

Emerging Markets Debt

Monthly Review and Outlook

March 2017

Market review

Emerging Market (EM) Debt markets continued to rally in March and the benchmark EM Debt index rose 0.4% in March, extending gains in 2017 to nearly 4%.

The month saw high volatility in the US Treasury market. Treasuries initially sold off ahead of the Federal Reserve's meeting in mid-March, but rallied towards month-end. Commentary accompanying the Federal Reserve's 0.25% interest rate increase suggested future monetary policy tightening might not be as aggressive as some investors had feared. The Treasury market was also supported by President Trump's failure to garner enough support to undertake the healthcare reform, prompting the market to re-consider the likelihood of aggressive fiscal policy by the Trump administration in the near term.

Political developments also had a notable influence on the performance of individual issuers, in particular on Venezuela, Ecuador and South Africa. As well as being impacted by oil price weakness, Venezuela (-8.9%) fell after the Supreme Court ruling to strip parliament of its powers, sparked global concerns that the country was sliding towards a dictatorship. Several countries withdrew their ambassadors and the opposition announced protest marches. In the face of this negative reaction, the Supreme Court later reversed the ruling. In Ecuador (-3.4%) the less market friendly candidate, Moreno, was declared the winner of the general election, which dampened sentiment towards the credit. Ecuador had outperformed similar credits late in 2016 as the market had priced a chance that the more reformist candidate, Guillermo Lasso, could win the election and potentially secure a financing program with the International Monetary Fund. South Africa (-1.5%) was another weak performer as President Zuma announced a cabinet reshuffle which included the removal of the Minister of Finance, Pravin Gordhan. Given Gordhan's credibility, the reshuffle was poorly received and led to market speculation that downgrades to 'junk' may follow. At the time of writing, two rating agencies downgraded South Africa to BB+, putting further pressure on South African credit spreads.

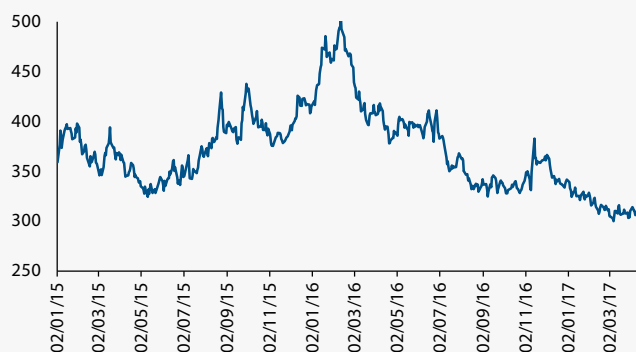
Strategy positioning

We maintained our long-term strategy to be overweight high yield and underweight investment grade credit. March was a very heavy month in primary markets and we participated in a number of attractively priced new issues, including in Oman, Lebanon and

Nigeria. We also took advantage of a number of relative value opportunities. Some of the strategy's exposure to Bahrain was shifted into Egypt, reflecting our assessment that the improvement in Egypt's external balance will continue to support relative spread compression. Our expectation is that an IMF program and liberalization of the Egyptian pound will result in improvements in the balance of payments which are not fully priced in. We also shifted some Pakistan exposure into Sri Lanka. Following the completion of an IMF program, we expect fiscal and external balances in Pakistan to slowly deteriorate. Sri Lanka on the other hand, is currently undertaking fiscal reforms under a current IMF program and should outperform.

Outlook

We expect global macro conditions to remain supportive of EM Debt. Particularly in an environment where US fiscal policy is likely to be less aggressive than the market has priced. In a scenario of stable global growth, higher commodity prices and stable EM FX, EM debt should continue to be resilient.



Source: First State Investments and JP Morgan.

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