

<http://blog.en.erste-am.com/2016/05/25/yield-opportunities-of-east-european-bonds-still-intact/>

Yield opportunities of East European bonds still intact

Paul Severin



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An interview with Anton Hauser, senior fund manager ERSTE BOND DANUBIA, about the yield opportunities of East European bonds.



*Anton Hauser, senior
fund manager ERSTE BOND
DANUBIA*

In your opinion, what are the features that speak in favour of East European government bonds?

First of all, the higher yields that East European government bonds currently offer in comparison with euro government bonds. The average yield across the entire bond portfolio is 3.5% . Also, I am quite positive about the good economic data from the region. The rate of inflation is low or falling, economic growth is robust – many central banks can still loosen their monetary policy. This would be positive for bond prices, above all in the case of Turkey.

But the higher yield also reflects higher risk...

Generally speaking, that's correct. The average rating of all bonds is currently BBB-. By comparison, the average rating of common government bond indices of the Eurozone is A+. Also, the foreign exchange risk has to be taken into account, given that the fund invests two thirds of its assets in so-called local currency bonds. For example, I quite like Polish government bonds denominated in Polish zloty at the moment. I think that the political risk in Poland has been assessed incorrectly. This pushes bond prices down – and as a result, the yields are higher than would be justified.

That means that price fluctuations should therefore be expected? What is the outlook for the ongoing year?

In the year to date the fund has achieved a nice gain of +2.19%; however, on a year-on-year basis it is in slightly negative

territory (-0.48%). In the past five years, the fund has gained an annual 3.7%. This performance should also be achievable on average in the coming years.

What might be the risks that could weigh on your positive assessment?

At the moment political factors play a very important role. Along with Poland and Hungary, Russia and Turkey are subject to critical scrutiny by market participants. Whereas the general decline in commodity prices was beneficial to many countries, this was not the case for Russia. Then again, Russia has been the top performer in a year-on-year evaluation in spite of the sanctions.

What advice do you have for the shareholders of this fund?

I have been responsible for this fund for seven years, and have been analysing the region since 1997. There are always weak phases in the life of a fund – which are also opportunities to buy. The zero interest rate policy makes these bonds very attractive – also for institutional investors such as insurance companies or pension funds.

Thank you for the interview.

1) Value as of 30 April 2016. The fund ratio “yield” is defined as average yield of the assets held in the fund prior to any deductions for costs resulting from foreign exchange hedging; please bear in mind that this yield ratio is not equal to the fund performance. The following countries have been taken into account in the calculation: Czech Republic, Slovakia, Poland, Hungary, Russia, Turkey, Romania.

2) Forecasts are no reliable indicator for future developments

Advantages for the investor

- ✔ Investment in lucrative bonds of Eastern Europe.
- ✔ Broad diversification in issuances of selected countries, currencies and sectors.
- ✔ Foreign currency gains are possible.
- ✔ Gains when interest rates fall.

Risks to be considered

- ⚠ Rising interest rates may lead to losses.
- ⚠ Due to investments denominated in foreign currencies, the net asset value of the fund can be negatively impacted by currency fluctuations.
- ⚠ The addition of bonds with average or low credit ratings can lead to increased risk.
- ⚠ The value of units can rise or fall compared to their issue price.
- ⚠ A change in the credit rating of individual countries and in their political environment can have an effect on the net asset value of the fund (losses).

Risk notes according to 2011 Austrian investment Fund Act:

In accordance with the fund provisions approved by the Austrian Financial Market Authority (FMA), ERSTE BOND DANUBIA intends to invest more than 35% of its assets in securities and/or money market instruments of public issuers. A detailed list of these issuer can be found in the prospectus, para. II, point 12.

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Paul Severin

Paul Severin has worked at Erste Asset Management since April 2008. Until 2012 he was responsible for the company's product management; he has directed communications and PR activities since April 2012. From 1992 to 2008, he was director of equity fund management and deputy director for institutional funds at Pioneer Investments Austria in Vienna.

His career in the securities business began in 1992 at Constantia Privatbank as a portfolio manager and analyst. He worked as primary analyst at Creditanstalt Investmentbank in Vienna from 1994 to 1999.

He studied international business at Innsbruck University and Marquette University in Milwaukee, WI, USA. Before his university studies, he worked at Dornbirner Sparkasse in letters of credit and export financing.

Paul Severin is a member of the board at ÖVFA (Austrian Association for Financial Analysis and Asset Management) and a CEFA charter holder.