Vontobel

Monthly commentary / 30.06.2020
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)

Market developments
June was at first mostly a continuation of the large-scale market recovery. The medical situation was stabilizing in advanced economies and other hotspots and the massive stimuli provided by the global central banks/fiscal authorities continued to fill the market with cheap liquidity. Risk assets gained big time – the US dollar was at its weakest (on average) since 1Q19, the S&P 500 briefly touched levels from early January (aka before COVID-19), emerging market bond spreads tightened 50-60 basis points. Second half of the month, however, saw the long-feared 'second wave' capture first the US and later many other major countries, as the restrictions were gradually being lifted. Despite this, markets did not seem to price another big lockdown (at least so far) and stayed stable to firm. Equities in the US and EM bonds became range-bound. Throughout June, the price of oil continued its steady recovery, as lack of full discipline among OPEC members in May prompted Saudi Arabia and Russia to tighten the screws and, thus, bring compliance with quotas to nearly 100%; US demand pick up, to a large extent, and the country's shale industry shedding supply helped as well. Brent finished June 16% (41 US dollar per barrel) and WTI made first attempts to break above 40 dollars per barrel since the notorious March 6 OPEC meeting. Other commodities were stable to strong, large positive outlier being copper, thanks to a dire health situation in Latin America. In another important development globally, polls turned to increasingly predict President Donald Trump's loss in November elections for the first time. To date, this did not seem to disappoint the markets, against the common wisdom.

China's imposition of a strict National Security Law in Hong Kong at the end of June stirred a major geopolitical backlash from the US (prompting certain sanctions against the city-state and China as well) and other 'Western' countries. Separately, China had a border dispute with India, which led to a certain tit for tat, so far not too disruptive for the markets. In Russia, a referendum passed the constitutional changes, among most important of which is allowing President Vladimir Putin to stay in his post until 2036. Another central bank governor resigned in Ukraine, illustrating the political pressure the role implies and the rough path International Monetary Fund reforms could face. The move follows a recent disbursement from the newly established IMF program and caused a rare cancelation of the new Eurobond issuance that happened the same day. Argentina still has not reached an agreement with its bondholders, although seems to have progressed in terms of expected terms. Ecuador also started practical negotiations with bondholders. In Poland, the incumbent President Andrzej Duda won the first round, but still needs to prove he can prevail in the run-off. Continuing deterioration of fundamentals led to downgrades of India (by Moody's, now at Baa3/BBB-/BBB-), Oman (by Moody's, now at Ba3/BB-/BB), and Costa Rica (by S&P, now at B2/B/B). On the opposite side, Moody's has upgraded Ukraine to B3 (B/B from the other two agencies).

Primary market was active, with June seeing 37 billion US dollars of new paper in the EM ex China, in line with May, and stronger than Junes of the past three years. An inflow of 4.6 billion dollars into EM hard-currency funds (EPFR data) was nearly in line with January, itself the strongest month since August 2019. Such a combination likely indicates a more balanced supply/demand picture, compared to prior months, when inflows were more moderate, and therefore fund managers rather reduced their cash positions. EMBI GD spread is at 475 bps and CEMBI BD at 440 bps, compared to nearly 300 bps for each early in 2020.

Portfolio review
In June, the fund saw another month of inflows, overall size increasing from 1.13 billion to 1.24 billion US dollars, driven by a mix of performance and net inflows. The fund's cash holdings have not changed materially now at 3.2% (vs 4% month ago). Positive performance led to the decline in both headline yield to maturity (from 15.4% to 14.0% currently) and current yield (from 8.8% to 8.1%) numbers.

A solid rally in May/early-June made us somewhat cautious toward the general market, so the fund has shifted to higher-quality names, including via those rare primary issues that, in our view, had value left after the book-building process. We also reduced exposure to certain of our energy names, more out of risk management considerations, even if we are still positive on oil prices

(Pemex, Ecuador as two examples). We also continued to trade airline bonds, still mindful of potential risks, so with large degree of diversification within the sector.

Of the specific major market exposures, we have reduced our weight in Indonesia (mainly high yield), Brazil and the UAE (cross over in both cases), and added somewhat to Mexico and higher-rated issuers in Saudi Arabia and Peru.

Overall, weight of event-driven stories stayed unchanged at 22.5%. The average portfolio rating is still B+. We have to acknowledge difficulty of maintaining it, given numerous downgrades across markets and credits (see market comment above), but the fund's objective is still to maintain reasonable quality.

Performance analysis

The fund has outperformed the reference index in June. The fund had a return of 7.10%, while the reference index returned 2.75%. The outperformance has been broad-based within the portfolio, but energy sector had a somewhat higher impact, given how impressive the oil price rally has been. Higher-beta oil producers like Peru LNG and GTE were some of the single-largest contributors. Another pocket of performance has come from some idiosyncratic stories, such as Tianqi Lithium or Aeromexico. The only major distraction from an individual story this month came from Indonesia's Bumi Coal, as the coal price did not rebound with the rest of the commodities and technicals were defining trading in this specific name. Country-wise, China, Angola, and Brazil were the largest outperformers.

Outlook

July being a mid-summer month and a holiday season, we do not expect many major events to take place. The focus will undoubtedly be on the evolution of the second (or, for some countries, still first) wave of the coronavirus and whether it leads to renewed lockdowns. US election polls could drive the actions of the Trump administration on many fronts, including most importantly Sino-US trade agreement. Whether a major infrastructure plan in the United Stated is indeed conceived could matter for the commodities big time. July is also the last month of maximum OPEC+ cuts (at 9.7 million barrels of oil equivalent per day), which step down afterward, potentially affecting supply and demand balance. On the geopolitical front, the Libyan war continues with ceasefire being a fragile possibility. Israel, so far, has delayed its plan to annex a large part of Palestine settlements, but could also surprise. Dominican Republic has its first round of presidential elections on the July 5 (delayed from March due to COVID-19).

Emerging market yields have contracted a lot since March peak of 8%, currently at 5.5%. While some may view this as somewhat too low, given the medical situation still far from ideal, (near-)zero yields in the developed market world, still warrant close attention from global investors.

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Performance (in %)

Net returns			Rolling 12-month net returns			
USD	Fund	Index	Start date	End date	Fund	Index
MTD	7.1	2.8	01.07.2019	30.06.2020	-4.7	3.7
YTD	-7.1	-0.2	01.07.2018	28.06.2019	14.1	10.2
2019	15.6	13.1	01.07.2017	29.06.2018	5.0	-0.1
3 years p.a.	4.5	4.5	01.07.2016	30.06.2017	16.5	6.8
5 years p.a.	n/a	n/a	01.07.2015	30.06.2016	n/a	n/a
10 years p.a.	n/a	n/a	Index: JPM CEMBI Broad Diversified			
Since launch p.a.	9.5	5.8				
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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Vontobel Asset Management AG
Gotthardstrasse 43, 8022 Zürich
Switzerland
T +41 58 283 71 11, info@vontobel.com

vontobel.com/am