

# Emerging Markets Bond

## Monthly Review and Outlook

June 2016

- First State Emerging Markets Bond Fund primarily invests in debt securities issued or guaranteed by governments, financial institutions or companies in emerging market countries.
- The Fund invests in emerging markets which may involve a greater risk than developed markets including sharp price movements, liquidity risk and currency risk. The Fund may invest in below investment grade, unrated and high yield debt securities. This exposes the Fund to greater liquidity risk, default risk and price changes due to change in the issuer's creditworthiness. The Fund invests in fixed income securities which may be impacted by movement in interest rates. It is possible that the entire value of your investment could be lost.
- All or part of the Fund's fees and expenses may be paid out of capital resulting in an increase in distributable income and effectively a distribution out of capital. Similarly in certain circumstances dividends may be paid out of capital. This amounts to a partial return of an investor's original investment, or from any capital gains attributable to that original investment, and may result in an immediate decrease of the Net Asset Value per share.
- You should not base your investment decision solely on this document. You should not invest unless the intermediary who sells it to you has advised you that the Fund is suitable for you and explained how it is consistent with your investment objectives.

### Key highlights:

- Expectations of further US interest rate rises taking place this year were pushed out significantly, while the UK central bank indicated it will pull out the stops to maintain stability.
- Given low market liquidity, we prefer exposure in the more liquid countries.
- In the absence of negative surprises from China or on the inflation front in the US, we expect this favourable environment for emerging market hard currency bonds to remain in place.

### Market review

June produced two big surprises for markets: firstly, far weaker than expected US payrolls data, as US employers added the fewest number of workers in a month (38k) in six years in May, and secondly, the 'Brexit' referendum saw the British electorate vote to leave the European Union (EU). While there was significant volatility in the immediate aftermath of the UK vote, risk assets, particularly in emerging markets, performed well over the month. Expectations of further US interest rate rises taking place this year were pushed out significantly, while the UK central bank indicated it will pull out the stops to maintain stability.

Emerging markets (EM) debt rose 3.4% (in USD terms) over the month taking year-to-date returns to 10.3%. The yield on EM debt came down 43 bps to 5.38% though the spread narrowed only marginally, 9 bps to 388 bps, as US Treasuries rallied with the 10-year yield falling to 1.49%. With a growing proportion of developed world sovereign bonds trading on negative yields, the relative attractiveness of EM debt yields is likely to have supported performance over the month. Gains occurred evenly across investment grade and high yield, and sovereign and quasi-sovereign.

In terms of individual countries, higher-yielding and higher-duration EM credits performed especially well over the month, particularly those which are oil-related: Venezuela (+12.2%), Colombia (+7.5%), Azerbaijan (+6.4%), Brazil (+6.4%) and Ghana (+5.7%). Crude oil remained in a range around \$50 and the broader commodities complex is up around 20% since a January low.

Key country developments included a ceasefire agreement between the Colombian government and the insurgent group Farc, with the latter agreeing to demobilise and form a new political party. The two sides will work towards a final peace deal over the coming months to be ratified by a referendum.

In Peru (+5.4%), Pedro Pablo Kuczynski was elected president. As a former banker and World Bank economist it is reasonable to expect Kuczynski will pursue a pro-business agenda, he has proposed measures such as lowering sales taxes already, as well as potentially implementing fiscal stimulus.

### Portfolio positioning

The EM debt market is in our view driven mainly by global rather than idiosyncratic or country specific factors. Given low market liquidity, we prefer exposure in the more liquid countries. We reduced our positions in Central and Eastern Europe before the Brexit vote. In our view, these countries are vulnerable to any negative effects of Brexit on EU/UK trade, and we see better opportunities in Latin America and Asia. Select quasi-sovereign bonds look attractive relative to sovereign bonds, but liquidity remains low and we prefer those which will not need to undertake new issuance.

### Performance

In USD terms, the First State Emerging Markets Bond Fund returned 3.41% in June.<sup>1</sup>

<sup>1</sup> The Fund's calendar year performance: 0.2% (2015); 7.1% (2014); -4.5% (2013); 17.3% (2012); -0.5% (performance from inception date 8 Nov 2011 to 31 Dec 2011).

## Outlook

We view the Brexit vote as a positive for EM debt, since we would expect Brexit to lower global growth, supporting continued low interest rates in developed markets. In this low interest rate environment, the yields available in EM debt are attractive and we believe that the EM debt market will continue to attract investor interest.

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