Portfolio Manager Perspectives
BlueBay Emerging Market Debt Update
Weekly Update

September 26, 2018

Tariff(ic) recovery

Emerging market (EM) assets staged a recovery this week despite US actions to impose further tariffs on over USD200bn of Chinese goods. EM equities led the way but local markets and EM credit spreads also rebounded nicely; it was another case of 'buy the rumour, sell the fact', as the staggered nature of the tariffs provided a dose of optimism to investors. One side effect of the improved sentiment was higher US rates, with the 10-year rate fast approaching 3.1% and investors keeping a watchful eye on equity price action as a result. For now, however, US equities remain resilient despite the many shocks that could have impacted them this year.

In EM News:

- The US imposed a 10% tariff on more than USD200bn of Chinese goods beginning at the start of this week, alongside the threat to increase the levy to 25% on 1 January 2019 if Beijing refuses to offer concessions. China also scrapped planned trade talks with this US, offering little hope of a truce any time soon. The Chinese Premier stated that the country will not devalue the yuan in order to boost China's export competitiveness – despite devaluation seeming the most logical course of action.
- Turkey announced its New Economic Program (NEP) for 2019–2021 with a focus on export strength (to help the current account), fiscal discipline (primary targets of close to 1% surplus and growing) and structural reforms. The recent bout of currency weakness is already beginning to rebalance the external accounts, and investors took the NEP as a step in the right direction, despite it failing to create a comprehensive solution for the bank NPL issue (there is still hope this may materialise).
- Argentine assets rallied through the week as investors anticipated an improved IMF deal. Former President Cristina Kirchner was also formally indicted on corruption charges as part of an ongoing graft probe involving many officials from the previous administration.
- Brazilian assets rallied on the week as electoral polls showed Jair Bolsonaro gaining in the polls, with many seeing him as the favourite in a three-horse race involving Bolsonaro and two left-wing candidates.
- South African assets suffered as the GDP print showed the economy was in recession. The government is working on a package of reforms that it hopes will be able to revive growth.

In EM corporates news:

- Indian equities and local market corporates came under pressure as an infrastructure lender defaulted on its commercial paper last week, given its high debt levels and inability to convert receivables into cash. This led to pressure in the wholesale funding markets, which impacted many of the housing companies in India.

Weekly market snapshot as of 09/21/2018

	Total return 1 week	Total return MTD	Total return QTD	Total return YTD	Spread change 1 week	Spread change MTD	Spread change QTD	Spread change YTD	Current spread	Current YTM
Hard currency corp	0.31%	0.44%	0.93%	-2.15%	(10)	(21)	(15)	39	299	0.00%
Hard currency corp IG	-0.08%	-0.42%	0.75%	-1.40%	(3)	(8)	(15)	15	193	0.00%
Hard currency corp HY	0.83%	1.59%	1.19%	-3.10%	(20)	(42)	(11)	72	448	0.00%
Hard currency sov	0.48%	0.78%	1.57%	-3.74%	(12)	(27)	(25)	59	344	0.00%
Local currency corp	0.97%	0.54%	-1.34%	-2.30%	1	5	7	(38)	129	6.95%
Local currency sov	1.57%	1.59%	-2.78%	-9.04%	n/a	n/a	n/a	n/a	n/a	0.00%
Local currency sov - FX	0.49%	0.43%	-0.28%	-0.28%	n/a	n/a	n/a	n/a	n/a	n/a
Local currency sov - rates	1.07%	1.16%	-2.51%	-8.79%	n/a	n/a	n/a	n/a	n/a	n/a

Movers and shakers on the week

Sovereign credit		Corporate credit		EM FX		Local rates	
Argentina	4.63%	Oil & gas	0.79%	Argentina	5.28%	Argentina	5.43%
Lebanon	3.83%	Metals & mining	0.52%	South Africa	3.91%	Indonesia	1.78%
Ecuador	3.36%	TMT	0.36%	Chile	3.48%	Brazil	1.35%
Zambia	-0.65%	Diversified	0.00%	Mexico	-0.10%	Mexico	-0.08%
Ukraine	-0.76%	Transport	-0.35%	Philippines	-0.12%	Peru	-0.15%
Belize	-1.11%	Infrastructure	-0.45%	Turkey	-2.02%	Turkey	-0.33%

Source: Bloomberg, JPMorgan. Past results are not indicative of future results.

Outlook:

The Fed meeting on Wednesday is the first hurdle to overcome this week – expectations are for the Fed to confirm its normalisation path, but investors will be keenly watching for any change in signaling as wage inflation continues to show an upward trend in the US. For EM, the path of the Fed cannot be underestimated given the pain that the move in USD Libor has created for the asset class this year.

Yet there are also signs that sentiment and positioning are beginning to add up to more resilience within EM. Take the tariff announcements last week as an example; EM assets actually rallied on the day of the announcement. Even US rates touching 3.1% have not been enough to dampen sentiment too much this week. So it does seem that EM has become a little 'oversold' in the short term and prone to short squeezes, the likes of which we have seen over the last couple of weeks. Signs of a systemic crisis in EM also seem to be fizzling out with Argentina and Turkey both managing to stabilise their situations for now.

The inexorable rise in USD Libor, combined with relatively resilient EM fundamentals this year, means we should see a fourth quarter that resembles the first nine months of 2018, in that price action will be choppy, it will be differentiated, and it will also be prone to savage rallies (or sell-offs) when the right (or wrong) policies are implemented. Being light on risk and being positioned to be able to capitalise on these opportunities should be the game plan in Q4.

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