Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives BlueBay Emerging Market Debt Update

March 29, 2017

Investor attention has remained focused on the US, and trading activity in EM was relatively quiet. The Fund was flat in performance terms over the week. Market moves in EM were limited, and the core strategy of the portfolio is to remain long high yield sovereign credit.

The main question of the week was whether legislation to 'repeal and replace' Obamacare would successfully pass Congress. The inability of the new administration to even present a bill to the House of Representatives represented a significant setback for Trump. Investors began to question whether their optimism over tax reform and infrastructure spending may prove similarly misplaced. For the first time since last November, we began to see some weakness in US equities, and corresponding weakness in the US dollar and lower US Treasury yields.

Although Trump has clearly squandered political capital on healthcare, we believe it is premature to conclude that tax reform and infrastructure investment are also dead. If he learns the lessons from his first brush with the realities of US legislative politics, he is likely to approach fiscal reform in a more organised and bipartisan manner. We will find out more about his approach in the next few weeks.

At present, we still expect more active fiscal policy and a more active Fed as a consequence. We also remain alert to actions of international trade. This element of Trump's 'America First' approach to economic policy has faded from view over the past few weeks due to a lack of any policy detail. This may be a complacent conclusion; Trump and his team may actually revive this area of focus if they cannot make progress elsewhere.

Trump's forthcoming summit with President Xi at Mar-a-Lago is likely to be a cordial affair with some headline-grabbing announcements on Chinese investment in American manufacturing, but there is no doubt that trade tensions between the two countries continue to bubble away beneath the surface.

The final item of note in the US in the past week was the confirmation of a formal FBI probe into contacts between Russia and the incoming Trump administration. For the administration this will prove time consuming and distracting. For Russia it seems to push further into the distance hopes of a normalisation of relations.

I have commented in some detail on developments in the US because they remain the absolute focal point for all global investors. However, we do believe we will see a much greater volume of single-country newsflow in EM in the second quarter.

At the time of writing we are seeing another eruption in the long-running power struggle between President Zuma and Finance Minster Gordhan in South Africa. The President has humiliated Gordhan by ordering him to return home from an overseas investor roadshow. Speculation is rife that Gordhan is about to be sacked and replaced by a more malleable candidate. The situation is fluid but this would represent a high stakes gamble by Zuma as it is not clear he has the political support within the ANC to affect such a move. We remain short the rand at this point; current uncertainty is likely to lead to weaker asset prices after an exceptionally strong run.

We are also beginning to lock in gains from our long in Turkish assets. As we approach the 16 April referendum of the Executive Presidency, we are concerned that Erdogan has not been able to establish more of an advantage in opinion polling. This increases the risk of unorthodox policy and security measures before and after the vote. After a good run, it feels prudent to scale back.

We also have a knife edge election coming up in Ecuador this weekend. This has also been a favoured credit for the Fund, as we expected the market friendly opposition candidate Guillermo Lasso to be successful. This is now too close to call and, as oil prices are also declining, we have taken the position off the books.

Finally, when discussing political risk, we would also highlight Brazil. All assets in the country have had a strong start to the year as the feel-good story around falling inflation and reform potential has continued. We are now entering a potentially more volatile period where the gory details of exactly who is implicated in the Odebrecht corruption scandal will emerge, at the same time as the government tries to pilot pension reform through Congress.

The global growth backdrop remains robust which will in itself provide a supportive backdrop for EM. We believe investor interest remains strong and it still feels right to have a long bias to portfolios.

In terms of political risk, Q1 has all been about developed markets, and mostly the US. As we move into Q2 we expect EM political risk to increase. We would expect appropriate positioning to be a key source of alpha as spring approaches.

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