Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Emerging Market Debt Update

June 23, 2017

Argentina on Monday successfully issued US$2.75 billion of a bond intended to mature in 100 years time at a yield of under 8%. Despite the undeniable reform momentum demonstrated by the Macri administration, this is a country with weak institutions which is only tentatively emerging from a recession in 2016 and high inflation caused by the economic mismanagement of the unlamented Kirchner regime. It is also a country that has defaulted seven times in the past 200 years, thereby putting in context the optimistic view one needs to take in order to hope they will avoid such a fate at all in the forthcoming century.

We believe that it is natural to ask whether this is a classic example of collective hubris amongst EM investors. Have we forgotten the lessons of the past and are once more making irrational investment decisions in the desire to chase yield. Such fears may have been given renewed credence over the past week by a surprisingly hawkish message from the Federal Open Market Committee (FOMC), even despite recent weaker inflation and growth readings. This has led to some fears that the Federal Reserve (Fed) may be about to make a classic "Type 1" policy mistake by tightening financial conditions too much in the absence of inflation. Does the Argentina deal therefore represent a market top, a sign of investor excess just as financing conditions are changing?

We believe the answer to this question is "no". We don't believe there is a strategic case for holding the new Argentina centurion bond, but this does not mean that we need to reduce the long side of our book more generally. The growth backdrop generally remains positive for EM assets and the case for yield remains strong as the European Central Bank (ECB) and the Bank of Japan (BoJ) remain extremely accommodative.

The strongest thematic view on the portfolio is long local market duration exposure where we perceive a favourable inflation dynamic. This includes positions in local bonds in Turkey, South Africa, Malaysia and India, as well as through interest rate swaps in Mexico and China. Our biggest credit exposures are in Ecuador, Nigeria and Brazil. We are wary of the oil price, which has shown continued weakness, but only a move below US$40/barrel would cause us to fundamentally reassess our credit outlook. Over the past week we have moved to take effective short positions in Russia, both through CDS and against the currency. We are concerned that the geopolitical environment for Russia is about to become more complicated again. An intensification of sanctions sponsored by the US Senate may cause investors to reduce exposure.

Brazil and Turkey remain in focus. Members of our investment team have travelled to both over the past 10 days. In Brazil it seems likely that President Temer, whilst always vulnerable to new corruption allegations, will survive, but we think the path towards social security reform before next year's election is a narrow one. The asset that looks most compelling in Brazil right now is the currency, which is bolstered by a very supportive Balance of Payments cushion and a highly credible Central Bank. In Turkey, we are positive on all sovereign assets. We think the monetary policy consolidation story has further to run. Fiscal policy will loosen in the short term but this will be overshadowed by a strong growth outlook.

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