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Emerging Markets corporate bonds: sustainability turns into a factor of success for investments

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- **Corporate bonds from emerging markets: environmental focus and calling out companies on their sustainability efforts are turning into success factor**.

Several emerging countries, especially those in Asia, emerged stronger from the corona crisis. Countries like China have overcome the corona crisis comparatively well. China's gross domestic product (GDP) grew 2.3% in 2020 according to the Chinese statistical office, making it the only nation with positive growth in 2020 among the world's major economies.

The growth recovery was broad-based, led initially by investments and exports. A trend that will continue in 2021. The International Monetary Fund (IMF) assumes that China could grow by over 7 percent this year. "*Many industries are benefiting from China's upswing and the appetite for raw materials*," emphasizes Péter Varga, Senior Professional Fund Manager at Erste Asset Management Management and lead manager of the flagship fund ERSTE Bond Emerging Markets Corporate. "*Since the beginning of the year, China has been buying twice as much oil as the 4-year average. Partly to satisfy the economy and partly to replenish its reserves and stocks.* "

Senior Professional Peter Varga on our approach regarding emerging markets

Appetite for raw materials

In addition, China is investing heavily in the industries of the future. It starts with autonomous driving and ends with renewable energy. The reason behind this is very clear for Varga: to reduce the future dependence on liquefied natural gas and supplies of crude oil from abroad. The country's gigantic energy needs are to be increasingly met by nuclear, solar or wind energy in the future. The share of renewable energies in total consumption is currently just over a quarter (2019) and increasing. According to Varga, high-tech new economy companies such as Tencent have benefited enormously from the domestic upturn. "*In this sector as well as with the technology suppliers, we have taken profits, because here you can hardly find large risk premiums on bonds, the companies have built up enormous cash reserves*."

One trend is clear: companies that focus on sustainability and renewable energies and technologies have the best prospects, but it is important to note in this context: precise analysis and an assessment within a realistic framework is needed. "*Because this is where the wheat is separated from the chaff*," says fund manager Péter Varga. After all, bonds rise and fall with the economic successes and failures of the issuers.

When choosing a company, intensive analysis is crucial. "*While it was initially structurally important sectors such as food production or telecommunications that benefited particularly, classic industrial companies now also offer opportunities*," explains Varga. This primarily refers to so-called "brick an mortar" companies, i.e. those that not only provide digital goods and services, but are also active in traditional areas such as the chemical industry, mechanical engineering, the electrical industry and the paper sector. Varga cites the Brazilian paper manufacturer Klabin as an example, which is benefiting from the strong packaging and pulp price trends.

ESG factors relevant for companies in emerging markets

Traditional sectors are also going through changes. ESG- (environmental, social, governance) based sustainability factors have become mainstream and continue to go from strength to strength: both the new US President Joe Biden and the EU Commission headed by Ursula von der Leyen have presented ambitious plans on CO_2 neutrality and a more sustainable economy.

New regulations in the field of sustainability such as the planned CO_2 import duty or the plans concerning hydrogen business will have effects on the corporate sector in the emerging markets. The green economy is driven by new investments and the political will of heads of state and government. An example of how one can benefit from the trend is shown by Ukrainian steel producer Metinvest that profit from the demand for iron ore pellets (because they allow for lower CO_2 content in steel production).

"*Companies operating in the area of renewable energy and, for example, recycling will benefit from this wave. With traditional industries, analysis and engagement, i.e. the way we convince companies to engage with sustainable strategies, are crucial*," says Varga. Erste Asset Management's in-house sustainability team managed to set up a dedicated internal sustainability rating with the Brazilian chemicals producer Unigel. "*This provides us the opportunity for our ESG Funds to invest in the company. This is where alpha is created*," concludes Varga.

About ERSTE BOND EM CORPORATE

ERSTE BOND EM CORPORATE invests in global emerging markets corporate bonds. Investors can thus participate in the growth opportunities of these markets. Foreign currencies largely hedged against the euro. The fund currently has around EUR 630mn worth of assets under management (as of 26 February 2021).

Our successful track record has earned us multiple awards as fund managers. Most recently, we have received the Lipper Award and the 1st Prize from the German trade magazine *€uro* and *€uro am Sonntag*.

Legal note:
Prognoses are no reliable indicator for future performance.

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