Emerging Markets Debt

Monthly Review and Outlook

April 2017

Market review

Emerging Market (EM) Debt markets continued to rally in April, and the overall market returned 1.49%. Lower quality, high yield countries (+2.1%) continued to outperform investment grade (+0.9%) and US Treasury volatility remained high, largely due to changing risk sentiment on the back of geopolitical concerns. US military action in Syria, rhetoric towards North Korea and uncertainty around French election outcomes prompted a flight-to-quality Treasury rally during the first half of the month, which later partly reversed - Treasuries ended the month 11 basis points lower at 2.28%. The EM risk premium tightened from 310 to 303 as inflows to the asset class continued to support compression.

Idiosyncratic country developments were a large driver of performance differentials in April. Venezuela (+9.9%) was the best performer after the national oil company Petroleos De Venezuela made a large principal repayment that the market had not entirely priced in as certain. Mozambique (+5.6%), Argentina (+3.9%) and Ivory Coast (+3.6%) also performed very strongly. On the other end of the spectrum, Bolivia (-2.2%), El Salvador (-1.1%) and Trinidad and Tobago (-0.9%) underperformed. In El Salvador, government failure to make a payment promised to local pension funds, prompted three ratings agencies to downgrade the credit. We continue to believe that political brinkmanship will create headline volatility but that El Salvador will ultimately fulfill its Eurobond debt service obligations. We hold a small underweight in the credit and watch for more concrete signs of progress on local pension reform as a signal of higher political co-operation.

Strategy positioning

We maintained our long term overweight in high yield relative to investment grade credit in April, structural positioning that continues to add value (see chart 1). We continued to build on this position throughout the month, particularly in areas where we believe positive technicals will continue to support spread compression, such as in Africa. We added exposure in Ghana, Zambia and Cameroon as low issuance from the region continues to create a positive technical dynamic for secondary issues.

Notably, after meeting with the Ecuadorian Finance Minister in London, we used post-election weakness as an opportunity to add exposure to the country. Having reviewed the Ministry's deficit funding plan, we believe that imminent Eurobond supply is less likely than market pricing suggests and consider current yield levels generous compensation for supply risk.

Outlook

We expect global macroeconomic conditions to remain supportive for EM Debt. Moderate global growth and relatively accommodative developed market monetary policy will continue to encourage a search for yield, in our view. Strong technicals, given continued inflows and low issuance needs for EM countries should continue to compress the EM risk premium, in our view.

Chart 1: Spread of High Yield over Investment Grade (EMBIG Diversified Index)

Source: First State Investments and JP Morgan.