

Emerging Markets Debt

Monthly Review and Outlook

February 2017

Market review

Emerging Markets Debt performed strongly for the third consecutive month in February, returning 2% in USD terms. This favourable performance reflected further spread tightening, with spreads narrowing to 312bps, from 329bps at the end of January. EM high yield again outperformed EM investment grade as the ‘search for yield’ continued in an environment of high risk appetite.

Within the high yield space, idiosyncratic developments explained both the top and bottom performers. Mongolia (+7.6%) for example, concluded a US\$5.5 billion reform program with the IMF, easing concerns about its ability to fund bond repayments due in March. In Iraq (+7.4%) bond prices were supported by the army’s success in re-conquering territory from ISIS. Egypt also rallied strongly (+5.4%) as IMF-led reforms and the successful placement of \$4bn of debt left the market more optimistic about the trajectory of the country’s external balances. The one country that underperformed was Mozambique (-4.3%) as continued fall out post-default put pressure on bond prices.

In Latin America, the pension reform in Brazil is making slow but continued progress. President Trump’s trade agenda has not become more concrete and the NAFTA renegotiation is still lacking detail. In Ecuador, the incumbent party’s candidate Lenin Moreno narrowly missed the required 40% of votes in the presidential elections, so a second round of voting will be held in April. We would expect Ecuadorian bonds to rally if the opposition candidate Lasso won the second round, keeping open the possibility of a deal with the IMF.

Strategy positioning

In line with our positive view on EM high yield, we increased our positions in Gabon, Ecuador and Nigeria, where we bought some bonds in the secondary market and participated in the new 2032 issue. While FX policy is disappointing and the political situation fluid, Nigeria stands out among the sub-Saharan African countries for its low debt levels.

Outside the oil-exporting space, we reduced Hungary, which we believe is vulnerable to underperform in the event of increased European political noise, and added risk in South Africa, Turkey and Ukraine. Despite the political noise in Turkey before the referendum

and the loose monetary policy, we see the fiscal position of the country remaining robust. We also view the risk premium of Ukraine as attractive and do not expect further escalation of the conflict with Russia in the Eastern part of the country. We therefore increased our position as we believe that the market will re-focus on the continued financial support and reform pressure from the International Monetary Fund.

The strategy remains cautiously positioned in high quality long duration assets since we anticipate moderately higher US interest rates over the next few months.

Outlook

In spite of the recent rally – which has pushed EM spreads down by more than 100bps in the last year – the global macro backdrop is generally supportive for EM debt. In a scenario of stable to accelerating global growth, higher commodity prices and stable EMFX, EM debt should continue to be resilient in spite of the potential Fed hike in March. The new Trump administration in the US continues to be vague in terms of its fiscal agenda and there seems to be no consensus on any trade measures so far. Developments in the economic agenda of the new US administration will remain a focus for the market.



Source: First State Investments and JP Morgan.

Disclaimer

The information contained within this document is generic in nature and does not contain or constitute investment or investment product advice. The information has been obtained from sources that First State Investments (“FSI”) believes to be reliable and accurate at the time of issue but no representation or warranty, expressed or implied, is made as to the fairness, accuracy, completeness or correctness of the information. Neither FSI, nor any of its associates, nor any director, officer or employee accepts any liability whatsoever for any loss arising directly or indirectly from any use of this document.

This document has been prepared for general information purpose. It does not purport to be comprehensive or to render special advice. The views expressed herein are the views of the writer at the time of issue and may change over time. This is not an offer document, and does not constitute an investment recommendation. No person should rely on the content and/or act on the basis of any matter contained in this document without obtaining specific professional advice.

The information in this document may not be reproduced in whole or in part or circulated without the prior consent of First State Investments. This document shall only be used and/or received in accordance with the applicable laws in the relevant jurisdiction.

Reference to specific securities (if any) is included for the purpose of illustration only and should not be construed as a recommendation to buy or sell the same. All securities mentioned herein may or may not form part of the holdings of First State Investments’ portfolios at a certain point in time, and the holdings may change over time.

In Hong Kong, this document is issued by First State Investments (Hong Kong) Limited and has not been reviewed by the Securities & Futures Commission in Hong Kong. In Singapore, this document is issued by First State Investments (Singapore) whose company registration number is 196900420D. First State Investments is a business name of First State Investments (Hong Kong) Limited. First State Investments (registration number 53236800B) is a business division of First State Investments (Singapore).