Global Funds Outlook

EM flows on an uneven revival path

Q4 2019

Creating Opportunities

Key messages

The global economy and markets remain susceptible to shocks, fueled by trade tensions, geopolitical frictions and idiosyncratic issues.

Reassuringly, recent progress on US-China trade talks and Brexit, easing US recession concerns and policy easing has revived investor sentiment.

The need for resiliency in wake of prolific risk off episodes continues to drive core developed market (DM) bond inflows.

Meanwhile, search for yield has fueled debt flows to periphery Europe and emerging markets (EMs).

Demand for high yield and IG credit is robust, while sovereign bonds are losing sheen although are still an effective cushion during risk-off.

Flows to money markets remain elevated. We see some rotation towards equities but not a clear appetite for EMs yet.

Going forward, we expect ongoing easing in global uncertainties, and policy support to sustain flows into EMs, mainly those implementing ‘sound’ policies and with stable currencies.

Nevertheless, concerns over underlying vulnerabilities and the potential for further bouts of cross asset volatility will restrain a sharp recovery in EM inflows.

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Research

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Persistent uncertainty keeps core DM bonds in demand while search for yield benefits EM and Euro area periphery debt

Risks to global growth have eased somewhat amid recent progress towards addressing key global uncertainties and policy easing by major central banks

01

Global growth remains weak but the pace of deceleration has moderated while US recession risk has abated.

02

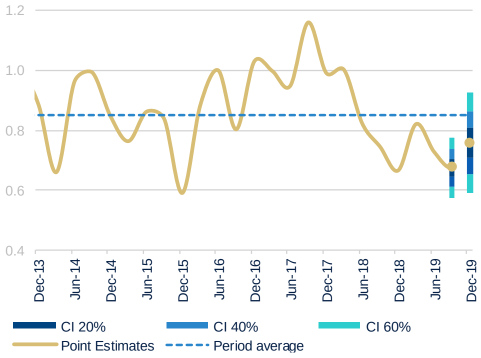
Major central banks remain accomodative but prospects of further easing has declined going forward.

03

Proliferate risk-off episodes fueled market **volatility in 3Q19. October has seen progress** on key issues.

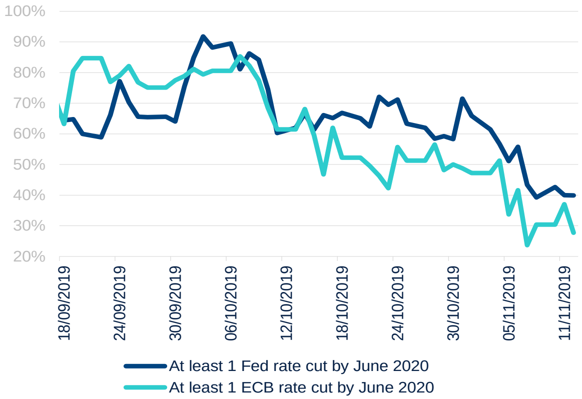
WORLD GDP GROWTH

(FORECAST BASED ON BBVA-GAIN, % QOQ)



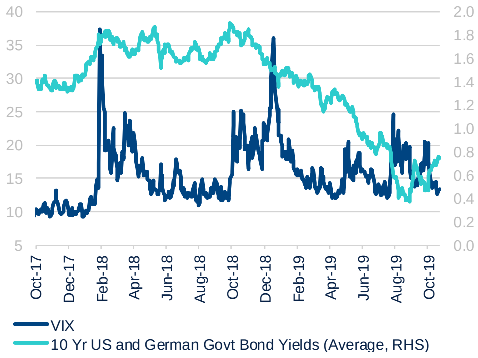
MARKET'S PROBABILITIES OF FED'S & ECB'S EASING

(%)



VIX VS. SAFE HAVEN YIELDS

(%)

