

## GEMs Watch

## EMFX: On your marks

**EMFX is 6% undervalued**

EMFX is undervalued by 6%, per our BEER model, driven largely by still-weak US terms of trade and an uptick in both US 5-y forward 5-y breakevens and the Chinese credit impulse. This pricing is consistent with a 5pp increase in US terms of trade – a 20+ year high. With the new US administration suggesting that universal tariffs are unlikely to come soon, we believe this value may be realized in the near future.

**EMFX Sentiment: out of the woods**

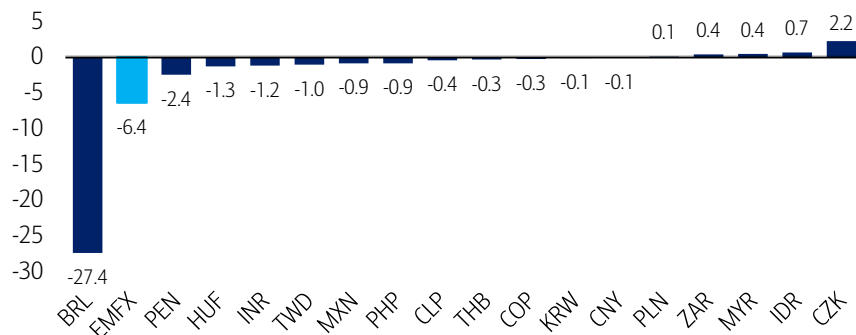
Our EMFX Sentiment Indicator has edged up to levels that suggest that we may be past peak EM bearishness (see: [Emerging Convictions: Inaugurating Emerging Opportunities](#)). A slower-moving measure of this indicator is creeping up to levels historically associated with short-run bullishness. Although positioning remains long USD, we believe the market is ripe for a turn back towards EM.

**Richest: CZK; Cheapest: BRL**

The koruna is the only meaningfully overvalued currency in our complex, driven largely by hawkish monetary policy in the face of weakening growth fundamentals that have dogged CEE3 recently. On the other hand, we believe BRL looks very attractive at these levels, especially with the BCB's new FX management stance. We like to express our bullish view by buying BRL/COP (spot: 714; see: [EM Alpha: Buy BRL/COP](#)). The two risks to the trade are a worsening of the fiscal outlook in Brazil, though Colombia also has its own fiscal issues. Also, oil prices could spike if Iran and Venezuelan oil production is knocked off via sanctions under the incoming Trump administration

**Exhibit 1: EMFX deviation from fair value**

EMFX remains undervalued, as US elections have driven EM currencies into new short-term regimes



Source: BofA Global Research, Bloomberg, Haver

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21 January 2025

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**Refer to important disclosures on page 5 to 7.**

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Timestamp: 21 January 2025 01:30PM EST

## EMFX: Poised to bounce back

While EMFX has been a near-consensus short for the past two months, we believe we may be close to peak EM bearishness (see: [Emerging Convictions: Inaugurating Emerging Opportunities](#)). This is especially the case for EMFX, which hit record lows in positioning to start the year, per our Liquid Cross Border Flows.

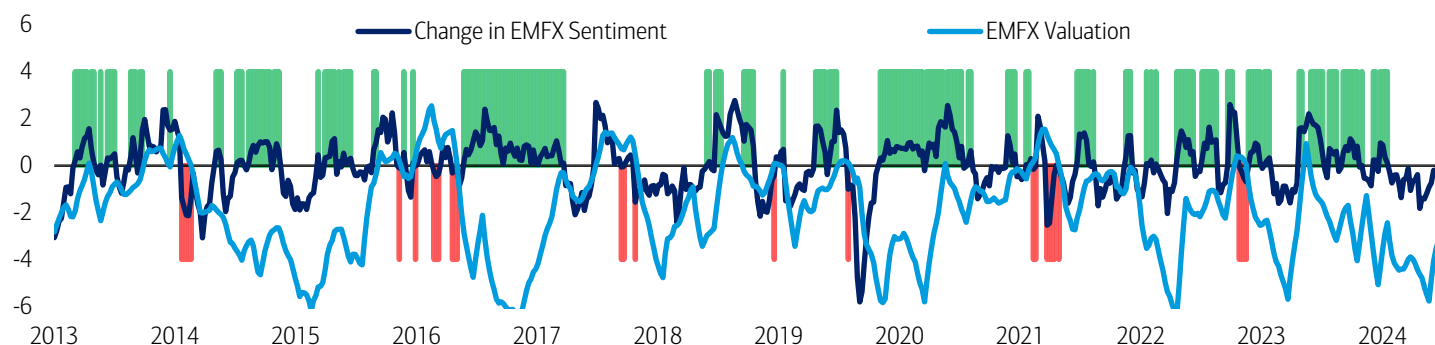
However, there are green shoots suggesting that broad EMFX sentiment is turning. Indeed, the FX component of our EM Sentiment indicator is approaching levels that, in combination with the low valuations, would trigger a bullish signal for EMFX.

