Vontobel

Monthly commentary / 31.07.2020
Vontobel Asset Management

Vontobel Fund - Sustainable Emerging Markets Local Currency Bond

Approved for institutional investors in: AT, CH, DE, ES, FI, FR, GB, IT, LI, LU, NL, NO, PT, SG (Professional Investors only)

Summary

- The biggest individual stories in the emerging market world this month were, in our view, Argentina and Ecuador reaching final restructuring deals with bondholders
- Flows were skewed towards hard-currency funds once again while the local-currency funds that we track lost approximately 1.7 billion US dollars in assets under management
- Fund's assets increased in July, and performance was higher than the reference index
- Emerging market local bonds have significantly lagged the rally since the end of May and valuations are now particularly attractive

Market developments

July was quite a positive month for a broad range of assets. Highlights of the month were: intensifying US-China rift, mainly in the political domain (apex so far being a Secretary of State Pompeo's speech); COVID-19 evolution being still negative in the US (and elsewhere), but showing meaningful signs of improvement by the end of the month; EU package of 750 billion finally being approved; and weak US dollar driving commodities soaring (gold, notably, first time above 2,000 US dollars per ounce and almost all mining commodities also up). The world continues to grapple with the pandemic and the second wave has crippled part of Europe, bringing new border closings in parts of the continent, but the vaccine progress was helping support the market, as well as the central banks' clear positive signals, the US Federal Reserve turning (even more) dovish. Oil crawled up slowly this month and finished at near 44 US dollars per barrel (Brent), the highest since the notorious March OPEC+ meeting. That is, despite OPEC+ quota cut phase-out starting from August 1, which speaks to a balanced market.

The biggest individual stories in the emerging market world this month were, we believe, Argentina and Ecuador reaching final restructuring deals with bondholders. The long haggling of the former with the holders amidst a lot fanfare contrasted to a rather modest bargaining in Ecuador's case. Ultimately, Argentina's owners get around 55% recovery and Ecuador's 60% (with a commitment of a fast International Monetary Fund program) and turn a page in this long chapter. In Malaysia, previous Prime Minister Najib Razak was indicted on corruption charges and sentenced to 12 years, whereas the government settled with Goldman Sachs a related high profile 1MDB case. If, as rumored, Malaysia also settles the fight with the UAE funds, it could be another important and historic positive. Russia has reached a rather historic ceasefire with Ukraine in the east of the latter, seemingly, far from the final one, but the progress is notable. Belarus at the same time is preparing to its August 9 presidential elections, cracking down harshly on the opposition leaders and stoking tensions with the long-time friend Russia over intervention. In Ivory Coast, the death of a front-runner in the upcoming presidential elections (aka then-current Prime Minister) could further polarize the already charged political environment, possibly stirring the incumbent to controversially run for the post for the third time in a row. Egypt saw geopolitical risks increasing on two fronts – in Libya over possible intervention in the western neighbor's borders, as well as with Ethiopia over a major hydropower plant, which is highly sensitive over access to the Nile's waters. Chile adopted a controversial bill, allowing people to withdraw 10% of their pensions early, a drag on the country's prized pension system. In Poland, the incumbent Andrzej Duda has narrowly won the presidency for another five years. In the Dominican Republic the opposition leader Luis Abinader has unseated the incumbent, though, rather expectedly by the markets. No major shift is expected on the economic front in both cases. Suriname reached a consent of bondholders of one of the bonds to defer an amortization and Belize did similar to its next three coupons. Negatively, El Salvador lost its market-friendly finance minister to the one viewed more as a political person.

Flows were skewed towards hard-currency funds once again (+3.6 billion US dollars according to EPFR data) while the local-currency funds that we track (UCITS funds listed in Luxembourg and Dublin + ETFs) lost approximately 1.7 billion US dollars in assets under management. With this background, external spreads continued to tighten, EMBI GD – from 475 basis points to 440 bps and CEMBI BD – from 440 bps to 410 bps. It is however surprising in this context that local-currency funds did not attract fresh money despite their strong performances. The GBI-EM GD index was up 3.02% in July, with local yields tightening by 15 bps and EM currencies up 2% vs. the US dollar.

Portfolio review

Fund's assets increased by 6.3% in July, fading the negative tone in local currency fund flows. Most of the trades of the month were again curve and security arbitrages, especially in Argentina, Poland, and South Africa. In addition, we increased exposure to select currencies (mainly Malaysia and Zambia) where, for completely different reasons, valuations have become somewhat attractive.

By country split, Latin America remained the largest exposure (34.5%), followed by Central & Eastern Europe (20.6%), Asia (19%) and Africa (12%). Positioning in frontier markets was slightly down to 15.7% of the portfolio, while exposure to reserve currencies (via cash, bonds and FX forwards in US dollar, euro, and Japanese yen) was reduced to 10.9%.

Performance analysis

In July, the fund performed significantly better than its reference index (GBI-EM GD). Main positive contributors were Argentina, Russia and Turkey (both excluded by our ESG filter), Malaysia and Peru. On the other hand, and to a lesser extent, our policy in Central Europe and Chile contributed somewhat negatively.

Outlook

Sri Lanka will see its parliamentary elections on the August 5 and Belarus its presidential election on August 9. Presidential elections in the US are drawing closer by the day, keeping many controversial political and geopolitical topics in focus potentially, as a possible menu for President Trump. China, Iran, Venezuela, Russia, EU, and North Korea are in the long list of his beloved targets. Progress on the vaccine front will also be important to watch, as several pharma consortiums claim to be in a very advanced stage by now.

August is widely known for being a month of major surprises for the world and financial markets, but arguably, the biggest surprise of 2020 would actually be a smooth ride. With the US dollar seemingly poised for further weakness (assuming increasing risks of the elections, no major recovery in public health, or re-pricing of lower-for-longer Treasury rates), emerging markets should see continued focus from global investors, in our view. Emerging market local bonds have significantly lagged the rally since the end of May and valuations are now particularly attractive. We believe the stars will stay aligned as long as developed market stimuli are still in place, US dollar liquidity remains and commodities keep booming. We hope this environment would encourage global investors to top up their emerging market allocations, as busier autumn months near.

Performance (in %)

Net returns			Rolling 12-month net returns			
USD	Fund	Index	Start date	End date	Fund	Index
MTD	3.9	3.0	01.08.2019	31.07.2020	0.6	-0.8
YTD	-0.8	-4.1	01.08.2018	31.07.2019	4.1	8.0
2019	9.5	13.5	01.08.2017	31.07.2018	-1.7	-2.5
3 years p.a.	1.0	1.4	01.08.2016	31.07.2017	7.4	8.0
5 years p.a.	3.0	3.5	01.08.2015	29.07.2016	4.9	5.3
10 years p.a.	n/a	n/a	Index: J.P. Morgan GBI EM Global Diversified Composite USD			
Since launch p.a.	0.2	0.9				
Launch Date		25.01.2011	Share class: I ISIN: LU0563307981			

Past performance is not a reliable indicator of current or future performance. Performance data does not take into account any commissions and costs charged when shares of the fund are issued and redeemed, if applicable. The return of the fund may go down as well as up due to changes in the rates of exchange between currencies.

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Past performance is not a reliable indicator of current or future performance.
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