Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Emerging Market Debt Update
Weekly Update

January 24, 2018

Global Trade in a Spin

A synchronised acceleration in global growth appears to be underway and it is creating a virtuous cycle of improved sentiment, easier financial conditions and higher asset prices. We have previously noted that inflation is the key variable that can upset the apple cart, but so far the cart has remained stable with a gentle acceleration toward target, giving central banks optionality on rates. The strength of the growth impulse is making us question the sustainability of this benign environment, but given the many prior false starts it is fair to say that the burden of proof sits firmly on the side of inflation this time around.

Last year we expected global trade to be a key theme impacting markets but it turned out to be a much more benign trade environment than anticipated. However, it now seems that it could become this year's business, and soon.

The US administration made a significant move in this direction on Monday by enacting tariffs on washing machines and solar panels, in what may be the opening move in a bid to make good on the 'America First' campaign rhetoric. Opinion is very much divided on the ultimate impact of such trade policy – in particular in terms of job creation and the effect on domestic pricing. The equity price moves of the affected exporting companies were relatively muted in respect of the larger companies, but some smaller companies were down as much as 7% on the news. Macro markets have been similarly calm and we now look ahead to a period where Trump will be particularly visible with Davos and the State of the Union address. Needless to say, global trade and protectionism is likely to be a key theme over the coming weeks.

In emerging markets news:

- China printed stronger-than-expected GDP growth (6.6% q-o-q, seasonally adjusted annual rate) and higher frequency data confirmed improved momentum for the Chinese economy
- The Mexican peso outperformed as the mood music improved towards NAFTA negotiations, in stark contrast to the recent US tariffs targeting Asia
- South African local assets generated positive contributions as the central bank held its key rates at a MPC meeting and as hope built that President Zuma could be ousted
- Turkish assets came under pressure as President Erdogan accused the US of creating an "army of terror" along the Syrian border (referring to US support for Kurdish backed forces in the region) and began a military incursion into Syria
- Russian asset performance continued to be hindered by the impending US Treasury report exploring measures that can be

Performance to 19 January 2018:

	Contributors/detractors	+/-
EM Corporates	Positive contributions from event trades in a Brazilian mining credit and an Argentine utility where newsflow was positive in both cases, were offset by weaker performance in one distressed telecom name in Brazil. In this instance, the restructuring formalities required investors to begin reporting final holding levels that materially impacted secondary market liquidity, meaning bonds traded down in light flow. Once this procedural element is taken care of we would expect liquidity to improve and prices to recover.	+
EM Sovereign	Longs in Argentine warrants continued to perform given the shift in policy stance to prioritise growth at the expense of higher inflation and a weaker FX. Longs in Oman 10-year and 30-year credits continued to perform, as did a new long in the Bahrain long-end. The Argentina new issue detracted as the market struggled to digest the large issuance size.	+
EMFX.	Positive performance from longs in the Brazilian real and South African rand were more than offset by negative performance on short positions in the Mexican peso, which traded upward on the improved tone to NAFTA negotiations.	-
Macro Hedges	Shorts across the US Treasury curve contributed; we have further monetised some of these gains.	+
Local Rates	Payer positions in Hungarian 5-year/5-year benefited performance as the central bank swaps programme underwhelmed market expectations. Longs in South African local assets also contributed. Received positions in South Africa and its quasi-sovereign utility also benefited performance.	+

taken against Russian parastatal entities and oligarchs, as well as potential measures on Russia's foreign debt

- The Brazilian real outperformed as expectations built that an appeal court would unanimously uphold the decision of Judge Sergio Moro to find ex-President Lula guilty of a corruption charge – this outcome would make it very difficult for Lula to run in the upcoming presidential elections (he is currently leading in the polls)
- On the supply front, Brazil tapped its long bond and Qatar mandated banks for a multi-tranche deal, adding to the slew of expected supply from the Middle East

In EM corporates news:

- As Asian commodity trader reportedly received expressions of interest from a Chinese conglomerate looking to buy control of the company; given the distressed nature of its balance sheet this sent the company's bonds and shares meaningfully higher
- A Venezuelan oil production company continued to dramatically decline as evidenced by the OPEC production numbers, which showed a double-digit decline for December and continued to fuel some hope of increasing pressure forcing regime change. Bond prices remained well supported in the high 20s
- A Mexican petroleum name began an investor roadshow and also announced the signing of a memorandum of understanding (MoU) with a Japanese conglomerate to work on a refinery expansion, a sign that the Mexican energy reform is still ongoing even in an election year, and that foreign investors see potential in the industry

Outlook:

It has been a positive start to the year for markets and many asset managers have benefited from an environment of rising risk assets and weaker core rates. While improving fundamentals have had a large part to play in market performance, it is likely that we are due a pause here with investors searching for the catalyst for a market sell-off. Inflation, and now trade protectionism, has been pegged as the most likely culprits. In credit markets, spreads have reacted well to the higher rates environment but there is a limit to the market's tolerance for consistently higher rates – we saw the first signs of investor concern over the last few days. The heavy issuance pipeline of late has also likely left investors longer duration risk than they were at the start of the year.

All in all, it feels like we are at a crucial juncture for markets here with core rates at key levels, spreads meaningfully tighter on the year and conviction in the benign inflation and trade environment being tested. Ultimately, we believe the core anchor for markets is the improving growth outlook and setbacks are likely to be moderate and temporary, but taking some risk off the table in the very short term is likely to be a theme across many portfolios given the prosperous start.

Global Asset Management

RBC Global Asset Management (U.S.) Inc.
Minneapolis | Boston | Chicago
800.553.2143 | **us.rbcgam.com**