Monthly commentary / 31.08.2020
Vontobel Asset Management

Vontobel Fund - Emerging Markets Debt

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

Market developments
August was very kind to risky assets. As the COVID-19 statistics out of the US started to materially improve, the authorities kept supporting the economy. Trump's economic support via executive order, despite lack of congressional consensus on the Phase IV and Powell's Jackson Hole speech (adopting average inflation targeting etc.) both pushed US Treasury rates and equity markets higher. Ten-year rates are up 20 basis points on a month, at 75 bps currently, while S&P 500 is beating new highs – at 3500 now. Despite a resurgence of new COVID-19 cases across Europe, death counts remain very modest, but the countries continue to maintain soft lockdown measures. Certain major EM countries also saw pandemic peaks (officially) passing. Industrial metals were largely stronger, gold price moderated (below 2000 US dollars per ounce again), while Brent was range-bound (44-46 US dollars per barrel) despite OPEC+ cut tapering formally starting on August 1.

On a geopolitical level, the US led a two-pronged approach. Hawkishly, it kept pressuring Iran via an attempted UN sanctions snapback (failed), haggled with China in the South China Sea (adding a few companies to the sanctions list). At the same time, in an epochal development, the US has promoted establishment of diplomatic relations between Israel and the UAE (the third Arab country ever to do so). Hong Kong legislative elections were postponed by a year.

In EM-specific headlines, there was no lack of big developments, but not of the shocking type August is known for. As one, Belarus presidential elections, that resulted in a formal landslide for the incumbent Lukashenko. The protests are still ongoing, if fading, and now is another cause of disagreement between the EU and Russia. Argentina and Ecuador both settled their respective debt restructuring processes with close to 100% execution by volume. On the back of it, Ecuador has already agreed a higher-than-expected IMF program and Argentina has started negotiations on its own program too. In Mexico, AMLO's attacks against prior political leaders continues, as compromising video tapes were uncovered. Unexpectedly, however, another video of AMLO's own brother has also surfaced. Turkey has found a new large gas field in the Black Sea and, independently, its geological search in the East Med continued, causing a major diplomatic fight with several EU members, including Greece and France. In South Africa, President Ramaphosa managed to strengthen his support within the ruling party, although his reform push has not progressed much in the past few months. Sri Lanka parliamentary elections solidified the position of the president Rajapaksa, as his brother led a party to win a landslide majority. In Lebanon, a big explosion in a port led to a humanitarian catastrophe and brought about major protests that kicked out the country's government. The new one, introduced end of month, seems to be in an equally weak position, however, so prospect of an IMF program is tough.

August saw continued decent inflows in EM fixed income (3.6 billion US dollars in hard currency, and 1.5 billion in local currency, according to EPFR data). The primary market was also strong, which is highly unusual for August, when typically only sporadic and small deals happen. That underlines the strength of the market, especially its high yield part – the spreads across both sovereigns and corporates drifted lower. EMBI GD is down from 440 to 422 bps on a month, while CEMBI BD – from 410 to 388 bps.

Portfolio review
While the market turned risk-on towards the end of the month, we reallocated some of our high yield bets. In Africa, we reduced the overweight in Tunisia as it has been struggling to form a lasting government. We sold some Senegal bonds after it outperformed most of its peers. In return, we diminished our underweight in lagging Egypt and Ghana. Exposure to Africa remained roughly flat over the month. In the Gulf Coast countries we switched from Oman into Bahrain, and from Saudi Arabia to UAE. In Ecuador, the bond exchange was accepted and settled after the awaited announcement of a substantial 6.5billion US dollar IMF program. The combination of new Ecuador bonds is valued considerably higher in the portfolio, leading to a boost in performance. Elsewhere, the exchange of Argentina bonds reached the necessary acceptance levels to exchange 99% of bonds (leaving a few minor holdouts). While we held bonds in euros, we opted for new US-dollar bonds in the exchange as they offer better value. A break-even valuation would require the euro yield to trade 75 bps inside the US-dollar yield, which we believe is

very unlikely to happen anytime soon. Accordingly, most euro investors chose new US-dollar bonds in the exchange, which limits the size and thus liquidity of the new euro-denominated bonds.

Performance analysis

The fund outperformed its reference index by 1.59% (net, I share class) this month. The outperformance is partly inflated due to the exchange of Ecuador bonds. The higher valued, new bonds were delivered in August into the portfolio, while the reference index deferred the booking to September. On an individual level, we captured performance in Ukraine after GDP warrants rallied when the government allegedly swept up 10% of the outstanding paper. Other contributors to the outperformance were Ivory Coast, Tunisia, and El Salvador, where the portfolio sustains an overweight. Although we missed some performance in Turkey and Sri Lanka.

After moving in lockstep in July, high yield (HY) assets resumed the outperformance of investment grade (IG) in August. That helped performance, as the portfolio sustains an overweight in HY. We continue to see value there, as HY still shows a significant underperformance versus EM IG as well as US HY. Elevated spreads in EM HY are partly justified with many idiosyncratic risks still present; nonetheless, we believe there is room for further compression.

Outlook

US presidential elections enter the most active phase. The end-September budget deadline is nearly guaranteed to spill into an eleventh hour partisan battle, particularly around the Phase IV stimulus package post-pandemic. The gap between the two major parties remains quite big. Further progress on the vaccine is also important to watch, as several candidates have emerged as close to being in a final phase of testing. The EU Summit on 24-25 September may decide to impose sanctions against Belarus and Turkey for the August developments (see comment above). In Ukraine, an IMF review and the subsequent disbursement were anticipated in September, which could be delayed though, given that not all objectives (e.g. central bank independence and anti-corruption) seem fully achieved yet. Elsewhere, we are closely watching the presidential race in Ivory Coast with elections coming up in October.

More broadly, as we enter a quasi ‘back-to-office’ month of September (well, its COVID-era version, at least), especially following the comforting stabilization narrative of Powell (lower-for-even longer), we believe that EM bonds are in an attractive position. Relative spreads are still high, especially high yield versions of both sovereign and corporate JP Morgan benchmarks, if one looks versus pre-COVID period. Investment grade bonds, which have already enjoyed a major rally, a lot affected by longer duration, seem to have much less juice left.

Performance (in %)

Net returns			Rolling 12-month net returns			
USD	Fund	Index	Start date	End date	Fund	Index
MTD	2.1	0.5	01.09.2019	31.08.2020	1.4	2.7
YTD	-1.9	1.4	01.09.2018	30.08.2019	11.6	13.8
2019	14.8	15.0	01.09.2017	31.08.2018	-4.2	-3.4
3 years p.a.	2.7	4.1	01.09.2016	31.08.2017	10.2	5.0
5 years p.a.	6.7	6.3	01.09.2015	31.08.2016	15.8	14.2
10 years p.a.	n/a	n/a	Index: J.P. Morgan EMBI Global Diversified			
Since launch p.a.	4.7	4.7				
Launch Date		15.05.2013	Share class: I			
			ISIN: LU0926439729			

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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Vontobel Asset Management AG
Gotthardstrasse 43, 8022 Zürich
Switzerland
T +41 58 283 71 11, info@vontobel.com

vontobel.com/am