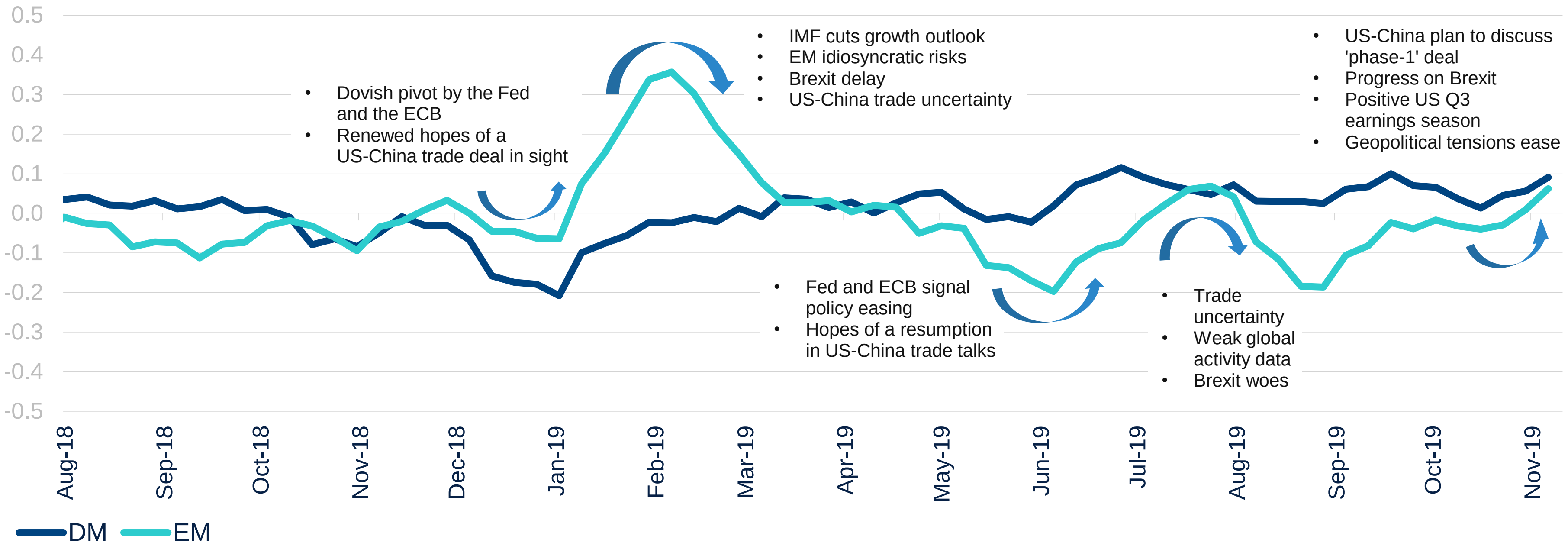


Source: BBVA Research, Bloomberg

3Q19 saw EMs exposed to global risk-off episodes, geopolitical frictions and idiosyncratic issues. The past month has seen a modest revival in EM flows

WEEKLY FLOWS, 4W MOVING AVERAGE

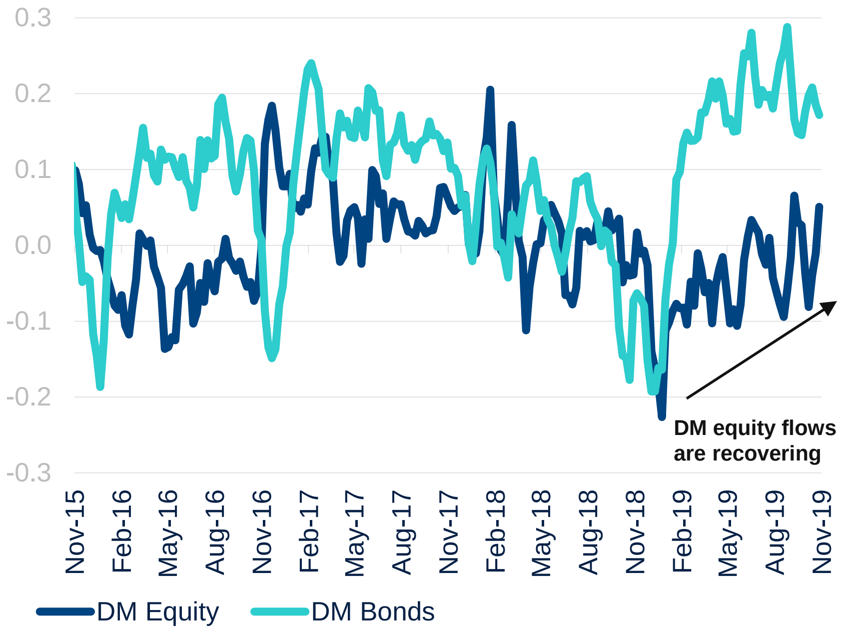
(% AUM)



