

Portfolio Manager Perspectives

BlueBay Emerging Market Debt Update

Weekly Update

July 18, 2019



Event Risk Rising

Near-term market dislocation could bring opportunities.

Summary

US equities made new highs this week but the pace of gains has moderated somewhat. It is notable that emerging and European equity markets actually ended in the red, with Chinese equities one of the underperformers.

US equities were spurred on by Federal Reserve (Fed) chair Jerome Powell's testimony and the release of Fed minutes, both of which confirmed that a July interest rate cut is as good as done.

On the data front, the US consumer price index (CPI) actually showed some signs of life, with a marginal uptick vs expectations in both headline and core readings. Chinese trade data was weaker, with imports dragging. However, this was overshadowed

by the positive read-through to infrastructure from June's total social financing report, which showed a large increase in special local government bond issuance.

One theme worth noting was the weakness in core rates markets, with US 10-year Treasury yields 9bps higher on the week, and German Bunds up 15bps. The extent of the move in Bunds has raised some concern of a value-at-risk (VaR) shock, and is worth monitoring closely given the extent of long positioning in core rates.

In EM fixed income, returns were mixed as local-currency markets outperformed on good EM FX performance. In hard currency, the backup in US Treasuries made for negative total returns, despite a small tightening in spreads.

Market Review

- In Mexico, the Finance Minister Carlos Urzua resigned and was replaced by Arturo Herrera. Urzua is the third member of the AMLO cabinet to resign, but the most significant in terms of the importance of the position, and the timing – as the Ministry of Finance is working on both next year’s budget and the Pemex business plan.
- On Pemex, the business plan is due to be released this week and has already been talked about in the government’s morning briefings. At this stage the plan looks underwhelming, and certainly will do nothing to stave off a potential Moody’s downgrade, which would take the credit into high-yield status.
- Brazil’s lower house approved the base text of the pension reform bill with a large majority, but final approval will have to wait until after the two-week recess. It should pass some time in August, and will subsequently go to the Senate.
- Turkey began to take deliveries of components of the Russia S-400 missile-defence system, but hasn’t yet received the actual missiles. Negotiations with the US appear to be ongoing at this stage, with the threat of US sanctions looming large over Turkish assets. With this in mind, and a new central bank governor at the helm, the CBRT meeting on 25 July will be watched very closely.
- EM central banks have taken a decidedly dovish tilt lately, with Turkey, Russia, South Africa, Brazil, Mexico and India all easing, or likely to ease, over the coming months.

Market Outlook

The economic data remains mixed, despite some stronger numbers out of the US this week, with the poor Chinese trade print a case in point. This leaves the Fed on course to cut rates at the end of July, particularly as Mr Powell has begun to reference global factors as being relevant to the decision-making process.

Investor attention will surely now focus on the earnings season, which is upon us. A trend of falling profitability and declining margins will make the current lofty valuations hard to sustain, but equally important will be company guidance for the second half.

Here investors will be trying to gauge when companies see conditions recovering, if at all. Any sense that recessionary risks are receding will of course be welcomed by risk assets.

Emerging markets continue to enjoy global tailwinds, but there are some key catalysts approaching. In August we should get lower-house approval of pension reform in Brazil, and we have the primaries in Argentina.

Even more imminently, we will likely have further noise around US sanctions on Turkey given the S-400 deal. We should also have both the official Pemex business plan and the company’s second-quarter results release (scheduled for 26 July).

So while EM continues to benefit from a very supportive global backdrop, we see heightened event risk in the next few weeks, and expect there will be excellent opportunities to take advantage of the resultant market dislocations.

