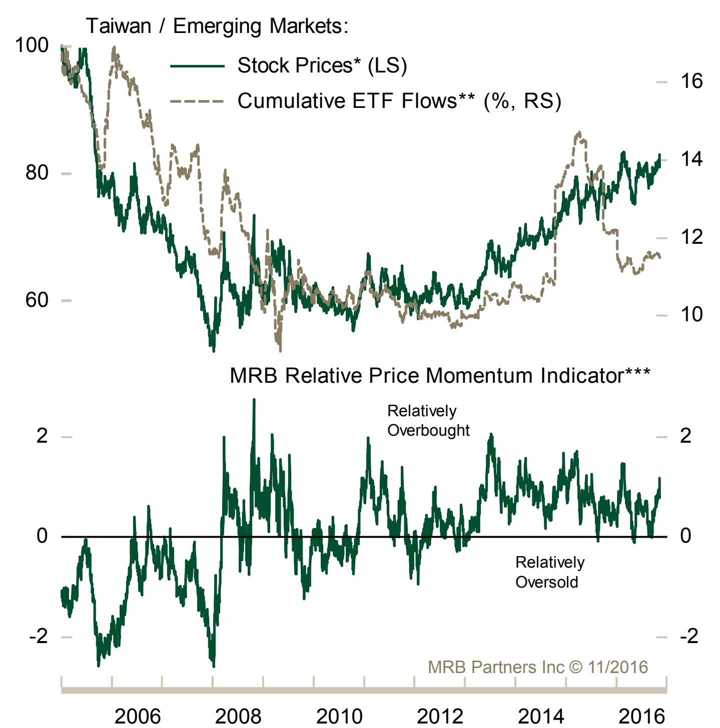
* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

Valuation



* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals



* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

Turkey[16]: *Underweight*

Relative growth and earnings momentum will continue to weaken and the lira's underperformance is a headwind for returns earned by foreign investors.

Growth: We see no imminent upside for relative earnings growth. Domestic activity is weakening given ongoing political and economic policy uncertainty, which is weighing heavily on business confidence and investment. In addition, a recovery in retail sales appears unlikely for now as the lagged effects of the precipitous decline in tourism revenue weigh on consumer sentiment and spending. Banks account for the lion's share of earnings and market capitalization, and a credit cycle unlikely, so the relative earnings impulse will be negative.

Policy: The central bank has paused the easing cycle and risks to the policy rate are now skewed to the upside. We expect that the weaker lira and the probable abandoning of fiscal prudence to raise inflationary impulses and force the central bank to hike rates amidst an unfavorable external bond backdrop.

Valuation: Valuations are relatively attractive but this is justified by heightened political risks that are unlikely to recede over the next 6-12 months.

Technicals: The market is oversold and a countertrend rally is possible.

Final Word: *Turkish equities are relatively oversold but the earnings and monetary policy outlook, coupled with the high degree of political uncertainty, point to underperformance.*

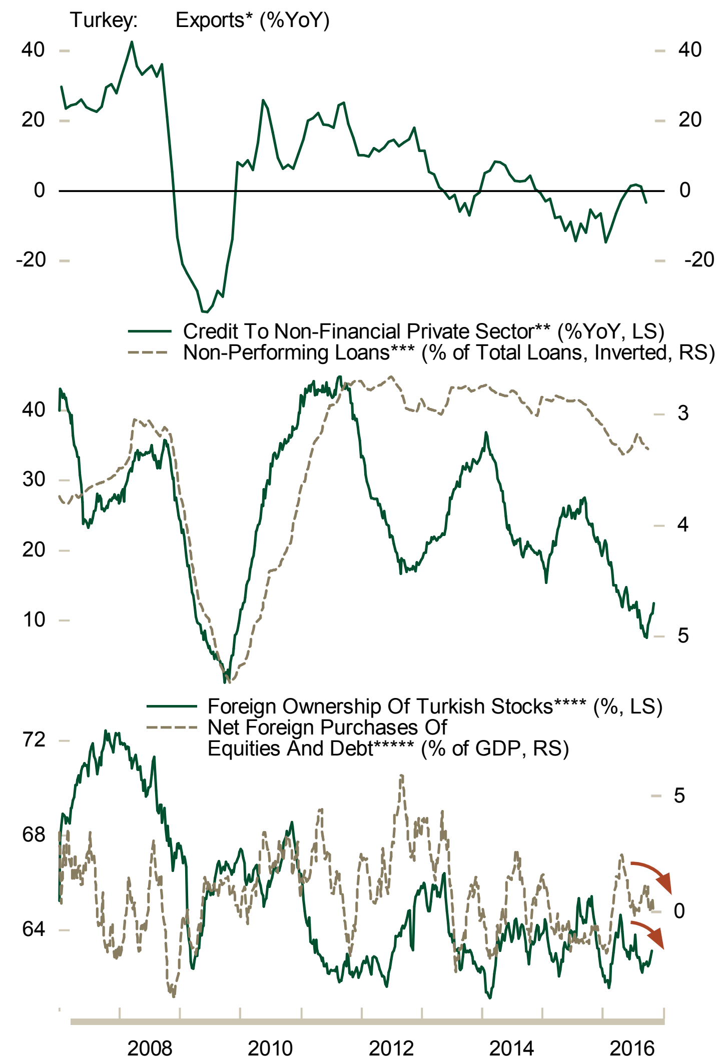
16 **MRB *Weekly Macro Strategy Report***, July 22, 2016