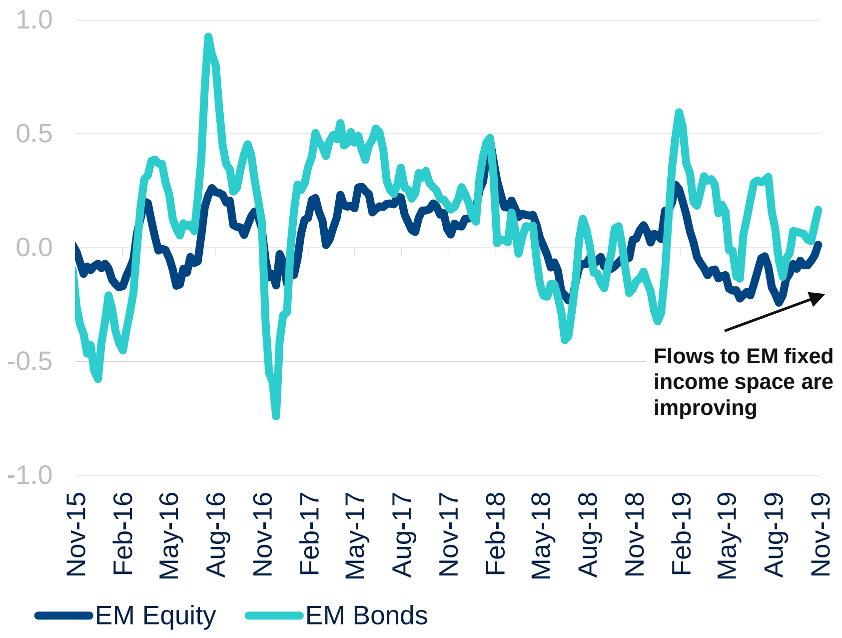
Source: BBVA Research, Bloomberg

Inflows into DM bond funds. Flows to EMs led by hard currency bonds

DM FUND FLOWS – EQUITY VS. BONDS
(% AUM)



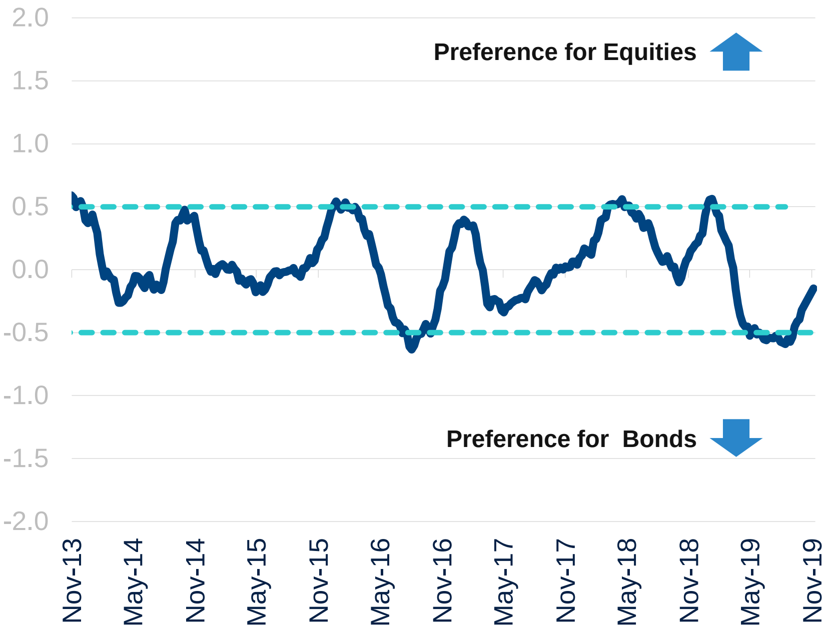
EM FUND FLOWS – EQUITY VS. BONDS
(% AUM)



