



# Portfolio Manager Perspectives

## BlueBay Emerging Market Debt Update

### Weekly Update

October 17, 2018

#### Fed 'Going Loco' but EM BRATs are Starting to Behave - Emerging Markets Update

US equities suffered their worst declines since February as President Trump accused the Federal Reserve (Fed) of 'going loco' in its inexorable pursuit of policy normalisation. The equity move was exacerbated by positioning as the US economy has been the star performer this year and investors have built up overweight positioning in a market where valuations have run a long way.

Meanwhile, the IMF meetings in Bali may also have soured sentiment somewhat as the IMF cut its global growth projections as a result of trade wars and EM volatility. For its part, EM actually behaved relatively well, with stocks down around 2% but local fixed income markets actually up 0.4%. FX rallied 0.2% given US dollar weakness. This proved an important support for EM hard currency bonds.

#### In EM News:

- After much speculation throughout the week, Turkey released Pastor Brunson and returned him to the US in what is considered a win for Trump ahead of the US mid-term elections. It is also a win for Turkey, with Trump saying he could see "good, perhaps great" relations with Turkey. The mood music between the two countries is now much more positive.

- Saudi Arabia was thrown into the spotlight for all the wrong reasons when a Saudi journalist for the Washington Post was apparently murdered within the Saudi consulate in Istanbul. While this brought international condemnation, it is unlikely the US will take meaningful action against Saudi Arabia given the country is a lynchpin of US/Middle Eastern policy. Saudi bonds moved about 30bps wider on the news but subsequently retraced that entire move.
- In China, the equity market continued to trade poorly, touching a four-year low. Meanwhile, the country issued USD3 billion of bonds to international investors in a bid to build-out its curve to allow more efficient pricing of its quasi-sovereign paper.
- The South African rand rallied as President Ramaphosa appointed Tito Mboweni as finance minister. With South African assets the laggard over the last few months, this appointment sparked more positive sentiment towards local markets in particular.
- In Brazil, Jair Bolsonaro won the first round but failed to achieve a 50% majority. Polling for the second-round runoff indicates he should win comfortably, leading to investor optimism around his ability to pass fiscal reform. Brazilian local assets were the best performers, with local rates up to 50bps tighter and the real trading well.

Weekly market snapshot as of 10/12/2018

	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	0.06%	-0.40%	-0.40%	-2.05%	9	6	6	40	299	5.89%
Hard currency corp - IG	0.05%	-0.41%	-0.41%	-1.48%	8	4	4	18	196	4.89%
Hard currency corp - HY	0.07%	-0.39%	-0.39%	-2.77%	9	9	9	72	448	7.47%
Hard currency sov	-0.10%	-1.36%	-1.36%	-4.36%	11	16	16	66	351	6.65%
Local currency corp	0.24%	-1.06%	-1.06%	-2.84%	3	7	7	(30)	137	7.03%
Local currency sov	0.67%	-1.02%	-1.02%	-9.09%	n/a	n/a	n/a	n/a	n/a	6.77%
Local currency sov - rates	0.10%	-0.53%	-0.53%	-0.29%	n/a	n/a	n/a	n/a	n/a	n/a
Local currency sov - FX	0.58%	-0.49%	-0.49%	-8.82%	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	
Turkey	1.80%	Transport	0.61%	Argentina	4.53%	Turkey	3.54%
Argentina	1.34%	Oil & gas	0.33%	Turkey	3.13%	Argentina	2.29%
Brazil	1.21%	Financial	0.14%	Brazil	2.48%	Brazil	1.47%
Nigeria	-1.47%	Metals & mining	-0.11%	Peru	-0.39%	Philippines	-0.74%
Senegal	-1.54%	Real estate	-0.16%	Chile	-1.33%	Hungary	-0.78%
Zambia	-2.81%	Infrastructure	-0.25%	Colombia	-1.88%	Indonesia	-1.64%

**In EM corporates news:**

- Brazilian corporates continued to trade-up on expectations of a Bolsonaro second-round victory – almost all sectors rallied.
- Ongoing arbitration in the US against a Venezuelan oil & gas name was delayed until a 20 December court hearing. This means investors will be holding their breath (again!) on a Venezuelan bond payment heading into year-end.
- Indian oil refiners suffered from spread widening as the government brought back its subsidy regime – possibly a sign of things to come as we head into Indian elections in the first quarter of 2019.

**Outlook:**

The most recent bout of volatility has investors feeling a sense of déjà vu from February when a US equity market correction sent risk markets reeling. This time around a combination of a hawkish Fed, higher rates and growing fears around global growth sparked the move, which was then exacerbated once again by trend-following accounts.

With this in mind, the upcoming third-quarter earnings season in both developed and emerging markets will be particularly important in either providing fundamental support for a market stabilisation, or confirming recent investor fears that the end of the cycle is near and equities are overvalued. On that front, the recent undershoot on US CPI does provide some comfort that the Fed will not be pushed into a more aggressive hiking cycle, but an uptick in global growth expectations would also do wonders for equities.

For EM, the recent bout of weakness in the US has actually provided some relief as the theme of US dollar strength has cooled and US yields have pulled back from the highs. Some idiosyncratic EM events have helped too, with the BRATs (Brazil, Russia, Argentina and Turkey) all showing positive signs and piquing investor interest after a tough year.

While it is too early to call the bottom in emerging markets, a yawning valuation gap between EM assets and the rest of the world, in combination with light investor positioning, means, in our view, EM is proving much more resilient than many gave it credit for.

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