Emerging markets corporate bond outlook 2019 + Video

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- **Emerging markets bonds were affected by the interest rate policy in the USA, weak commodity prices, and political risks last year**
- **Many companies in the emerging economies have solid fundamental data and are well-positioned for the coming year**
- **Volatility will remain high in 2019 due to possible trade conflicts**
- **The ERSTE BOND EMERGING MARKETS CORPORATE**

What were the biggest challenges last year, and what are the opportunities in 2019? Emerging markets fund manager Péter Varga answers the most important questions.

Trade conflict dampening euphoria

Last year was challenging for emerging markets bonds for various reasons. In addition to the interest rate hike cycle in the USA and the correction on the commodity exchanges, the elevated political risks in countries such as Venezuela, South Africa, or Turkey generated elevated volatility. The main issue, however, was the intensifying rivalry manifesting as trade conflict between the two super powers USA and China. The worry of the US government is that China might more and more turn into a technology leader.

This worry is substantiated by the R&D investments by the People's Republic, which have increased exponentially over recent years. "The Chinese company Huawei has passed Apple in terms of the global number of smartphone sales and is now second behind Samsung. The USA is definitely not indifferent about this. Nor about the Chinese achievements in space exploration, investments in Africa, or the One Belt, One Road Initiative," as Péter Varga, Fund Manager responsible for emerging markets corporate bonds with Erste Asset Management, explains. "The tense situation between the USA and China will not just vanish into thin air even in the event of a trade agreement between the two parties in 2019."

Exposed weaknesses, good investment opportunities

Europe, which had clearly exceeded expectations in 2017, put in a weak performance in 2018. This was due to the quarrels around Brexit and the slowdown of the global economy. Said events and the widening spread between US and Euroland interest rates led to a USD rally. The combination of higher US interest rates and a strong US dollar, in turn, exposed the weaknesses of susceptible emerging markets. Argentina and Turkey, which are operating at large current account deficits due to a lack in foreign direct investment, experienced a currency crisis and a significant decline in asset prices.

Fund manager Péter Varga on the Erste Bond Emerging Markets Corporate

These factors led to a generally worse sentiment vis-à-vis emerging markets and to outflows of retail investors – although less so than expected. "The sizeable fluctuations of bond prices last year brought about good investment opportunities, even in countries such as Turkey and Argentina. It was the year of active investors," says Varga.

Do not overlook the positive trends

There are numerous positive developments: after the presidential elections in Brazil, plans are for a much-coveted path of reforms to be taken by the new government. Investors responded with a rally. In South Africa, we can see first positive steps towards reform, and prior to the deteriorating rivalry with the USA, China was in the process of transforming its economy towards growth that was based on technology, sustainability, and higher domestic demand.

While the rising US dollar was challenging for some countries, there was no contagion. "Many emerging economies have low debt levels, increasingly resort to local currency to finance themselves, and are thus in a good position. Also, the long-term economic growth prospects for the emerging economies are still positive, with capital flowing in again," as Varga points out.

Where are the most interesting companies based?

Investors are faced with a number of important questions, whose answers may continue to drive the performance in 2019. Historically, emerging economies have always been tied to the development of the global economy in addition to the US dollar. In recent years, they have become a driver in their own right. In China, where the economy has slowed down slightly and the trade tariffs are burdening the sentiment, the government has taken clear stimulus measures such as tax cuts and looser lending.

“We are interested in Chinese high-yield bonds in the residential building sector. In Brazil, companies in the high-yield sector can benefit from an economic upswing. In Mexico, we can see industrial and real estate companies which have become attractive due to the political steps of the new government. Of course, we are constantly monitoring the markets for opportunities, and this also includes defensive sectors with stable demand such as telecoms companies like Turkcell in Turkey,” explains Varga.

What parameter(s) create performance, and what sort of expertise is crucial?

Basically, very active managers who react quickly to new situations and are close to the market can protect the capital entrusted to them by their clients best in this volatile environment and avoid losses during sell-offs. Active management can also react flexibly to market frictions such as for example liquidity shortages. Also, the margin of safety, which is the differential of the undervaluation of selected companies and their actual, intrinsic value, constitutes an additional risk puffer. Excellent active management is therefore always also lived risk management.

Especially in asset classes like emerging markets bonds, the track record of expertise shown by niche providers relative to global firms is often an advantage. “Since ERSTE BOND EMERGING MARKETS CORPORATE was floated ten years ago, we have achieved a return of 9.8% p.a. Given this track record, we as fund managers have been awarded multiple times, for example the Lipper Award. We are the clear leader in our peer group as of the end of December 2018 with regard to 1Y, 5Y, and 10Y,” as Varga concludes.

INFO:

ERSTE BOND EMERGING MARKETS CORPORATE invests globally in corporate bonds from emerging economies, allowing investors to participate in the growth opportunities in these up-and-coming markets. The foreign exchange risks relative to the euro are largely hedged, and local currencies account for a maximum of 10% of assets under management, which currently amount to EUR 370mn (as of 30 December 2018). The Morningstar rating compares the historical performance of funds with similar investment goals across Europe.

The fund management team in charge manages almost EUR 1.5bn in corporate bonds from the emerging markets (N.B. mutual funds and institutional mandates).

Legal note:

Prognoses are no reliable indicator for future performance.

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