Source: BBVA Research, EPFR

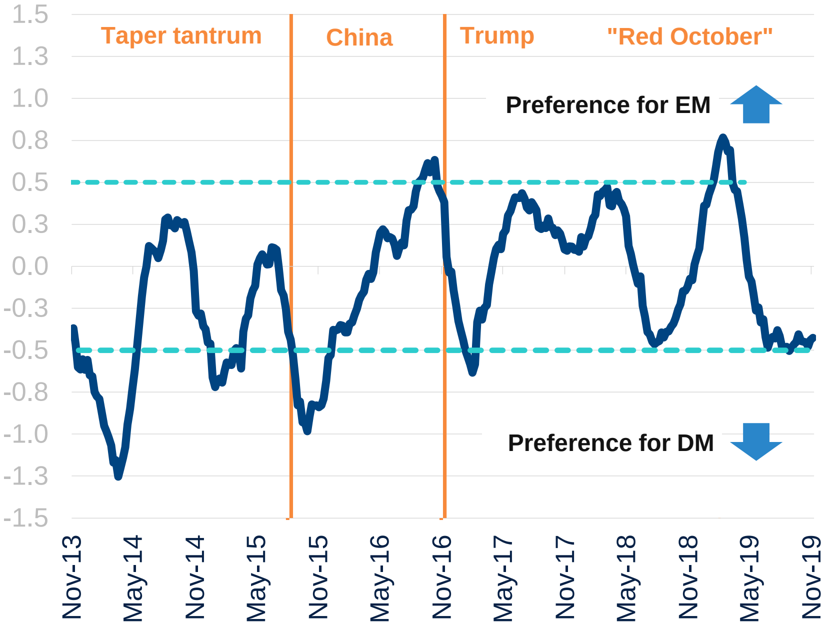
Rotation from bonds to equity funds has already started, while a clear appetite for EMs is still missing

INVESTOR APPETITE FOR EQUITIES VS. BONDS
(STANDARD DEVIATION FROM HISTORICAL MEAN)



Source: BBVA Research, EPFR

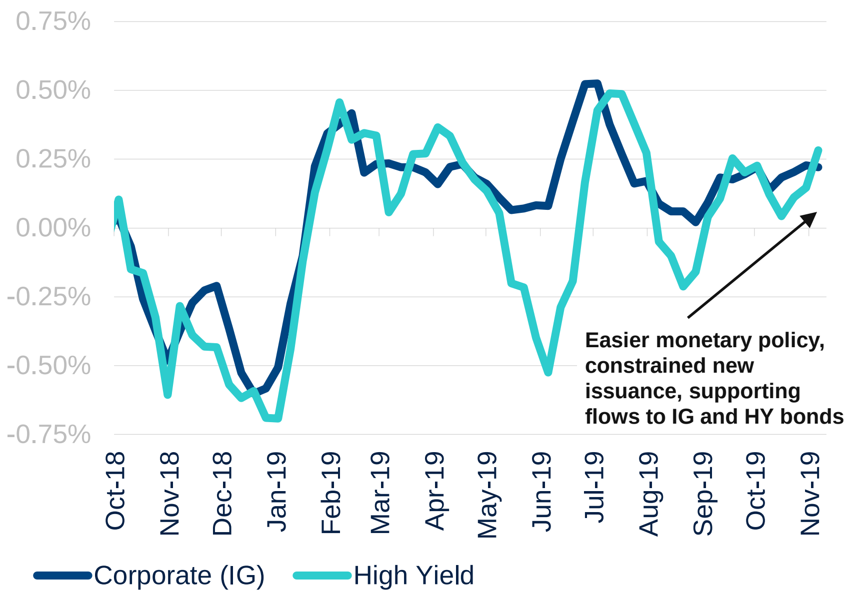
INVESTOR APPETITE FOR EM VS. DM
(STANDARD DEVIATION FROM HISTORICAL MEAN)



