Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Emerging Market Debt Update
Weekly Update

July 5, 2019

Remain Selective: Stay Long

With central banks supporting risk assets, EM and credit look to be in the sweet spot for inflows.

Summary

Risk assets consolidated last week ahead of the G20 meetings.

In the US, Federal Reserve Bank of St Louis president Bullard made supportive comments around the case for a pre-emptive 25bps rate cut but pushed back against the notion of a 50bps reduction.

In the Middle East, President Trump placed financial sanctions on Iran's supreme leader, Ayatollah Ali Khamenei, which prompted a testy response from the Iranians and seemingly closed the door to diplomatic negotiations for now.

Oil prices rose on a combination of these heightened tensions along with improving inventory data. OPEC+ also agreed on a nine-month extension on the previously agreed amount of cuts, which was marginally above market expectations.

Over the weekend, President Trump provided some positive headlines as he confirmed that the US and China would continue talks on trade and that no new tariffs would be levied on China while the talks are ongoing. He also seemingly softened his stance on Huawei, although the exact details of his position remained unclear as Huawei remains on the Entity List.

In EM fixed income, returns were positive across the board although spreads widened a touch in the hard currency space.

Local markets led the way again this week with 67bps of returns, capping a positive month where the local currency index delivered over 5%

Market Review

- In Turkey, the Justice and Development Party (AKP) was handed a notable defeat by Ekrem Imamoglu of the Republican People's Party (CHP) in the re-run of the Istanbul elections. The fact President Erdogan accepted the result this time around was taken as a positive sign for Turkish assets.
- South African Reserve Bank Deputy Governor announced his intentions to step down at the end of June, while ratings agency Fitch pointed out what the market was already thinking — that pressure is to the downside for the sovereign rating, with a national utility being the main focus.
- In Indonesia, the courts upheld the re-election of Joko Widodo, ending the past months of political uncertainty caused by the opposition's challenge of the election result.
- Mexico's central bank voted to keep interest rates on hold but the decision was not unanimous, with one dissenter who voted to cut rates in response to falling inflation.
- In Argentina, the economic data continues to improve with activity numbers beating expectations. Inflation is also likely to continue on its downward trajectory given the recent FX stability. The question is whether it is too little too late for Macri.
- The bonds of a Mexican petroleum name continued to create new wides versus Mexico as the company released lower-than-expected production numbers. Stabilising and ultimately growing production is key if the company is to stave off another possible downgrade later this year, which would see it fall out of the investment-grade indices.

Market Outlook

The G20 outcome was clearly constructive for the market as it removed the near-term tail risk, which was an escalation in the US/China trade war.

This now leaves the market free to focus on the almost universally dovish tone coming out of central banks globally, which ultimately should be a near-term driver for markets.

On this note, the European council is proposing that IMF director Christine Lagarde becomes the next ECB president. This is a further dovish outcome from central banks and, in our view, increases the likelihood of policy continuity once Draghi exits.

The Fed, meanwhile, seems to be trying to lean against the extremely dovish market pricing in rates, but it seems almost certain that we will at least have 25bps of cuts at the next policy meeting as a possible start to its cycle. We see President Trump's two new nominees for the Fed board as a further dovish signal.

The most recent data round supports the notion that growth continues to slow. In particular, PMIs from Europe and China remain extremely weak and the new orders component of ISM in the US paints a fairly dismal picture on the growth outlook.

Central bank easing certainly seems justified — the question in rates seems to be how low can we go?

Crucially, it is important to note that the trade-off between dovish central banks and a weak growth environment remains unresolved.

Near term, central banks are supporting risk assets but the G20 did not actually resolve anything on trade, it simply acted to delay further tariffs for now.

In simple terms, that is not going to help companies when they consider their next round of capex, for example, and so we believe the remaining uncertainty regarding the medium-term trade outlook will continue to weigh on growth.

In the current environment, we see the sweet spot for risk being in carry assets.

Emerging markets (EM) and credit are both likely to see inflows on the back of this theme; therefore EM credit should be ideally placed to benefit.

Local markets should remain more nuanced as growth is the key to FX performance, but there is certainly an argument to be made for some of the higher-yielding stories or those that are improving given structural reform or political tailwinds. In short, we think it best to remain selective, but stay long of EM.

Index Review – Weekly Market Snapshot as of 06/28/2019

	Total return			Spread / yield change (bps)				
	Weekly	MTD	YTD	Weekly	MTD	YTD	Spread (bps)	Yield (%)
Hard Currency Sovereign	0.11%	3.40%	11.31%	4	-32	-69	346	5.55
Hard Currency Corporate	0.39%	2.24%	9.14%	1	-16	-42	317	5.07
Local Currency Corporate	0.40%	3.17%	7.98%	2	15	44	201	6.95
Local Currency Sovereign	0.67%	5.51%	8.72%	0	-38	-77		5.69

Source: Bloomberg, JPMorgan