

<https://blog.en.erste-am.com/2016/07/21/the-comeback-of-the-emerging-markets/>

The comeback of the Emerging Markets

Paul Severin



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Interview with Christian Gaier, Senior Fund Manager for emerging markets government bonds

Emerging equity and bond funds have borne the brunt of the consequences of the global uncertainties in the past years. Wars and conflicts in the region, slumping commodity prices (especially oil), and fears of an interest rate reversal in the USA have caused many investors to withdraw their capital and “park” it in safe havens. Now signs are indicating that investors have been staging a comeback.

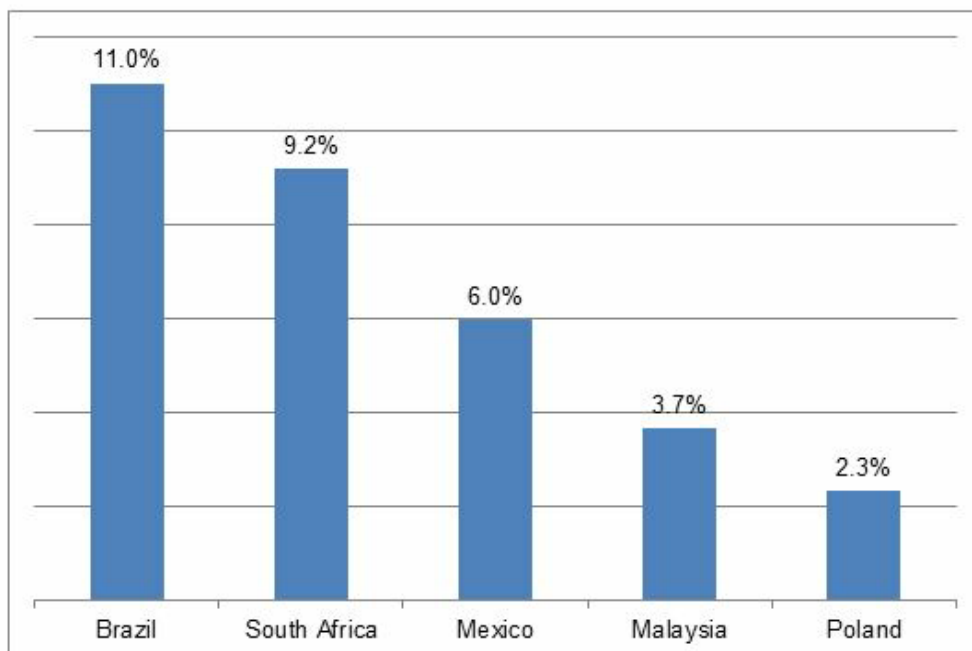
What is the focus of this fund?

ESPA BOND LOCAL EMERGING invests mainly in emerging markets bonds denominated in local currency; for example, Indonesian government bonds in Indonesian rupiah or Brazilian government bonds in Brazilian real. We also hold Hungarian government bonds, issued in forint. The fund holds more than one hundred bonds from emerging markets issuers from all over the world. The performance of the fund consists of an interest component (local currency bond) and a currency component (changes of the local currency relative to the euro).

Bond yield of selected issue countries in local currency



Christian Gaier, senior fund manager of government bonds of emerging markets



Source: JP Morgan; as of 30 June 2016; the chart shows the yield levels prior to fees and taxes; caveat: the ratio "yield" is an inadequate estimate for the future performance of this fund, given that on top of the development of the interest rate, the development of the local currency vis-à-vis the euro plays an important role with regard to the performance.

Is the period of unsteady markets coming to an end?

The unsteady period has been reflected in the capital markets. In the past five years, there have been years of extensive corrections, especially in 2013 (-14.1%) and in 2015 (-5.6%), where local currency bonds generated significant losses for euro investors. This year however, they have shown a very positive performance. The fund has gained 9.6% in the year to date (NB in euro)*. Overall signals abound that suggest that a trend reversal is imminent on the so-called emerging markets stock exchanges. Over the past five years, the fund has gained 1.3% p.a.

How strongly will emerging economies be able to grow this year?