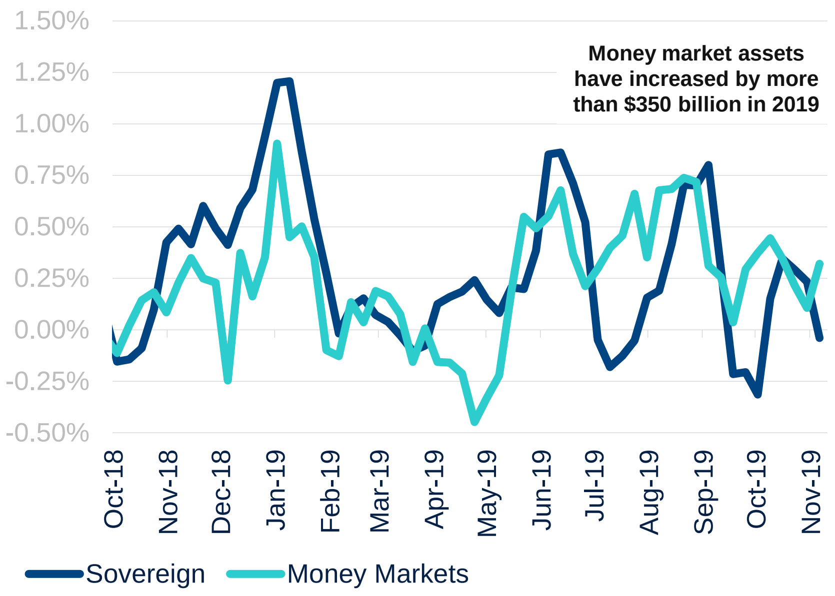
Source: BBVA Research EPFR

Strong demand for IG credit and, recently for High Yield. Sovereign bonds losing sheen although still an effective cushion against sudden selloffs

FLOWS TO HY & INVESTMENT GRADE CORPORATE BONDS
(4W M.A. % OF AUM)



FLOWS TO SOVEREIGN BONDS & MONEY MARKETS
(4W M.A. % OF AUM)

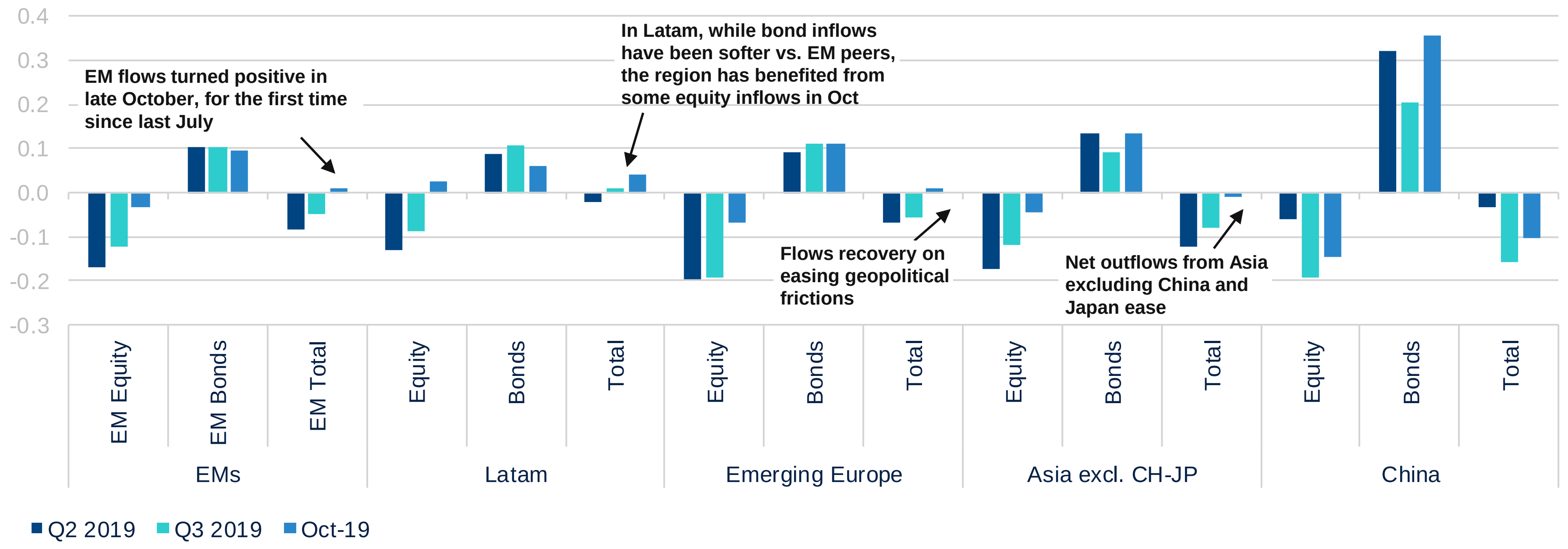


Source: BBVA Research, EPFR

While bond flows to EMs stabilized in Q3, election uncertainty and socio-economic tensions have weighed on flows to Latam and Asia in October

