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The investment segment of emerging markets corporate bonds has matured

Paul Severin

For many institutional investors corporate bonds from emerging markets issuers have become an important instrument of portfolio diversification. Our fund management team estimates that a portfolio made up of 70% investment grade bonds and 30% high-yield bonds can yield an average 5% in the medium term. This sort of yield can hardly be achieved with fixed income papers from the industrialised nations.

In the interview Peter Varga, fund manager of ESPA BOND EMERGING MARKETS CORPORATE, talks about the upsides of emerging markets corporate bonds.

Picture: Peter Varga

How has this asset class of emerging markets corporate bonds changed?

Peter Varga: This year, assets under management held in this class will surpass USD 2bn in the hard currency segment – a sign that this asset class has long become indispensable. More and more long-term institutional investors such as insurance companies and pension funds employ emerging markets corporate bonds. This is of course due to the lack of alternatives in the developed markets in view of the currently low yields, but also to the relatively low correlation with other asset classes. It is also important to point out that the investors have started seeing this asset class from a changed perspective. They are differentiating more now, and their time horizon has shifted to the long end. Countries and companies are not completely ruled out anymore if individual factors deviate. This development has created a much higher degree of stability – it has improved liquidity and reduced fluctuations.

How do you assess the pick-up relative to other bond classes, and how has this changed most recently?

Peter Varga: The picture has changed. The spread for government and corporate bonds from the developed markets has increased drastically, and in parts that is definitely justified. But in our emerging markets corporate bond universe with high-yield bonds accounting for 35% the spread for medium-term maturities is 400 to 500bps. This level has not been exceeded in the past four years. Overall one can say that emerging markets corporate bonds are an asset class that is well-diversified by sector, and offers a broad high-yield segment and increasingly large and liquid issues. This bond segment has matured, and the gap to the American corporate bond market has been closed in the meantime.

What is your expectation for emerging markets corporate bonds this year?

Peter Varga: With active strategies you can achieve 5 to 6% per year in the medium term even in the current phase. Passive strategies and ETFs, on the other hand, have a rather more negative outlook for the coming one to two years. In our mandates we prefer bonds in hard currency, but also complement them with local currency bonds. Due to political and economic events such as the Ukraine conflict, the expected interest rate increase by the Fed, and the falling commodity prices this segment is currently still a bit risky. That being said, it has become more attractive on account of the depreciation of the local currencies that we have already seen relative to the US dollar: it should be a good idea to keep monitoring the market for investment in the foreseeable future. But the years of plenty are for now behind us: while some of the yields are justifiably high, it takes experience and good management to exhaust them. The declining economy and the widening spreads have dampened the issuing activity in some areas.

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.