RBC Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Emerging Market Debt Update
Weekly Update

July 25, 2019

Critical Meetings Loom

If determining market direction validates pricing, then we foresee support for risk assets.

Summary

Emerging market (EM) equities eked out small gains this week but developed markets did not fare as well, with the S&P down over 1% and the Euro Stoxx 50 also in negative territory. A combination of renewed trade war rhetoric by President Trump and some mixed earnings reports were the main culprits, but in truth, with equities at all-time highs, the market was overdue some consolidation.

In the US, Federal Reserve speakers came out with a slightly garbled message ahead of their meeting scheduled for the end of the month, with the market at one point pricing almost two cuts for the July meeting before walking this back closer to 25bps. Either way, with at least one cut seemingly as good as done, core rates resumed their rally this week.

Tensions in the Middle East rose once again, this time as a UK-flagged oil tanker was seized by Iran's Revolutionary Guard in the Strait of Hormuz. This halted the slide in oil prices, although they are still down by more than 7% from the recent peak.

In EM fixed income, returns were positive with local markets leading the way and returning just over 1%. In hard currency, spreads were stable in sovereigns and a touch wider in the corporate space, although the rally in duration meant total returns were positive.

Market Review

- In China, 2Q GDP printed slowed to 5.9% quarter-on-quarter but industrial production increased along with retail sales. In combination with the improved showing in fixed-asset investment last month, this likely portends a stabilisation in the Q3 Chinese growth numbers.
- In Turkey, the focus remains possible US sanctions over the S-400 missile system, with Trump seemingly less inclined to pursue harsh sanctions. Thursday will bring the small matter of the Turkish central bank's interest rate decision. Here you can forget about debating whether the central bank will cut by 25bps or 50bps – it is more a question of 200bps or 400bps! We lean toward thinking more than 300bps of cuts is on the cards, although that would still leave the country with some of the highest real rates in EM. The potential impact on the currency is therefore unclear.
- Lebanon's parliament finally approved the 2019 budget while also releasing 4m19 fiscal data, which showed a narrowing of the deficit to less than 7.5% of GDP. Both of these factors should help the country in its bid to unlock some of the CEDRE funding, which in turn should help Lebanon buy some time to execute further reforms.
- EM central banks continued with their easing bias. Last week there were rate cuts from Indonesia, Ukraine, South Africa and South Korea.
- Pemex released its business plan which outlined a government capital injection of approximately USD7.4 billion over the next three years but that failed to address any of the structural problems with the company, leaving the path of least resistance wider spreads and a likely ratings downgrade before year-end.

Market Outlook

Global data trends, while still weak, are beginning to see some stabilisation at the same time as hopes of central-bank easing have driven asset prices up and created easier financial conditions. We believe Thursday's ECB meeting and then the Fed meeting next week will be critical to determining the near-term market direction, but it seems likely that both will move some way towards validating market pricing, which should be supportive for risk. Not doing so would seem counterproductive to the goal of insuring against a steeper loss of confidence from firms and households at a time when sentiment remains fragile.

So far, the US earnings season has been mixed, with financials guiding towards a weaker outlook ahead as lower US interest rates begin to erode margins. This week will feature some large technology and industrial companies which will be closely watched, particularly in relation to forward guidance.

In EM, there are also some near-term risk events for investors to navigate. First up is Turkey's upcoming central bank meeting, where excessive cuts could create a vicious cycle of currency weakness and inflation. Secondly, and in our view, more importantly given the weight of market positioning, are the Argentinian elections in October, where the 11 August primaries should provide a good guide to the ultimate result.

Recapping EM fixed income performance for the year to-date shows hard currency markets up around 12% on the year and local currency markets up over 10%. With defaults extremely low by historical standards, central banks in easing mode and inflows still coming into the asset class, we see no reason for the party to end any time soon, although a degree of caution is warranted as we navigate near-term event risks.

Index Review – Weekly Market Snapshot as of 07/19/2019

	Total return			Spread / yield change (bps)				
	Weekly	MTD	YTD	Weekly	MTD	YTD	Spread (bps)	Yield (%)
Hard Currency Sovereign	0.48%	0.73%	12.13%	0	-11	-80	335	5.49
Hard Currency Corporate	0.13%	0.52%	9.70%	5	-7	-49	310	5.04
Local Currency Corporate	0.40%	1.21%	9.28%	6	4	25	182	6.84
Local Currency Sovereign	1.01%	1.70%	10.56%	-10	-17	-94		5.51

Source: Bloomberg, JPMorgan

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