GIF FLOWS ACROSS EM BY REGION AND ASSET CLASS

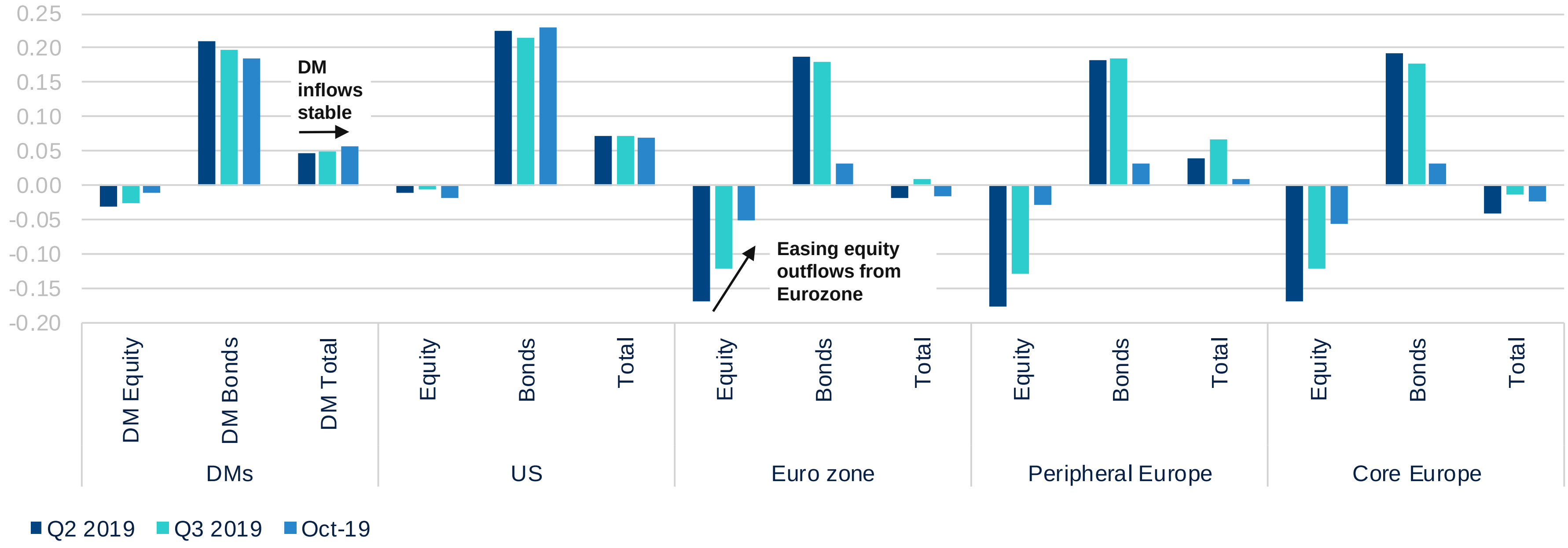
(FLOWS, % AUM)



Source: BBVA Research and Bloomberg

The search for yield has bolstered debt flows to peripheral Europe, although Brexit uncertainty and US-EU trade standoff pose downside risks

GIF FLOWS ACROSS DM BY REGION AND ASSET CLASS
(QUARTERLY FLOWS, % AUM)



