Vontobel Fund – Emerging Markets Debt

Market developments

June was a typical "sell the news" month after "buying the rumor" in May, though risk appetite remains elevated. Following a strong May rally (+4.4% month-on-month), in anticipation of a US-Iran deal, global equities (MSCI World) corrected 0.72% in June, after the US and Iran signed a memorandum of understanding that is poised to lead to a peace deal eventually. Importantly, oil flows through the Strait of Hormuz started to recover rapidly through June, even before the preliminary agreement was signed, and are estimated at about 8.7 million barrels per day (mbd) as of the third week of June. That is still significantly lower than the roughly 20 mbd that used to flow prior to the war but about triple the average daily volume that passed in May. Brent oil prices declined by 20% toward the low USD 70s per barrel in June. Metal commodities corrected by 7.5%, although copper outperformed, dropping by just 3.02%.

Much of the action in fixed income was driven by core rates, which were boosted by two opposing narratives. On the one hand, the inflation shock has so far been less severe than feared. Combined with a sharp decline in oil prices, it capped the upward pressure on core yields: US 10-year Treasury yields ended the month 3 basis points (bps) higher, at 4.465%, while 10-year Bund yields fell 8bps to 2.86%. In the euro area, German and French consumer prices declined by 0.3% and 0.2%, respectively, according to preliminary data, which brought the year-on-year (y/y) inflation down to 2.3% (from 2.6%) and to 1.8% (from 2.4%), respectively. We have also seen signs of weaker inflation in Eastern Europe and other emerging markets (EM). In Poland, y/y inflation dropped from 3.1% to 2.5% in June, while in Mexico, the bi-weekly y/y inflation fell to 3.6 (from 3.8%) during the first half of the month. On the other hand, the markets have read Kevin Warsh's first meeting as the new Fed chair as hawkish and are now pricing in a higher probability of an interest-rate hike by September or October.

EM fixed-income indices performed well this month, outperforming global equities and global aggregate fixed income.

EM hard-currency sovereign bonds (EMBIG Div) rose 0.72%, led by the high-yield (HY) segment that rose 0.97%, while its investment-grade (IG) counterpart rose 0.45%. Latin America (+1.0%) and EM Europe (+0.95%) outperformed other regions, while the Middle East (-0.04%) lagged.

Three South American countries topped June's performance. Bolivia (+4.75%) recovered strongly, having underperformed after the issuance of the new 2031 bond in early May. The country's protests have finally faded, and the central bank has devalued the boliviano by almost 40% after running a fixed (and increasingly overvalued) exchange rate since 2011. This is seen as a positive move toward obtaining an International Monetary Fund (IMF)-supported program and exiting the slow-motion balance of payment crisis the country has been in for so long. But the country still needs to implement a large fiscal adjustment, and the political support for these necessary, albeit painful, appear to be very low. Colombia (+3.54%) was the second-best performing sovereign, following the victory of right-wing candidate Abelardo de la Espriella in the runoff presidential election. Argentina (+3.65%) was the third-best performing country. Its sovereign spreads compressed after S&P upgraded the country's rating to B- (the second B- rating in addition to Fitch's unsolicited B-), and the government secured a USD 2 billion loan from the World Bank, and another for USD 550 million from the Internamerican Development Bank. These multilateral loans, plus a larger trade surplus (driven by higher oil prices and higher oil production), are allowing the country to repay its Eurobond maturities this year without having to refinance in the markets, adding technical support to bond spreads.

Sovereign credit rating upgrades continued. Apart from Argentina (upgraded to B- by S&P), Uzbekistan was upgraded to Ba2 by Moody's reflecting sustained improvements in the country's institutional and policy framework.

The oil-related sovereign performance. Fragile, oil-importing countries performed well in June after the decline in oil prices – Sri Lanka (+3.95%), Pakistan (+2.70%), Kenya (+2.15%) – while oil-exporting countries underperformed. Venezuela (-3.90%) saw the worst performance of the month, after a Financial Times article reported that the total debt stock to be restructured is likely to be significantly higher than initially estimated, which would likely result in lower recovery values. HY oil exporters Gabon (-1.81%), Angola (-0.60%), Nigeria (-0.55%), and Cameroon (-0.83%) were among the worst performers, although they remain among the best-performing year-to-date, and are still in a much better financial position today than before the war.

Portfolio review

We maintained the fund's average credit risk at BB+, consistent with the benchmark rating. We moved exposure from Africa to Latin America. The United Arab Emirates is now out of the fund's benchmark after the fourth and final reduction in exposure, given the country exceeded the benchmark's wealth criteria for several years. The country's exclusion significantly reduced the fund's underweight in the Middle East over the last few months. We believe that many bond valuations in the UAE still look relatively attractive given their issuer's high credit quality, hence, we kept the bulk of the exposure despite the benchmark exclusion. However, we reduced some exposure to the Emirate of Sharjah, and some relatively expensive quasi-sovereign bonds in Abu Dhabi. In Africa, we reduced exposure to sovereign bonds of Cameroon, Kenya, Morocco, South Africa, and Zambia. In Latin America, we mainly increased exposure to Brazil, Ecuador, and Mexico. In Argentina, we bought short bonds in local law that offer an attractive spread premium versus foreign law bonds. Elsewhere, we increased corporate bond exposure in Türkiye. We increased quasi-sovereign exposure in Indonesia in the primary market. Overall, we achieved a slight improvement in the portfolio's credit quality. This was supported by the reduction in the overweight to HY bonds, as well as the credit rating upgrade of Argentina from CCC to B.

