Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Emerging Market Debt Update
Weekly Update

October 24, 2018

Waiting for 'Bolso' - Emerging Markets Update

Global equities suffered last week as the release of minutes from the 25–26 September Federal Reserve (Fed) policy meeting were deemed marginally hawkish, leading to a sharp reversal higher in rates on the evening of the release. There were many other reasons cited for the sell-off, including concerns around the Chinese growth outlook and worries that US earnings will peak in the third quarter, but the most plausible explanation is that the Fed hike has induced higher real rates, and all risk assets are repricing off this. Emerging market performance was actually mixed on the week, with equities suffering while fixed income markets fared better, with positive returns in EM local markets and hard currency spreads also outperforming their developed-market peers. Another trend we are watching is oil, where recent weakness bears monitoring given large speculative longs in the space.

In EM News:

- Saudi Arabia remained in the spotlight as the events at the Saudi embassy in Istanbul drew international condemnation and Turkish authorities claimed to have the full details. The Saudi story is that rogue operatives carried out the mission, but international pressure continues to mount and the US may be forced into some form of sanctions against one of its major allies in the Middle East (and indeed a very lucrative business partner). Meanwhile, this provides Turkey with a much better bargaining position with both the US and Saudi Arabia.
- On that note, Turkish assets rallied again as positive sentiment from the release of Pastor Brunson led to further speculation that US sanctions could be eased. Turkey took advantage of the rally and issued USD2 billion of 5-year bonds, which were well received by the market.
- The US/China relationship showed no signs of thawing as Trump continued to threaten more tariffs and warn China that the US was closely watching the yuan, although the US Treasury did stop short of naming China a currency manipulator. Chinese equities continued to trade poorly, touching lows last seen in 2014 and compounding investor fears around Chinese growth.
- In Brazil, second-round polling continues to point to Jair Bolsonaro ('Bolso' for short) winning by a healthy margin this weekend. Both Brazilian equities and the real rallied again this week despite news that central bank president Ilan Goldfajn was preparing to depart by year-end. The market read is still that Bolsonaro's economic advisor, Paulo Guedes, will ensure a market-friendly appointment if Goldfajn were to ultimately leave. Whether or not this weekend will be another case of 'buy the rumour, sell the fact' will be interesting, but there may be a window here where Brazilian assets can continue to outperform into the end of the year.

Weekly market snapshot as of 10/19/2018

	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%	-0.34%	-0.34%	-2.00%	(3)	3	3	37	297	5.90%
Hard currency corp - IG	-0.07%	-0.48%	-0.48%	-1.55%	(1)	2	2	17	195	4.92%
Hard currency corp - HY	0.23%	-0.15%	-0.15%	-2.55%	(6)	4	4	66	443	7.45%
Hard currency sov	-0.16%	-1.52%	-1.52%	-4.52%	(1)	15	15	65	350	6.70%
Local currency corp	0.34%	-0.72%	-0.72%	-2.51%	(4)	3	3	(34)	133	6.96%
Local currency sov	0.76%	-0.27%	-0.27%	-8.39%	n/a	n/a	n/a	n/a	n/a	6.71%
Local currency sov - rates	0.47%	-0.06%	-0.06%	0.18%	n/a	n/a	n/a	n/a	n/a	n/a
Local currency sov - FX	0.29%	-0.20%	-0.20%	-8.55%	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	
Lebanon	2.83%	Transport	0.43%	Turkey	4.16%	Argentina	6.54%
Kenya	1.38%	Diversified	0.39%	Brazil	1.98%	Brazil	1.10%
Cote D'Ivoire	1.11%	Financial	0.27%	Russia	0.99%	Chile	0.09%
Uruguay	-1.18%	Pulp & paper	-0.22%	Romania	-0.65%	South Africa	0.47%
Venezuela	-2.67%	Real estate	-0.29%	Argentina	-1.29%	Thailand	0.17%
Costa Rica	-3.04%	Infrastructure	-0.37%	Mexico	-1.42%	Turkey	2.31%

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

- Ukraine agreed a new 14-month USD3.8 billion stand-by arrangement (SBA) with the IMF; the IMF board will consider the agreement after the full approval of the 2019 budget. To this end, Ukraine also approved a hike in gas prices, which was another prerequisite for the IMF approval. In terms of timelines, the Ukraine budget should be passed in November, leading to IMF disbursement in early 2019 (most likely). In the meantime, Ukraine has announced a roadshow and will be marketing a 10-year USD-denominated bond, with a view to tendering their 2019 bonds and improving their liquidity profile.

In EM corporates news:

- Mexican assets came under pressure as Pemex issued just ahead of this weekend's referendum on whether or not to proceed with the construction of the new Mexican airport. Given around USD6 billion of bonds have been issued to fund construction as of now, the referendum itself is a reminder that AMLO's policies have the potential to be very investor unfriendly.
- A Dutch chemical company is expected to make an offer for the 38.3% stake in a Brazilian petrochemical name held by a multinational after the second round of the elections are concluded.
- Venezuela's state-own oil & gas company remained the subject of intense speculation as the amortisation and coupon payments approach at the end of this week on its secured 2020 bonds. The payment will hit investors' accounts next Monday if it is paid on time. A payment should mean that the bonds are close to fully collateralised, which would likely lead to a rally in bond prices, whereas a non-payment will lead to material downside. It looks like investors will once again be on the phone to their operations departments very early on Monday morning asking whether the funds have appeared.
- A Brazilian metals & mining name confirmed that one of its subsidiary-owned mines would likely resume operations in early 2020, providing a boost to the entire subsidiary bond curve as investors are now getting closer to being able to engage in restructuring talks.
- An Indonesian conglomerate was the subject of bribery allegations around its township property project, leading to its real estate bonds selling-off multiple points from already distressed levels.

Outlook:

Higher real rates in the US are beginning to impact risk markets, with the downturn in developed market equities the most recent example of this. For EM investors, this volatility is really something they have been living with all year, as EM has borne the brunt of almost every risk downturn in 2018. As such, EM assets are priced more cheaply than many others and it is therefore perhaps less of a surprise that EM assets have outperformed their developed-market counterparts in this very recent round of volatility.

Having said that, the EM giant in the form of China is increasingly visible on investor's radars, with Chinese growth concerns bearing at least part of the blame for the recent global growth concerns. This adds extra importance to the third-quarter earnings season; in particular, company guidance for the year ahead will be closely monitored, especially as it relates to the Chinese outlook. Caterpillar reported yesterday and struck a positive tone on the 2019 China outlook, but this goes against the feedback from the majority of companies which have reported so far and which have generally noted a weakening in the Chinese market.

For EM into year-end, it remains the case that (assuming we get a resounding win for 'Bolso' this weekend, as the polls suggest), in our view, most of the major EM-specific risk events have already played out. This is significant given the repricing in EM assets year to date, but with developed market risks looming in the form of US mid-term elections and Italian bonds markets, it seems that volatility is likely to remain. This will likely create an interesting conundrum for investors who, by and large, have had a poor year and are sitting on decent piles of cash. If the macro stabilises and we start to see a squeeze in EM assets into year-end, this could feed on itself as investors feel compelled to put cash to work and chase returns. For now though, it is time to check that phone line into the operations team…

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RBC Global Asset Management (U.S.) Inc.
Minneapolis | Boston | Chicago
800.553.2143 | **us.rbcgam.com**