Monthly commentary / 31.08.2020
Vontobel Asset Management

Vontobel Fund - Emerging Markets Corporate Bond

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

Summary

- The fund outperformed the reference index in August.
- The fund kept the same average rating of B+
- We see increased appetite for the markets to go into stories that previously stayed under the radar
- Relative spreads remain high, especially in both sovereign and corporate high yield

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 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

In August, the fund saw minor outflows, more than compensated for by the positive performance, so the overall size increased slightly – from 1.30 billion US dollars to 1.32 billion. The fund kept the same average rating of B+ and main the parameters did not change materially. Yield to maturity is lower from 14.1% to 13.6%, on the back of positive performance, however current yield is nearly flat at 8.0% (from 8.1% a month ago). We have further reduced our exposure to event-driven stories, now at 19%. That said, we did add certain new events, such as a sovereign and a corporate in Belarus, following bond drop. In general, we have increased the weight of BB and BBB stories, while reducing B and CCC names. We also made several switches within higher-grade names, such as within Sasol curve and within Dubai-based quasi-sovereigns. Besides, we were continuously reducing smaller, less liquid bonds, where the rally justified fixing positions.

Among major EM markets, we have somewhat reduced China, Mexico, and Turkey exposure, but added in the UAE, Oman, Argentina, and Indonesia. We also increased our exposure to Israel via a single primary deal – Leviathan – which we believe is underrated for the underlying credit quality.

Performance analysis

The fund has outperformed the reference index in August. The fund had a return of 2.51% while the reference index returned 0.90%. Given the broad-based risk-on sentiment and fund's higher exposure to lower-rated names. We certainly see increased appetite of the markets to go into stories that previously stayed under the radar for different reasons. Thus, Stoneway, an Argentine electricity producer, performed well in August, following Argentina's announcement of reaching an agreement with its bondholders. This in itself is, of course, a positive event for the all country's bonds, corporate or sovereign. However, until this moment Stoneway was disproportionately punished, even adjusting for its restructuring process. Another example is Indian non-bank financial company Indiabulls, which was recovering already before, leaped this month for no obvious reason. There were also several individual names, which distracted from the positive performance this month, but smaller in magnitude and in number. We believe this was not driven by any particular credit events in these names.

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).

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 the 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	2.5	0.9	01.09.2019	31.08.2020	1.0	6.0
YTD	-3.2	3.1	01.09.2018	30.08.2019	13.3	10.9
2019	15.6	13.1	01.09.2017	31.08.2018	1.3	-1.5
3 years p.a.	5.0	5.0	01.09.2016	31.08.2017	13.4	5.6
5 years p.a.	n/a	n/a	01.09.2015	31.08.2016	n/a	n/a
10 years p.a.	n/a	n/a	Index: JPM CEMBI Broad Diversified			
Since launch p.a.	10.1	6.3				
Launch Date		13.11.2015	Share class: I			
			ISIN: LU1305089796			

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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