Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Emerging Market Debt Update
Weekly Update

December 6, 2018

When the Doves Cry

Emerging markets (EM) have been hit with a trifecta of good news (yes, you read that right – good) over the past week. First was a dovish tilt from Federal Reserve (Fed) chair Powell, which helped fuel the rally in both EM equities and local markets. Second was a temporary truce called between presidents Trump and Xi at the conclusion of the G20 meetings in Buenos Aires. Third was a tentative agreement between Russia and Saudi Arabia to extend their deal to manage the oil market into 2019.

Perhaps the most significant shift in direction was in the Fed messaging. Powell reversed his October comments where he stated rates were a "long way" from neutral, this time describing rates as "just below" neutral. The trade truce and the oil agreement will both be tested in the coming weeks with actions speaking louder than words in the first instance, while Thursday's OPEC meeting will need to deliver production cuts if oil is to remain supported at these levels.

In EM News:

- Ukrainian and Russian ships clashed near Crimea, sparking renewed fears of an escalation in tensions between the two countries. Russia responded by selling EUR1 billion of bonds into the market – a notable feat given the Ukrainian bond curve fell by around four points on the news.
- Chinese PMI data was weak once again, but sentiment remained upbeat given the positive outcome from the G20 meetings.
- Turkey's trade balance improved in October as imports continued to compress as a result of this year's sharp lira depreciation.
- The Egyptian central bank closed a mechanism whereby investors were able to repatriate funds, pushing new investors to the interbank market. We view the news as a sign of confidence from the authorities.
- The Brazilian central bank held FX auctions to stabilise the real following a bout of volatility that came despite the orthodox approach taken so far by incoming President Bolsonaro.
- Colombia proposed a cut to withholding tax payable by foreign investors from 14% to 5%.

Weekly Market Performance as of 11/30/2018

	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	Spread	Yield
Hard currency corp	0.01%	-0.21%	-0.86%	-2.51%	3	26	43	76	336	6.15%
Hard currency corp - IG	0.10%	-0.03%	-0.73%	-1.80%	3	23	38	52	230	5.08%
Hard currency corp - HY	-0.13%	-0.47%	-1.05%	-3.42%	5	35	59	122	498	7.87%
Hard currency sov	0.50%	-0.42%	-2.57%	-5.53%	(3)	29	60	110	395	6.98%
Local currency corp	0.25%	1.46%	-0.90%	-2.68%	1	16	13	(20)	147	7.18%
Local currency sov	0.21%	2.81%	0.79%	-7.42%	n/a	n/a	n/a	n/a	n/a	6.62%
Local currency sov - rates	0.27%	1.72%	1.64%	1.88%	n/a	n/a	n/a	n/a	n/a	n/a
Local currency sov - FX	-0.06%	1.07%	-0.84%	-9.13%	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	
Costa Rica	6.43%	Real Estate	0.45%	Indonesia	1.67%	Argentina	3.51%
Ecuador	3.44%	Pulp & Paper	0.32%	Turkey	0.77%	Hungary	0.80%
Angola	2.17%	Industrial	0.23%	Uruguay	0.53%	Turkey	0.74%
Georgia	-1.04%	Infrastructure	-0.08%	Russia	-1.00%	Dom Rep	-0.09%
Mongolia	-1.14%	Oil & Gas	-0.34%	Brazil	-1.49%	Uruguay	-0.09%
Ukraine	-1.67%	Metals & Mining	-0.34%	Argentina	-2.62%	Mexico	-0.38%

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

In EM corporates news:

- A Mexican petroleum name announced that its Ixachi field, discovered in 2017, has over a one billion barrels of oil equivalent (BOE), compared to the 366 million BOE initially claimed, in a rare spot of positive news for the embattled quasi-sovereign company.
- A Jamaican telecom company extended the deadline for exchange offers on its 2020 and 2022 holding company bonds to 7 December, as creditors continue to work with the company on a suitable proposal.

Outlook:

Over the last few years, investors who have 'bought the dip' have generally profited, while this year the leading strategy has typically been to sell the rallies. The last few days have proven no exception to this rule as the initial euphoria around the G20 outcome has faded into another sharp sell-off in US equities. Investors are now left wondering whether the traditional 'Santa rally' will indeed materialise, or whether it will be more doom and gloom into year-end.

The Fed has been adding more volatility to markets of late, with Chairman Powell arguably sending markets into their recent tailspin with his comments around rates being a "long way" from neutral. His comments last week declaring that rates are "just below" the neutral range are therefore important, not because they indicate the Fed may hike less next year (indeed, the market now only prices one hike for 2019), but because the comments indicate, in our view, that the Fed is moving away from auto-pilot and back towards watching the data and financial conditions to determine the appropriate path for rates.

We have, in a sense, seen that the 'Powell put' and the one-way bet that was US monetary policy moving in one direction (tighter) and the rest of the world moving in the other direction, is no longer so certain.

For EM, this should come as a welcome relief, with the most beaten-up areas (local markets and equities) standing to be the biggest beneficiaries. Crucially though, this narrative also hinges on improved EM growth prospects. It is here that much debate will be had and where the Chinese growth outlook remains the wild card.

Turning to more imminent matters, the OPEC meeting on Thursday stands as the next critical event for markets. A production cut is expected and delivering on this will be essential to improve sentiment as oil prices attempt to stabilise following a 20% sell-off.

US Treasuries are another market showing signs of stress as a strong flattening bias has taken hold over the last few days. Whether or not this is truly telling us something about sharply lower global growth, or if it is simply investors getting stopped out of another consensus trade, is yet to be seen, but the inversion of the two-year and five-year points of the curve has begun to grab investors' attention and is fuelling nervousness around the growth outlook.

We are left thinking that, if OPEC does deliver reasonable assurances to the oil markets on Thursday, and assuming the trade truce between China and the US holds for now (note the positive comments from China overnight), the change in tone from the Fed is meaningful for markets. As such, we would expect to see a decent squeeze in risk assets into year-end. However, it may be that after a year like this that markets are just too demanding, they're never satisfied…

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