Index Review – Weekly Market Snapshot as of 07/12/2019

	Total return			Spread / yield change (bps)			Spread (bps)	Yield (%)
	Weekly	MTD	YTD	Weekly	MTD	YTD		
Hard Currency Sovereign	-0.39%	0.25%	11.59%	2	-11	-80	335	5.55
Hard Currency Corporate	0.02%	0.39%	9.56%	-2	-12	-53	305	5.05
Local Currency Corporate	0.52%	0.80%	8.84%	-2	-2	19	176	6.87
Local Currency Sovereign	0.36%	0.68%	9.46%	3	-7	-84		5.62

Source: Bloomberg, JPMorgan

This document is issued in the United Kingdom (UK) by BlueBay Asset Management LLP (BlueBay), which is authorised and regulated by the UK Financial Conduct Authority (FCA), registered with the US Securities and Exchange Commission (SEC) and is a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC). This document may also be issued in the United States by BlueBay Asset Management USA LLC which is registered with the SEC and the NFA. In Japan, by BlueBay Asset Management International Limited which is registered with the Kanto Local Finance Bureau of Ministry of Finance, Japan. In Switzerland, by BlueBay Asset Management AG where the Representative and Paying Agent is BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, 8002 Zurich, Switzerland. The place of performance is at the registered office of the Representative. The courts of the registered office of the Swiss representative shall have jurisdiction pertaining to claims in connection with the distribution of the shares in Switzerland. The Prospectus, the Key Investor Information Documents (KIIDs), the Articles of Incorporation and any other applicable documents required, such as the Annual or Semi-Annual Reports, may be obtained free of charge from the Representative in Switzerland. In Germany, BlueBay is operating under a branch passport pursuant to the Alternative Investment Fund Managers Directive (Directive 2011/61/EU). In Australia, BlueBay is exempt from the requirement to hold an Australian financial services licence under the Corporations Act in respect of financial services as it is regulated by the FCA under the laws of the UK which differ from Australian laws. In Canada, BlueBay is not registered under securities laws and is relying on the international dealer exemption under applicable provincial securities legislation, which permit BlueBay to carry out certain specified dealer activities for those Canadian residents that qualify as “a Canadian permitted client”, as such term is defined under applicable securities legislation. The registrations and memberships noted should not be interpreted as an endorsement or approval of any of the BlueBay entities identified by the respective licensing or registering authorities. To the best of BlueBay’s knowledge and belief this document is true and accurate at the date hereof. BlueBay makes no express or implied warranties or representations with respect to the information contained in this document and hereby expressly disclaim all warranties of accuracy, completeness or fitness for a particular purpose. The document is intended only for “professional clients”

and “eligible counterparties” (as defined by the FCA) or in the US by “accredited investors” (as defined in the Securities Act of 1933) or “qualified purchasers” (as defined in the Investment Company Act of 1940) as applicable and should not be relied upon by any other category of customer. In Hong Kong, the Fund is not authorised by the Securities and Futures Commission for sale to the retail public and this document is only available for professional investors (as defined in the Securities and Futures Ordinance (Cap 571)) only. This document does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product in any jurisdiction and is for information purposes only. Except where agreed explicitly in writing, BlueBay does not provide investment or other advice and nothing in this document constitutes any advice, nor should be interpreted as such. No BlueBay Fund will be offered, except pursuant and subject to the offering memorandum and subscription materials (the “Offering Materials”). This document is for general information only and is not a complete description of an investment in any BlueBay Fund. If there is an inconsistency between this document and the Offering Materials for the BlueBay Fund, the provisions in the Offering Materials shall prevail. An investment in the Fund will involve significant risks and may fluctuate in value and investors may not get back the amount invested. You should read the offering memorandum carefully before investing in any BlueBay fund, in particular the risk section. No part of this document may be reproduced in any manner without the prior written permission of BlueBay. In the United States, this document may be provided by RBC Global Asset Management (U.S.) Inc. (“RBC GAM-US”), an SEC registered investment adviser. In Asia, this document may be provided by RBC Investment Management (Asia) Limited, which is registered with the Hong Kong Securities and Futures Commission. RBC Global Asset Management (RBC GAM) is the asset management division of Royal Bank of Canada (RBC) which includes BlueBay, RBC GAM-US, RBC Investment Management (Asia) Limited and RBC Global Asset Management Inc., which are separate, but affiliated corporate entities. Copyright 2019 © BlueBay, is a wholly-owned subsidiary of RBC and BlueBay may be considered to be related and/or connected to RBC and its other affiliates. ® Registered trademark of RBC. RBC GAM is a trademark of RBC. BlueBay Asset Management LLP, registered office 77 Grosvenor Street, London W1K 3JR, partnership registered in England and Wales number OC370085. All rights reserved.

