First State Investments

Emerging Markets Bond

Monthly Review and Outlook

March 2016

Key highlights:

- In USD terms, the Emerging markets (EM) debt delivered a return of 2.9% over the month.
- The European Central Bank delivered a strongly-anticipated fresh round of easing measures, cutting the deposit rate and increasing the size and scope of its monthly bond buying program.
- We remain selective in terms of adding risk exposure given the high level of correlation across markets and in particular of risk assets with the oil price.
- Technicals remain important for EM debt and we expect more issuance, especially among high yield names and corporates.

Market review

Accommodative monetary policy and reasonable economic data, notably US jobs data, provided the backdrop for a continuation in 'risk-on' sentiment over the month. The oil price rose 10% following the rebound in February helping to boost market sentiment. The European Central Bank delivered a strongly-anticipated fresh round of easing measures, cutting the deposit rate 10 bps to -0.4% and increasing the size and scope of its monthly bond buying program.

In USD terms, the Emerging markets (EM) debt saw returns of 2.9% over the month. Gains were spread quite evenly across sovereign (3.1%) and quasi-sovereign (3.7%), and investment grade (3.0%) and high yield (3.6%) bonds. The yield on EM debt rallied 42 basis points (bps) to 5.86% with the spread narrowing by 45 bps to 409. US 10-year yields were up marginally at 1.77%.

The oil price appreciation provided further impetus to high beta oil and commodity credits with strong returns for Mozambique (20.3%), Ecuador (13.9%), Mongolia (12.2%), Zambia (11.4%) and Iraq (10.0%). In Mozambique, additionally the restructuring of bonds in state-owned company EMATUM was well received by the market.

Lower beta European credits were relatively weak, reflecting risk appetite. Slovak Republic and Serbia bonds were flat while those of Poland (0.2%), Latvia (0.4%) and Romania (0.4%) also lagged. Federal Reserve comments during the month were taken as dovish prompting a rally in the euro against the dollar toward month-end, which does not help those European economies with a strong manufacturing component.

Political risks remained significant. In Brazil, following allegations implicating former President Lula in the Petrobras scandal, President Rousseff appointed Lula chief of staff. Lula, who remains hugely popular in Brazil, will now play a prominent role in fighting Rousseff's impeachment with a debate on this to begin in congress on April 17. Brazil performed well over the month (7.3%) with investors hopeful that an impeachment will lead to positive change.

In South Africa, April will see parliament debate the impeachment of President Zuma following the revelation that the president violated the constitution.

Portfolio positioning

We selectively added risk over the month in long-dated Latin American bonds, particularly Uruguay, Mexico and Costa Rica. After a non-deal roadshow by the Ecuadorian Finance Minister, we also added a small amount of Ecuador since the minister confirmed that the country was receiving the promised financial support from China. We also added to holdings in Eskom (South Africa), which had widened relative to the sovereign. We remain selective in terms of adding risk exposure given the high level of correlation across markets and in particular of risk assets with the oil price.

Performance

In USD terms, the First State Emerging Markets Bond Fund returned +2.9% in March.[1]

Outlook

The continued dovish bias of central banks globally has underpinned all risk assets and high correlations in this momentum-driven market. In EM debt, the technical picture has also been supportive, as issuance in the first quarter was less than expected and many countries issued in euros rather than US dollar. Technicals remain important for EM debt and we expect more issuance, especially among high yield names and corporates.