



Portfolio Manager Perspectives

BlueBay Emerging Market Debt Update

Weekly Update

November 21, 2018

EM Local Markets 'Pardoned' Ahead of Thanksgiving

Emerging market (EM) local currency was the star performer last week, but this was just about the only market to receive a pardon from the broader risk malaise. EM equities also managed to buck the trend and turned in positive performance in stark contrast to negative returns in the US and European equity markets. The main catalyst was a repricing in the outlook for the Federal Reserve (Fed) as the front end of the US curve priced out more than half a hike last week, leading to a weaker US dollar. Oil prices also contributed to the stronger rates environment as a further 5% fall in WTI brought the one-month drop in oil to 18%, fuelling investor concerns over global growth and challenging the outlook for inflation. Notably, Brent oil still trades with a material premium to WTI, and with Brent being the more relevant benchmark for EM, this likely also explains some of the weekly outperformance of EM credit markets when compared to developed market credit.

In EM News:

- Chinese stocks posted strong returns as hopes were built into the planned meeting between presidents Trump and Xi at the

upcoming G20 event in Argentina, despite later comments from US Vice President Mike Pence that were much more antagonistic and indicated that a near-term resolution is unlikely.

- The Mexican central bank raised rates in response to the worsening inflation outlook, which was at least partially attributed to the decision of incoming President AMLO to cancel construction of a new airport. With further public referendums planned on various issues, ranging from infrastructure projects to social security benefits, we are likely to see more volatility in the coming weeks and a higher risk premium for Mexican assets.
- Brazilian assets outperformed after Roberto Campos was announced as the new central bank head in another market-friendly appointment by incoming President Jair Bolsonaro.
- The Indian rupee was a notable performer as lower oil prices continued to help reverse sentiment in the local market.
- Russian assets rallied as the US indicated legislation ordering new sanctions was likely to be next year's business.
- Turkey printed a current account surplus for September in another example of the rapid pace of rebalancing in the external accounts, given the sharp currency depreciation earlier in the year.

Weekly Market Performance as of 11/16/2018

	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	-0.29%	0.05%	-0.60%	-2.26%	20	13	30	63	323	6.04%
Hard currency corp - IG	0.00%	0.02%	-0.69%	-1.75%	14	12	27	42	220	5.03%
Hard currency corp - HY	-0.69%	0.09%	-0.50%	-2.88%	30	15	39	102	478	7.67%
Hard currency sov	-0.52%	-0.22%	-2.37%	-5.35%	21	16	47	97	382	6.90%
Local currency corp	0.71%	1.13%	-1.22%	-3.00%	5	13	10	(23)	144	7.11%
Local currency sov	1.13%	2.56%	0.55%	-7.64%	n/a	n/a	n/a	n/a	n/a	6.63%
Local currency sov - rates	0.44%	1.07%	0.99%	1.23%	n/a	n/a	n/a	n/a	n/a	n/a
Local currency sov - FX	0.68%	1.47%	-0.44%	-8.77%	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			
Mozambique	1.89%	Utilities	-0.03%	Russia	2.59%	Turkey	2.72%
Belize	0.58%	Infrastructure	-0.03%	Turkey	2.55%	Russia	1.25%
Uruguay	0.56%	Diversified	-0.08%	Chile	2.00%	Brazil	0.82%
Angola	-2.39%	Consumer	-0.52%	Poland	-0.28%	Uruguay	-0.46%
Venezuela	-2.53%	Metals & Mining	-0.61%	Malaysia	-0.34%	Mexico	-0.48%
Ghana	-2.76%	Transport	-0.78%	Argentina	-1.38%	Dominican Rep	-1.17%

■ In EM corporates news:

- Brazilian economist Castello Branco was announced as the replacement for Ivan Monteiro as the CEO of the country's semi-public petroleum giant in another market-friendly appointment by the incoming administration.
- The CEO of an Italian telecom was ousted from his role in a setback to the potential merger with a Brazilian peer, given he was thought to favour this tie up.
- A Chinese bank printed a USD1.4 billion AT1 issuance at 5.6%, which repriced by 15 points down on the first day of trading. While this was placed largely to local accounts, and in our view clearly at the wrong price, it is an interesting reminder that 'caveat emptor' should be the catchphrase in Asian markets.

Outlook:

As we approach Thanksgiving, the lack of liquidity is exacerbating moves and creating a spike in volatility across almost all risk markets. However, trying to decipher the signals from these moves is increasingly difficult given traditional correlations have broken down.

What seems increasingly clear is that a post-QE world is a higher volatility one and, when combined with the lagged effects of Fed rate hikes, it is leading to markets that are lacking conviction, resulting in short-term investment horizons and choppy price action.

Credit markets in both the US and Europe are the most recent victims of the surge in volatility, with bell-weather credits wider this week. Whether or not these cracks in the credit markets prove to be the canary in the coal mine is the subject of much debate, but it does serve to dampen risk appetite into year-end.

While the recent moves down in both equity and oil markets reflect investor concerns around the global growth outlook, they have also had the side effect of repricing Fed hiking expectations. This has been accompanied by a subtle shift in tone from the Fed, and if the recent malaise in risk markets eventually allows investors to see the pause in the Fed hiking cycle, then there may just be a silver lining to this most recent bout of volatility.

Here we would note the recent outperformance of EM local markets, which have been under extreme pressure all year on the back of a tightening Fed.

As consensus trades across the globe continue to weaken, EM may benefit on a relative basis given the clean positioning in the asset class following a very difficult year. For now though, it is survival mode as we approach Thanksgiving, with the hope that some normalcy can return in the week after and as we head into the G20 meeting at the end of the month.

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