Performance analysis

The fund outperformed its benchmark by 0.22% in June (net, I share class). The main contributor to relative performance was the overweight in Colombia, and our preference for the state-owned oil and gas company Ecopetrol. The overweight in Argentine sovereign bonds and the selection of corporate bonds in Mexico contributed positively as well. The fund profited from not having any exposure to Venezuela, where bond prices moved lower due to a combination of negative developments: Lower oil prices impairing export revenues, the delayed publication of government debt composition, and the earthquakes. The overweight in the Republic of Congo contributed negatively, bond spreads widened, factoring in lower oil prices, given the country's high export sensitivity. For similar reasons, there was pressure on bond prices of Cameroon and Gabon. Given the small underweight position, and defensive bond selection, the portfolio could not fully capture the performance of Ukrainian bonds.

Outlook

The US and Iran have come to preliminary agreement, with a full peace deal still pending, and the conditions under which commodities and other merchandise will transit through the Strait of Hormuz are not yet determined. However, trade flows have been recovering at a good pace, roughly tripling through the first three weeks of June. We believe that further trade disruptions are possible, which would result in upside risk for oil prices and inflation. But in the unlikely event of a return to full-blown war, the market reaction to such risk events would probably be more muted than the already sanguine reaction of the last few months, in our view. So far, inflation has been much tamer than in 2022 despite the similarity of the oil shock. Less expansionary fiscal policy, tighter monetary policy, lower savings rates at a global level, and less tight labor markets may all have contributed to a slower pass-through. Moreover, oil prices have come down by roughly 40% in the last two months, and lower-than-expected inflation data coming from Eastern Europe and other EM countries suggest that this inflation cycle will likely be much more short-lived than in 2022. That would bode well for fixed income, particularly via local-currency rates.

Risk appetite remains elevated, and we believe this will likely remain the case over the summer. EM hard-currency sovereign and corporate spreads are now back to the early February pre-war levels. Therefore, upside coming from spreads is now probably more limited on aggregate, but there are still plenty of relative value opportunities, in our view. Fundamentals appear strong and did not deteriorate significantly with the war shock. In fact, the ongoing credit rating upgrade trajectory for EM sovereigns has continued in Q2 2026. Although there have been a couple of downgrades due to fiscal concerns (Mexico and Colombia), the upgrades have outpaced them by far: Argentina received to upgrades to B-, South Africa and Uzbekistan got their third BB equivalent rating, Maldives avoided default and was upgraded to CCC-, Nigeria and Ghana were upgraded to B by S&P and Fitch, respectively, and the Bahamas obtained its third BB- equivalent rating. Thus, we believe that tight spreads are here to stay for longer.

Fund characteristics

Fund name	Vontobel Fund – Emerging Markets Debt
ISIN	LU0926439729
Share class	I USD
Benchmark	J.P. Morgan EMBI Global Diversified Index
Inception date	15.5.2013

Historical performance (net returns, in %)

Time period	Fund	Benchmark
MTD	0.9%	0.7%
YTD	4.6%	3.3%
1 year	12.8%	11.8%
3 yrs p.a.	14.3%	10.3%
5 yrs p.a.	4.3%	2.6%
10 yrs p.a.	5.1%	3.7%
ITD p.a.	4.7%	3.8%

Time period	Fund	Benchmark
2025	14.9%	14.3%
2024	13.8%	6.5%
2023	14.3%	11.1%
2022	-19.9%	-17.8%
2021	1.0%	-1.8%
2020	1.4%	5.3%
2019	14.8%	15.0%
2018	-6.5%	-4.3%
2017	17.0%	10.3%
2016	12.7%	10.2%

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Investment risks

- Distressed securities have a high credit and liquidity risk as well as a potential restructuring and litigation risk. In the worst case, a total loss may result.
- Securities with a lower credit quality means a higher risk that an issuer may fail to meet its obligations. The investment value may fall if an issuer's credit rating is downgraded.
- Using derivatives creates significant leverage and entails valuation risks and operational risks. Leverage magnifies gains but also losses. Over-the-counter derivatives involve corresponding counterparty risks.
- CoCo-Bonds may entail significant risks such as coupon cancellation risk, capital structure inversion risk, call extension risk.
- Investments in emerging markets entail increased liquidity and operational risks as these markets tend to be underdeveloped and more exposed to political, legal, tax and foreign exchange control risks.
- Asset-backed and mortgage-backed securities, and their underlying receivables are often intransparent. The sub-fund may also be subject to a higher credit and/or prepayment risk.
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