Jake Siewert: Welcome to our Exchanges at Goldman Sachs markets update for Friday, April 23rd. Each week we check in with a leader across the firm to get a quick take on what they're watching in markets. This week we're looking at how emerging markets, or EM, have been faring in the throes of the pandemic and a nascent recovery.

I'm Jake Siewert, global head of corporate communications at the firm. And today I'm joined once again by Jen Roth. Jen manages FICC, global currencies and emerging market sales in North America and a whole bunch of other stuff, too. But, Jen, welcome back to the program.

Jen Roth: Jake, it's great to see you as always. I'm sad this is one of our last podcasts, but I'm glad to be here on one of your last weeks.

Jake Siewert: All right. Well, me too. Jen, last time you did a webcast or a podcast in mid-January, we discussed clients having a pretty constructive view on EM as an asset class for 2021. You know, sitting here in late April, how does that assessment look?

Jen Roth: You know, unfortunately, that conversation was far from correct. In the first quarter, the EM external index was down 4.74% and the local index was down 6.67%. This looks even worse given the S&P was up 5.77%. EM performance was really challenged by a number of factors that were set into motion after the Georgia elections. The market repriced expectations for fiscal growth and inflation which fed through the rates market. Higher rates led to a stronger dollar and renewed talk of US exceptionalism. This in turn led to material overpricing of risk premia across EM assets with rate-sensitive products really taking the biggest hit.

The interesting part is that the weakness seen in EM was not about EM, per se. If you look at how US credit fared, it did just as poorly. What happened was more of a broad-based overpricing of global fixed income, and EM assets were caught right in the middle. You also had idiosyncratic events in places like Turkey and Brazil which put a damper on the performance also.

Jake Siewert: So vaccines are rolling out in the US, and the domestic economic forecast is pretty bright right now. Is that having an impact on how investors are thinking about emerging market economies or not?

Jen Roth: You know, as with a lot of things, it really depends on who you ask with two predominant views in the market right now. The first is that this bout of US exceptionalism will be extended as data [UNINTEL] remains strong over the next month or so. Basically until we see peak growth in the US, US assets should outperform, effectively capping enthusiasm around non-EM assets like [UNINTEL].

The other view is that this material bump higher in US growth on the back of fiscal and vaccines is already well priced in the market. So the opportunity set outside the US is finally becoming more interesting. This would benefit EM and specifically the harder-hit countries like Mexico and Brazil, which haven't really participated in the rally.

Jake Siewert: So we're seeing a slightly stronger US dollar. What effect does that have on emerging markets when it comes to things like commodities?

Jen Roth: So, I mean, look, the feedback loop historically has been really clear. A weaker dollar has tended to fuel stronger commodity prices which has led to [UNINTEL] outperformance. This time shouldn't necessarily be different, but for the time being there does seem to be some disconnect as commodity price strength and demand is no longer being driven by EM players like China but rather by developed countries like the US.

Given the strength isn't EM driven, the asset class may only see benefits once it becomes clear that they will also experience strong economic activity which we haven't seen yet in the data.

Jake Siewert: So COVID rates seem to have stabilized and come down quite a bit in developed economies, but there have been a spate of infections playing out in some EM countries, some pretty serious ones. How are investors thinking about the new variants that could slow immunity progress there?

Jen Roth: So variants in South Africa and Brazil and now India -- I mean, I'm sure you saw the numbers today; they were pretty bad -- have led to periods of volatility in the respective markets given the economic impact these variants have and, unfortunately, will continue to have on these markets. Even though lockdowns have fallen out of favor politically, the variants are still expected to dampen activity.

That being said, even in countries with new variants, there are peaks of infections, after which things subside and markets became more sanguine. The real challenge with variants is not on a country level but, given what we know about infections, is really still at the global level.

Jake Siewert: Okay, given all of that, longer term, how do you see the rest of 2021 shaping up for emerging markets?

Jen Roth: So, look, as we learned from our conversation in January, it's a very difficult year to forecast EM returns, especially given there's still considerable uncertainties around the virus and its impact on growth outside the US. That being said, I'll attempt to put a framework around how I'm thinking about the asset class for the rest of the year.

As the US rates market has become more fairly priced, the scope for an abrupt taper tantrum-like move in rates really has decreased, so this should bode well or at least better for EM than we saw in Q1. The challenge is going to be providing a true value proposition for the asset class. This can either be in the form of significant carrier or, better yet, because EM countries finally start to grow. If this happens, the skies will become much clearer and we should see more interest in the asset class, not just from dedicated but also from crossover investors.

Jake Siewert: All right, Jen. Always appreciate hearing your point of view. It was great to chat with you.

Jen Roth: You as well. Thanks for the time, Jake.

Jake Siewert: That concludes this episode of Exchanges at Goldman Sachs. Thank you very much for listening. And if you enjoyed the show, we hope you subscribe on Apple Podcasts and leave a rating or a comment. This podcast was recorded on Thursday, April 22nd, 2021, which just happens to be Earth Day. Thanks for listening.

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