



Portfolio Manager Perspectives

BlueBay Emerging Market Debt Update

Weekly Update

March 7, 2018

EM Credit Market Update

Last week we identified Federal policy, supply and trade tensions as the main risks to an otherwise positive fundamental backdrop for risk markets. Trade has now clearly moved to the top of that list with President Trump confirming that he will impose significant tariffs on steel and aluminium imports. The market has obvious concerns around the aggressive rhetoric, which has the potential to escalate into a trade war. This was reflected in equity prices over the week, with the S&P 500 down 2% and emerging markets (EM) and European equities down closer to 3%. This created a safe-haven bid, with the Japanese yen the preferred asset given the effect on US Treasuries remains quite uncertain at this point.

In Emerging Markets News:

- South Africa's President Cyril Ramaphosa appointed a new cabinet that included the reinstatement of Nhlanhla Nene to the post of finance minister. The rand, however, was a poor performer on the week as the country posted a large trade deficit as imports increased.
- The Russian ruble also weakened as oil dropped and the US promised a further round of sanctions.
- The Mexican peso was hit by concerns around aggressive US trade policy even though the announcements around steel and aluminium do not have a large impact on the country.
- The Argentine central bank held its key interest rate at 27.75% but the currency still performed poorly given the drought and the perceived loss of central bank credibility.

In EM Corporates News:

- Rumours continued to circulate that a Brazilian industrial conglomerate had hired advisors to work on a restructuring of the company's financial liabilities. However, later in the week there was talk that the company was working on a deal to raise a seventh line on the shares of a Brazilian petrochemical company to be able to meet the redemption. In short, we believe restructuring is inevitable, but the timing is uncertain.

- A Brazilian foods name was targeted in another wave of the 'Carne Fraca' investigation involving bribes paid to government inspectors to allow the sale of inferior meat products. This coincides with a board shake-up at the company and raises the prospects of a ratings downgrade to high yield.
- Both a Colombian and a Mexican petrochemical company reported results, with the Colombian name showing strong cashflow generation that was reflected in strong performance post results. The Mexican firm's results were more mixed but bonds remained stable.

Outlook:

We believe there are still three key risks facing markets for the near term: Fed policy, supply risk and trade tensions. The resignation of Trump's economic advisor Gary Cohn keeps trade tensions at the top of the list for now in our view, and it may indeed be a sign of more aggressive action to come from Trump. The risk of tit-for-tat retaliation is already playing out with the EU looking at tariffs on some well-known US brands.

Supply risk has increased but is being well absorbed for now. In US credit markets, a pharmaceutical company raised USD40 billion in bonds to help pay for an M&A deal. In EM credit, a Chinese state-owned enterprise is also in the market with a multi-billion dollar offering.

Fed speak of late has certainly begun to recognise, in our view, that risks are to the upside in terms of their rates projects, with 2019 dots looking most vulnerable. We will find out more in a couple of weeks when the Fed meets.

All in all, the market is likely to be quite choppy in the weeks ahead. The core supports from a global growth recovery and, on balance, still-accommodative central banks are there, but there are also some headwinds. Valuations have improved but it is still a matter of seeking out the pockets of value. Being lighter on risk and in a position to take advantage of market dislocations as they arise still seems to us to be the most sensible approach for now.

Performance to 2 March 2018:

	Contributors/detractors	+/-
EM Corporates	A long in an Argentine utility contributed as the company brought new plants on line.	+
EM Sovereign	Positive contributions from Nigeria, Egypt and Oman were offset by weakness in our Ecuador position, which suffered on the back of uncertainty heading into a cabinet reshuffle and the announcement of an economic reform programme. We expect this next week and think bonds should rally after the news is digested.	-
EMFX.	Longs in Israel and shorts in Mexico contributed while a long in the South African rand dragged on performance.	Flat
Macro Hedges	Shorts across the US rates curve were a drag on performance but CDS hedges contributed – the net result was flat on the week.	Flat
Local Rates	Received positions in Brazil contributed to performance while South African sovereigns and quasi-sovereign receivers detracted following a very strong run.	+

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