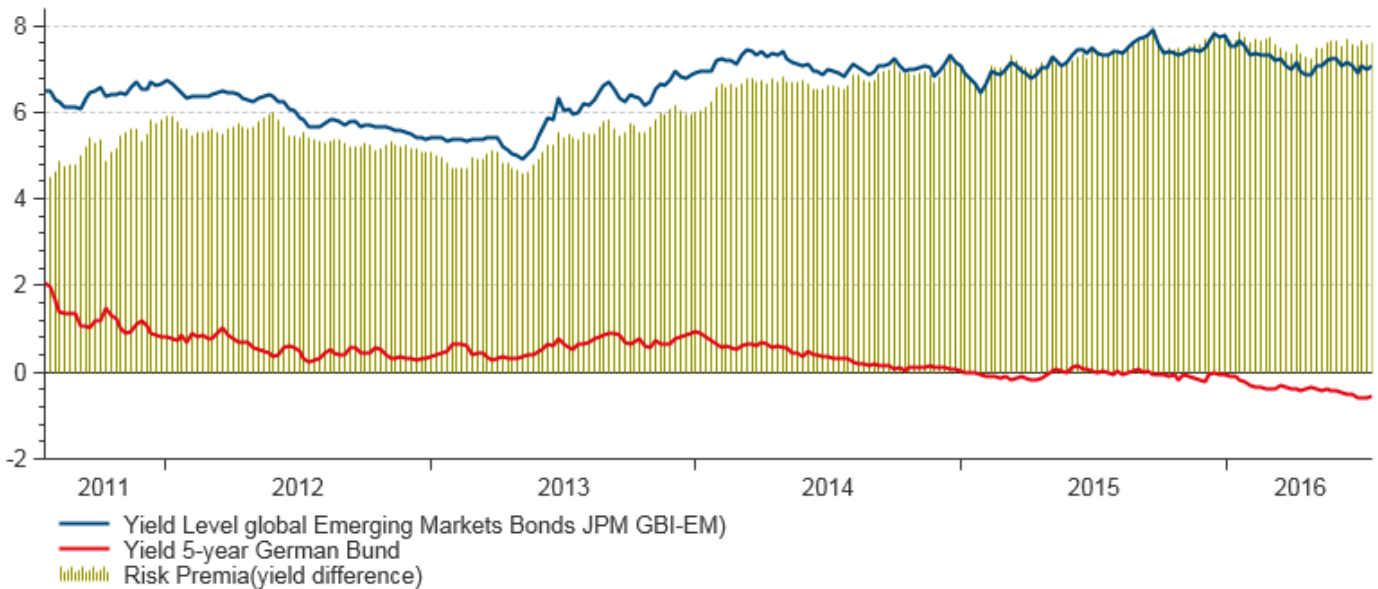
Estimates put 2016 growth at 3.5%-4.0%, which is clearly above the level of developed economies. Emerging economies have embarked on a long-term catch-up and growth cycle. We are talking about a region that is home to about 70% of the global population, with a largely young, consumption-prone demographic. Many innovations originate in the emerging markets, which also play an important role as sales markets for highly-developed products of the Western world.

Yet many investors give emerging markets a wide berth?

Many market participants have not engaged (much) with investments in the emerging economies – this is particularly true for the bond segment. Which is a shame, as the investment conditions have clearly improved especially for government and corporate bonds. The rising level of development of the economies alone boosts their ability to service and repay the debt they take out. In spite of these improvements, spreads are at a four-year high. I attribute the relatively high level of interest rates to primarily local, country-specific events: for example the sanction against Russia after the annexation of Crimea; the corruption scandal in Brazil; or the debt refinancing issues with Argentinean bonds.

Yield comparison Emerging Markets vs. German Bunds

Global Emerging Markets Bonds in local currency compared with 5y-German Bunds



Quelle: Thomson Reuters Datastream

Source: JP Morgan; as of 30 June 2016; the chart shows the yield levels prior to fees and taxes; caveat: the ratio "yield" is an inadequate estimate for the future performance of this fund, given that on top of the development of the interest rate, the development of the local currency vis-à-vis the euro plays an important role with regard to the performance.

What are the factors currently making a case for local currency government bonds?

The average yield of the securities held by ESPA BOND LOCAL EMERGING is currently about 6% p.a. (see chart above)**. The performance for the euro investor, however, is no one-way street. Experience shows that investors have to take into account high fluctuations. In the medium to long term, investors should be compensated for the risk they assume. I expect that over the coming three to five years an average performance of about 5% p.a. (prior to fees and taxes) should be possible. Given the current zero interest rate environment, this is very attractive.

Thank you for the interview.

**ESPA BOND LOCAL EMERGING will be renamed
ERSTE BOND LOCAL EMERGING on 29 July 2016.**

Please follow this link for facts on the ESPA BOND LOCAL EMERGING fund:

http://www.erste-am.at/en/private_investors/our-funds/search/1-107701/overview

Benefits for the investor:

- Broad diversification of risk due to a selection of bonds from various emerging markets
- High chances of return in the long run
- Chance of high annual payout

Risks to be aware of:

- Emerging markets are traditionally subject to high fluctuations, which means that medium-level to high fluctuations are possible
- Elevated risk due to the inclusion of issuers with low to medium ratings
- Due to the investment in foreign currencies, the performance of the fund (and its shares) may be affected by foreign

- exchange fluctuations
- Capital losses are possible

***) Data as of 30 June 2016: performance calculated according to the OeKB method. The performance accounts for the management fee. The chart does not allow for a one-time load of up to 3.50% nor any other fees reducing return such as individual account or depositary fees. Past performance is not indicative of future fund performance.**

****) Please note: the ratio “yield” equals the average yield of the securities held in the portfolio prior to management fees and other fees of the fund; Please bear in mind that the ratio “yield” is an inadequate estimate for the future performance of this fund, given that on top of the development of the interest rate, the development of the local currency vis-à-vis the euro plays an important role with regard to the performance. For a performance overview of the funds mentioned, please visit http://www.erste-am.at/de/private_anleger/unsere-fonds/suche/1-107701/overview**

About the interview partner:

Christian Gaier is senior fund manager and specialist for local currencies in global emerging markets bonds. He has been member of the ERSTE-SPARINVEST Fixed Income Team since 2006. Christian Gaier started his career at Generali Insurance Group. He holds a degree in Business Administration from the Vienna University of Economics and Business Administration and majored in finance, risk management, and information management.

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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.