Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Emerging Market Debt Update
Weekly Update

August 1, 2019

Positioning for Primaries

EM investors look to square their positions ahead of the first round of Argentine elections.

Summary

Equity-market outperformance was led by US markets this week; improving economic data and positive surprises from the earnings season sent the market to new highs. European equities also rallied, while emerging markets (EM) lagged as better US data led to an appreciating dollar.

In the US, 2Q GDP printed at 2.1%, beating expectations. However, the details were less supportive as the consumer remained upbeat but net exports, inventories and business investment were revised lower. Orders for durable goods also beat expectations, although prior-month revisions took some of the shine off.

The US earnings season is now well underway. So far, around 70% of companies have beaten consensus estimates for earnings, although forward guidance for Q3 has been negatively skewed. Among the outliers were weaker earnings from global bellwether Caterpillar, where tariffs and weaker demand from China continue to point to concerns around the manufacturing side of the economy.

In Europe, the big event last week was the ECB meeting, which underwhelmed market expectations as the central bank outlined the options available to it – including rate cuts, more QE and new forward guidance – but took no action. This is somewhat surprising to us given it is the European data that is the global

laggard and it is European inflation expectations that are most in need of an anchor. This backdrop now sets up the September ECB meeting as a critical one for markets.

In EM fixed income, returns were mixed with hard currency credit returning around 50bps against notable weakness in the local markets as FX sold off. It has been a positive period for EM local returns and some element of gain realisation ahead of the Fed meeting this week was likely. Whether or not this proves to be a period of consolidation or something more will, we believe, come down to the Fed's messaging around monetary policy for the rest of 2019.

Market Review

- In Turkey, the CBRT reduced its policy rate by 425bps from 24% to 19.75%. This was higher than market consensus but TRY rallied on the news. Why? In our view, it is most likely a combination of underweight market positioning, still high nominal rates and currently a high real rate with the inflation profile on a downward trajectory. All of this would suggest that the Turks should be cutting aggressively, if it weren't for the lack of credibility of the central bank, which means investors demand a higher risk premium for holding Turkish assets. Turkey is also being bailed out by a supportive external backdrop, but there was also a positive development this week on the S-400 issue, with the US now seemingly most likely to wait until the system is fully operational (next year) before deciding on sanctions.
- In Ukraine, President Zelensky won a mandate in the weekend's parliamentary elections, driving hopes for reform and sending Ukrainian assets soaring. Local markets are seeing healthy inflows and Ukraine warrants continue to reach new highs as growth prospects get revised upwards.
- South African assets came under pressure last week after Fitch revised its outlook on South Africa's BB+ rating to negative and Moody's also commented that increased support for Eskom was credit negative for the sovereign. With the fiscal deficit ballooning to around 6% of GDP this year and next, and public debt likely to breach 60% of GDP, investors are beginning to punish South African hard-currency bonds, as well as the local markets.

Market Outlook

Global data remains mixed with some positive signals coming from the US earnings season and more recent US economic data. However, European data is still notably lagging, particularly in Germany. In Asia, the data looks to us to be stabilising as trade data has improved but manufacturing PMIs remain weak.

In EM, there is still a huge willingness to look for the higher-yielding stories, as is evidenced by the rally in Turkish assets this month. We anticipate that the Argentinian elections will now move to the forefront of investors' minds, with the 11 August primaries almost upon us. Here, seven coalitions will likely present no more than one candidate each, meaning the ballot will likely have huge informational value in predicting the ultimate result in October's elections.

Overall, our view remains constructive on EM given the continued easing bias of central banks. However, we express some caution regarding the next few weeks as we expect investors to try and square positions ahead of the Argentine primaries and after a positive run for higher-yielding names.

Index Review – Weekly Market Snapshot as of 07/26/2019

	Total return			Spread / yield change (bps)				
	Weekly	MTD	YTD	Weekly	MTD	YTD	Spread (bps)	Yield (%)
Hard Currency Sovereign	0.48%	1.21%	12.66%	-9	-20	-89	326	5.44
Hard Currency Corporate	0.26%	0.78%	9.99%	-7	-14	-55	303	5.01
Local Currency Corporate	-0.70%	0.49%	8.52%	-3	4	25	182	6.84
Local Currency Sovereign	-0.85%	0.83%	9.63%	-1	-18	-95		5.51

Source: Bloomberg, JPMorgan

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