Source: BBVA Research and Bloomberg

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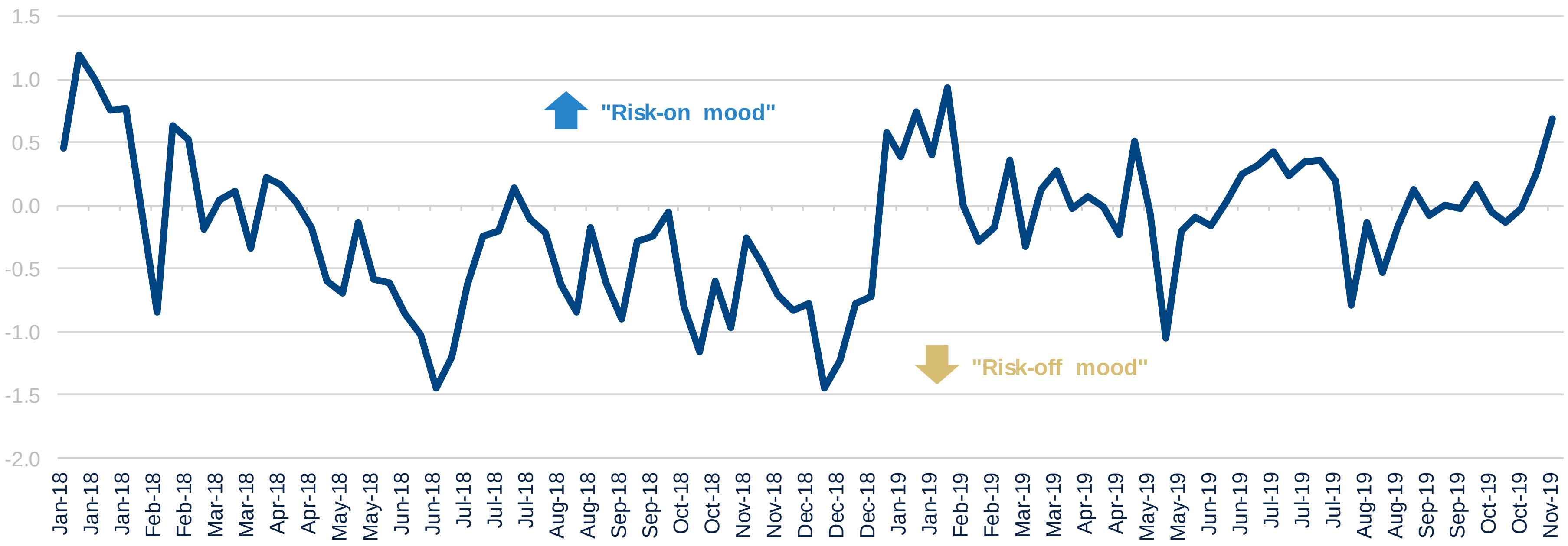
02

Warnings from our risk-off indicator

Our investment mood index indicates a notable improvement in market sentiment led by policy support and incremental progress on trade talks

INVESTMENT MOOD INDEX*

(ABOVE (BELOW) ZERO = RISK-ON (RISK-OFF) MOOD



Source: BBVA Research and Bloomberg

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03

What next?

Counter-cyclical policies will help to keep financial tensions under control, but will not prevent a global slowdown

COUNTERCYCLICAL POLICIES

Monetary policy:

- Central banks to remain accommodative…
  - … but prospects of further easing are low in DMs, especially by the Fed and the ECB .

Fiscal policy:

- Should play a bigger role…
- … but political issues and high debt will limit its use.
- More measures in Europe and mainly in China.

GLOBAL UNCERTAINTY

US – China tensions will remain in place:

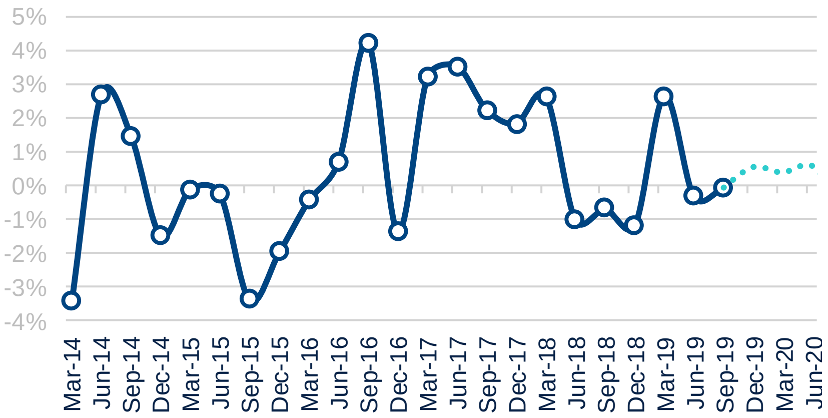
- A partial trade agreement between both countries is likely.
- Tariffs will only gradually return to levels seen a few months ago.
- Structural and technological issues will continue to generate turbulence.