Specifically, when the 12-week moving average of our EMFX sentiment indicator increases while EMFX is undervalued (per our BEER model), that is often a short-term bullish signal for EMFX. This view also aligns with our analysis in [November \(see report\)](#), which suggested that EMFX may rebound in February.

A common counterargument is that prices today reflect future weakness in EM terms of trade. Indeed, if tariffs pass through to EMFX values via US terms of trade, EMFX pricing is currently consistent with a 5pp increase in US ToT, which would push them to a 20+ year high. We believe – given recent newsflow – that universal tariffs are, at the very least, unlikely to materialize soon.

### Exhibit 2: Backtested EMFX sentiment and value indicators

EMFX remains undervalued, while EM FX sentiment is close to turning, which is usually a bullish signal for 1m returns



Source: BofA Global Research, Bloomberg, Haver

This performance is back-tested and does not represent the actual performance of any account or fund. Back-tested performance depicts the theoretical (not actual) performance of a particular strategy over the time period indicated. No representation is being made that any actual portfolio is likely to have achieved returns similar to those shown herein.

Note: Change in Sentiment= weekly change in the exponentially-weighted moving average of our EMFX sentiment indicator. EMFX Valuation: Deviation of EMFX from fair value, smoothed by a Kalman filter

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### Exhibit 3: EMFX value and sentiment combined hit rate

When our value and sentiment signals point in the same direction, that is a good short-term indicator

Signal Type	1 w directional hit rate	2 w directional hit rate	1 m directional hit rate
Bullish	57%	54%	55%
Bearish	63%	74%	80%
Combined	58%	57%	58%

Source: BofA Global Research, Bloomberg, Haver

Note: Bullish = buy when EMFX sentiment is improving and EMFX is undervalued, Sell = sell when EMFX sentiment is declining and EMFX is overvalued

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## Appendix: Charts and Tables

### Exhibit 4: BEER model: Full Results, Jan 2025

All valuations for EMFX in Jan 2025

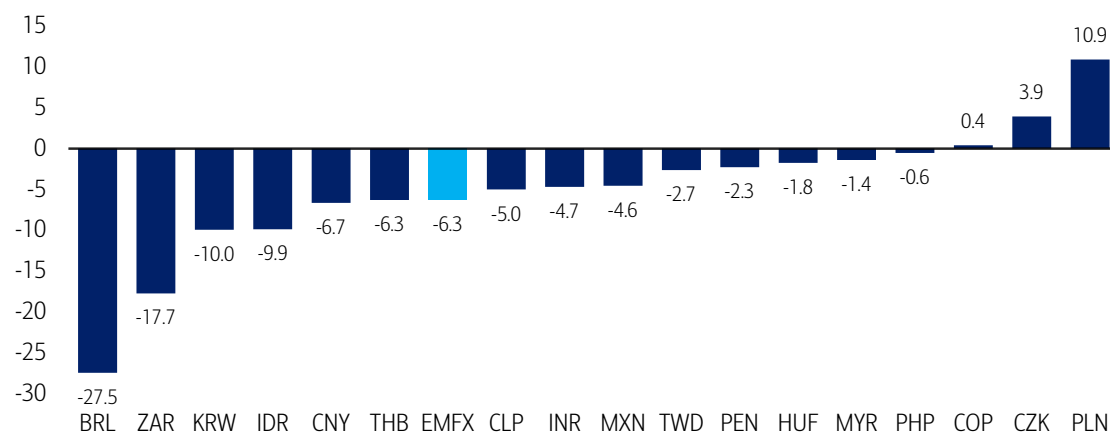
Currency	Ensemble Prediction	LR Prediction	Ensemble Deviation %	LR Deviation %	Regime
BRL	4.38	4.38	-27.5	-27.5	Long-Run
THB	31.91	31.91	-6.3	-6.3	Long-Run
EMFX	63.74	63.74	-6.3	-6.3	Long-Run
PEN	3.65	3.65	-2.3	-2.3	Long-Run
HUF	404.46	404.46	-1.8	-1.8	Long-Run
INR	85.65	82.48	-1.0	-4.7	Short-Run
TWD	32.54	31.91	-0.7	-2.7	Short-Run
MXN	20.58	19.78	-0.7	-4.6	Short-Run
PHP	58.16	58.16	-0.6	-0.6	Long-Run
KRW	1436.54	1297.58	-0.3	-10.0	Short-Run
CLP	999.99	951.39	-0.2	-5.0	Short-Run
CNY	7.29	6.80	0.0	-6.7	Short-Run
PLN	4.26	4.72	0.1	10.9	Short-Run
MYR	4.49	4.41	0.3	-1.4	Short-Run
ZAR	18.72	15.35	0.3	-17.7	Short-Run
COP	4335.07	4335.07	0.4	0.4	Long-Run
IDR	16451.30	14716.52	0.7	-9.9	Short-Run
CZK	26.18	26.18	3.9	3.9	Long-Run

Source: BofA Global Research, Bloomberg, Haver

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### Exhibit 5: BEER mode, long run model valuations

Long run model valuations for all EM currencies in Jan 2025



Source: BofA Global Research, Bloomberg, Haver

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