Turkey Equities: Drivers Of Relative Performance*

	-		N		+
Growth		■			
Policy		■			
Valuation				■	
Technicals				■	
Net Impact		■			

* 6-12 month horizon; relative to common currency emerging markets equity benchmark
Note: + = positive, N = neutral, - = negative MRB Partners Inc © 11/2016

Weakening Growth Is Negative For Banks



* Smoothed; source: Turkish Statistical Institute
** Source: Central Bank of the Republic of Turkey
*** Source: Turkey Banking Regulation and Supervision Agency
**** Source: Turkey Central Registry Agency
***** 3-month cumulative; source: Central Bank of the Republic of Turkey

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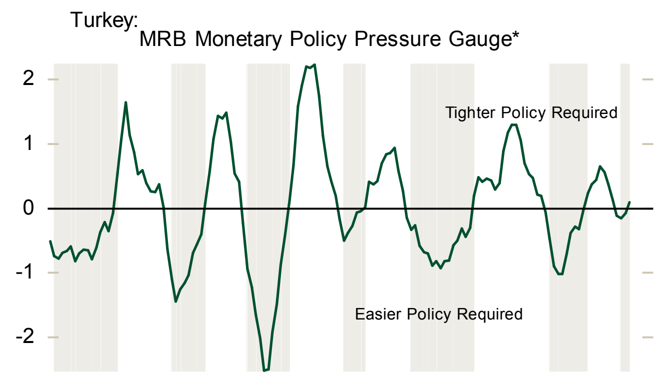
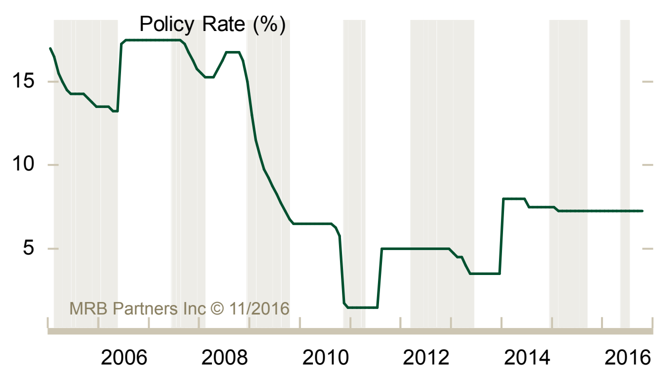
Policy





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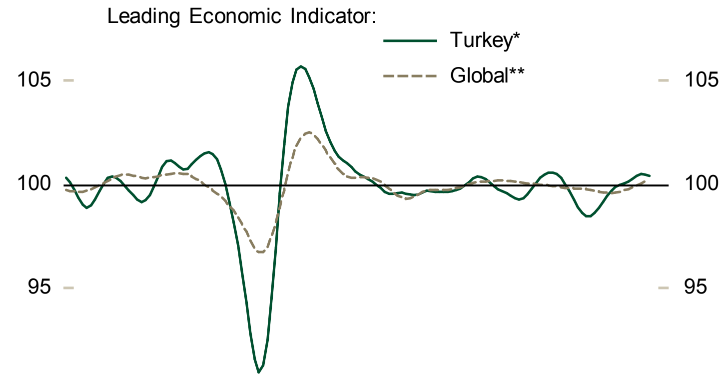
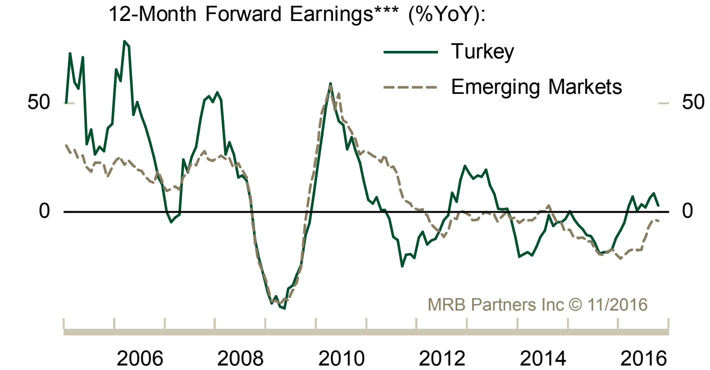
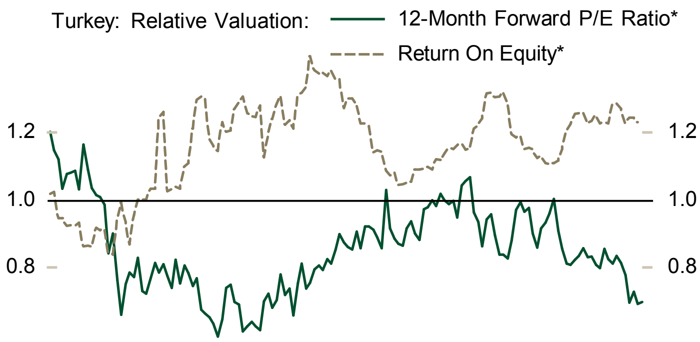
Growth