The Brexit issue, as well as political and geopolitical tensions in certain regions, will continue to fuel uncertainty.

Our baseline scenario expects a steady yet modest recovery in flows to EMs

- EM portfolio flows to be led by bond funds, amid 'search for yield' and relatively stable currency environment, while equity outflows from the region are also expected to ease going forward.
- The durability of EM inflows will hinge upon ongoing progress on a variety of factors, including US-China trade talks, Brexit, geopolitical frictions, policy actions by major central banks, as well as the nature of China's growth slowdown.
- Idiosyncratic risks, such as socio-political tensions in Latam, Hong Kong, shadow banking risks in India warrant attention.

PORTFOLIO FLOWS TO EM (ACTUAL AND FORECAST AS UNDER OUR BASELINE SCENARIO)
(% OF AUM)

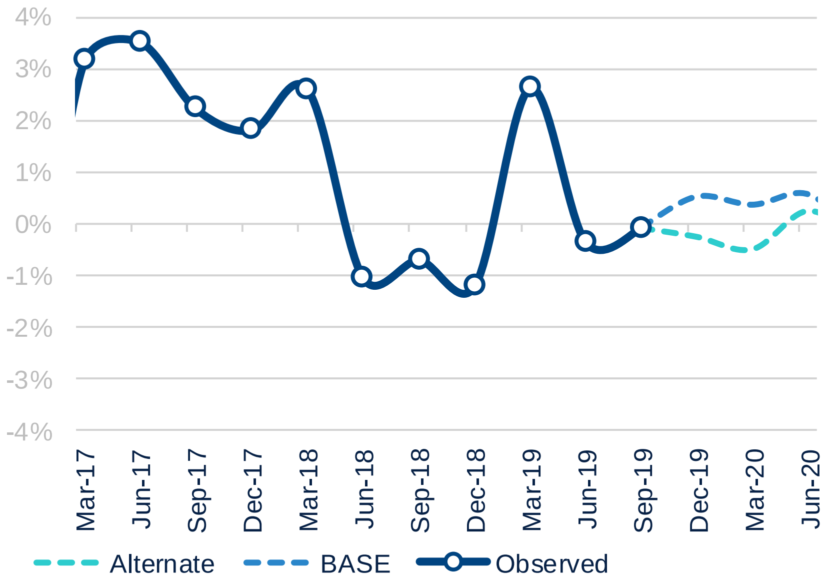


Assumptions under baseline scenario:

1. **Fed** on a long pause.
2. **Volatility** VIX averages at 14 over the rest of 2019 and Q1 2020.
3. **US 10 year treasury yield** averages around 1.7% over the next six months.

In a less favorable scenario, marked by proliferate risk off episodes and protracted global uncertainty, net outflows from EMs will pick up going ahead

PORTFOLIO FLOWS TO EM: BASELINE VS. ALTERNATE SCENARIO
(% OF AUM)



Source: BBVA Research, EPFR

Assumptions under a less favorable scenario:

1 **Fed** cuts rates by another 25 bps over the next six months.

2 **Volatility** VIX jumps to 19 in December and averages 18 over the next six months

3 **US 10 year treasury yield** returns to 1.50-1.60% on the back of safe-haven flows.

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04

Annex

Glossary

GIF

Global Investors Funds: these are the funds covered by the EPFR database in the “Country flows” allocation, with amounts shown in millions of US Dollars. This database includes the flows in country-denominated funds and the proportional amounts in global or supranational labelled funds.

AUM

Assets under management in the EPFR database.

DM

Developed markets included in our sample are Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the US.

EM

Emerging markets included in our sample are Argentina, Brazil, Chile, China, Colombia, Czech Republic, Hungary, India, Indonesia, Korea, Mexico, Peru, Philippines, Poland, Russia, Slovenia, South Africa, Thailand, Turkey and Venezuela.