TSX **SHZ**

MONTHLY COMMENTARY

Sphere FTSE Emerging Markets Sustainable Yield Index ETF

SHZ invests in up to 150 equity securities of public issuers in emerging markets

As at February 28, 2020

TICKER: SHZ (Hedged)

MACROECONOMIC HIGHLIGHTS:

February seemed like two different months rolled into one for emerging markets.

For much of the month, stocks were on the rise, buoyed by positive economic news from a number of nations. However, by February 21st, news came of an increase in the number of people infected by the coronavirus in South Korea, and investors realized that the COVID-19 outbreak was more severe and more global than previously expected. The markets reacted strongly, leading to volatility throughout the rest of the month and into March. MSCI Inc.'s gauge of emerging equities dropped 7.3%, its largest decrease since 2011.[i]

Emerging market stocks, including Chinese stocks, fared better than developed nation stocks by the end of business for February. Emerging markets were down by only 5.27%, and outperformed developed markets by 1.7% in February. However, Chinese stocks (representing the biggest economy in the sector) were already trading down going into February after investors foresaw coronavirus being a challenge to the emerging markets.[ii]

The slump in China's manufacturing sector in February was the largest ever recorded. Bloomberg Economics estimates that the Chinese economy was only operating at 60-70% of normal capacity by the end of the month.[iii]

The good news for emerging markets, however, is that while COVID-19 continues to spread in places like the United States, Italy, and Iran, there is growing evidence that the outbreak in China is slowing and being contained, allowing the Chinese economy to begin ramping back up to full production.

Already, metrics like daily coal consumption (a reliable indicator of industrial output) as well as workday traffic indexes (showing how many trucks and cars are on the road) are beginning to recover toward pre-pandemic levels. This could indicate the start of regained strength in the Chinese economy.[iv]

Elsewhere in emerging markets, having completed pension reforms to stabilize government debt levels, President Jair Bolsonaro's multiparty coalition in Brazil are turning to tax reform and increased privatization (including reducing the size of the state through the sale of government stakes in hundreds of companies and billions of dollars in property) before campaigning for municipal elections in October begins.

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With the outbreak of coronavirus, the exposure of Brazil's relatively closed economy to China via commodity exports has created uncertainty that has negatively impacted the currency. Brazil's 2020 GDP expectations were revised downward to 2.3% in February as a result of the outbreak and could decline further depending on the virus's final impact on the Chinese economy.[v]

Coronavirus fears combined with structurally low exchange rate volatility and political unrest in various regions contributed to currency declines for a number of emerging markets.

The Turkish lira weakened further, having now lost 2.6% of its value in 2020. The rouble slipped against the dollar, as Russia was hurt by declining oil prices, as did the South African rand, and Colombian peso—all three currencies weakened more than 4% against the greenback. Hungary, Poland and Romania all saw their currencies ease against the euro.[vi]

Emerging into a developed economy has never been an easy climb, nor one without setbacks. When there is unexpected upheaval—whether it is political upheaval or some type of natural disaster—it can negatively affect investments. However, in the wake of this pandemic, with China's economy potentially already on the mend, there could be good returns to be had in investment in this sector for investors willing to take the risk.

PERFORMANCE ATTRIBUTION:

At the end of February 2020, the fund held a diversified portfolio of securities across the different regions of the world, with its largest exposure (40%) to the Asia Pacific region. China (20%), followed by Taiwan (10%), were the largest country holdings in the Asia Pacific. Eastern Europe represented the next largest regional exposure (20%), with Russia its only exposure. North America was next (16%), with the United States the largest exposure (11%). South and Central American countries were close behind (15%), with Brazil the largest country exposure (14.76%). Africa/Middle East (6.4%), and Western Europe (0.84%) round out the holdings.

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SOURCES:

[i] https://www.thestar.com.my/news/regional/2020/03/02/after-a-us1-trillion-wipeout-emerging-markets-bank-on-stimulus
[ii] https://www.forbes.com/sites/simonconstable/2020/02/28/is-it-time-to-buy-emerging-markets-stocks-yes-says-ubs/#426360bf25df
[iii] https://www.thestar.com.my/news/regional/2020/03/02/after-a-us1-trillion-wipeout-emerging-markets-bank-on-stimulus
[iv] https://www.forbes.com/sites/simonconstable/2020/02/28/is-it-time-to-buy-emerging-markets-stocks-yes-says-ubs/#426360bf25df
[v] https://www.investmentweek.co.uk/opinion/4011207/play-brazilian-reforms-mean-emerging-markets-investors
[vi] https://www.reuters.com/article/emerging-markets/emerging-markets-virus-hit-em-assets-set-to-end-week-in-the-red-idUSL8N2AL2AH

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