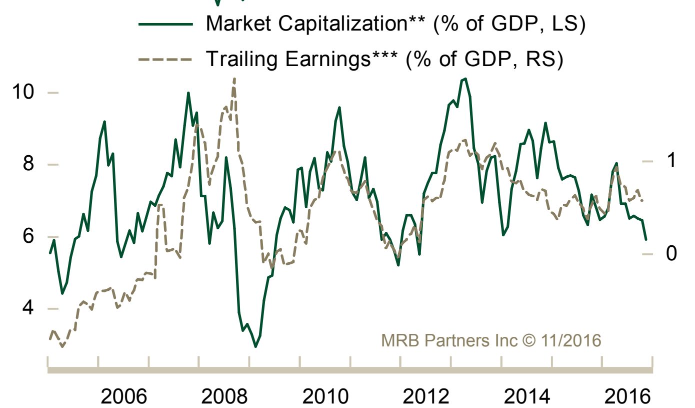




* Deviation from trend; source: OECD
** Deviation from trend; includes OECD countries plus 6 major non-OECD members; source: OECD
*** U.S. dollars; source: Thomson Financial / IBES

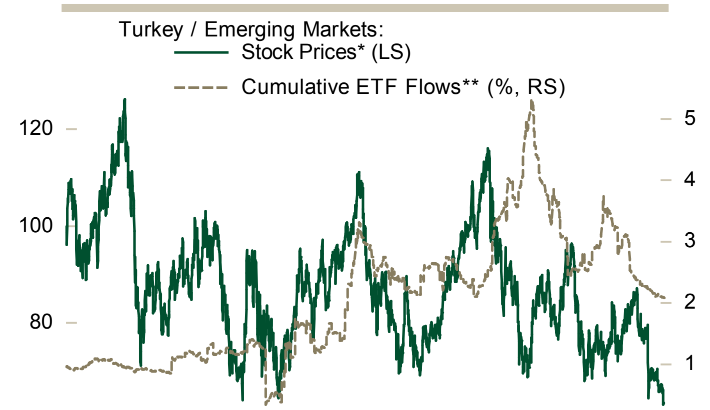
Valuation

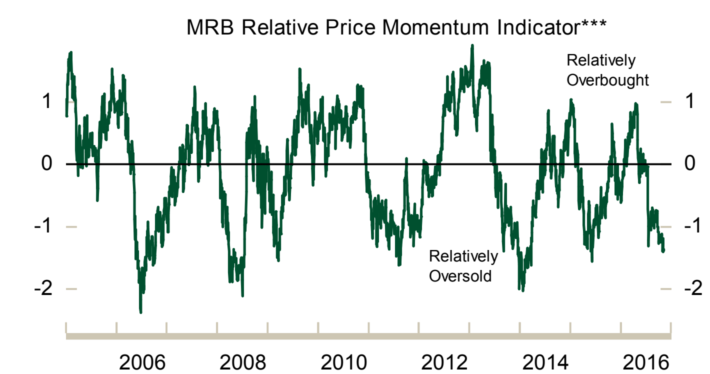




* Relative to sector-weighted emerging market valuation; sector adjusted; sources: Thomson Financial / IBES and MSCI
** Source: MSCI
*** Standardized; source: MSCI

Technicals





* U.S. dollars; rebased; source: MSCI
** Source: Bloomberg
*** Standardized

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