Vontobel Fund – Sustainable Emerging Markets Local Currency Bond

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

Investors in France should note that, relative to the expectations of the Autorité des Marchés Financiers, this fund presents disproportionate communication on the consideration of non-financial criteria in its investment policy.

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. 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.

Local-currency sovereign bonds (GBI-EM- Global Div) rose by 0.2% in June. While this may not sound like a stellar performance in absolute terms, considering that the dollar rose by 2.25% against major peers (as per the US Dollar Index), we find it quite remarkable that EM FX only lost 1.1%. We believe this highlights that elevated real rates and high-risk appetite make EM carry sufficiently attractive to mostly counter bouts of dollar strength. EM rates contributed with 0.9% of the monthly performance as GBI-EM rates dropped by 9bps, while the ever-stable carry contributed with another 0.5%. Latin America had the best performance, rising by 1.9% , while EM Europe lagged with a -1.0% return. Colombia (+15.3%) was by far the best performer of the month, following the victory of right-wing candidate Abelardo de la Espriella in the runoff presidential elections. The Colombian peso rose by 7.3% while Colombian rates dropped by 166bps, erasing the pre-electoral underperformance. Staying within the South American political theme, Peru (+2.0%) also had a good performance, as right-wing Keiko Fujimori was finally confirmed as president-elect (three weeks after the runoff election), beating the left-wing candidate by the narrowest of margins. Oil-importing countries performed well: Türkiye (+5.1%), India (+2.8%), Dominican Republic (+1.9%)

Chile (-2.7%) was the worst performer, as concerns over fiscal credibility and weak domestic economic data, combined with the central bank’s increasingly dovish stance relative to the Fed, more than offset the relief provided by lower oil prices. Malaysia (-2.6%) was the second-worst performer, weighed down by political uncertainty surrounding state elections and fiscal concerns, which compounded the headwinds from a stronger US dollar and lower oil prices.

There were a few notable underperformers outside the benchmark, including Israel (-5.3%), where the shekel came under pressure amid peace-deal uncertainty, deteriorating fundamentals, and growing expectations of monetary easing. South Korea (-4.2%) also lagged, driven by heavy foreign equity outflows, while Nigeria (-3.9%) was weighed down by lower oil prices. Argentina (-3.4%) underperformed as grain-exporter dollar liquidation proved significantly weaker than expected. On the positive side, several African frontier markets benefited from the renewed search for carry opportunities, delivering standout returns. Egypt led the pack with a gain of +8.2%, followed by Zambia (+4.7%), Ghana (+4.3%), and Uganda (+3.7%).

Portfolio review

The Fund's assets declined by 1.4% to about USD 354 million in June, as the positive market effect was outbalanced by net outflows.

Our positioning remains anchored in our core view that duration, particularly in Latin America and Central Europe, is poised to outperform EM currencies amid the current resurgence of US exceptionalism. The key risk to this thesis would be a disruptive acceleration in US dollar strength that could weigh on EM duration as well. However, we continue to view such a scenario as unlikely. Indeed, we believe the attractiveness of EM currencies on a real-rate basis remains intact and is broadly consistent with previous periods in which carry strategies delivered compelling risk-adjusted returns, even against a backdrop of a resilient US dollar. As a result, we believe it remains appropriate to express risk primarily through duration rather than FX, rather than adopting an outright defensive stance across the portfolio.

Main portfolio adjustments in June included a partial switch from Indian rupee-denominated supranational bonds into Indian government bonds; a modest increase in exposure to Egyptian pound-denominated supranational bonds; a reduction in our underweight in Indonesia, funded by a reduction in our overweight position in Colombia; and a reduction in our exposure to both the Chinese renminbi and the Singapore dollar.

By region, measured at the FX level, Asia remained the portfolio's largest exposure despite the reduction, accounting for 39.6% of total exposure, followed by Latin America (28.3%), Central Europe (18.5%), and Africa (12.5%). Frontier market positions continued to represent approximately 10% of the portfolio. Cash holdings were broadly unchanged at 3.8%, while the allocation to supranational bonds increased to 24.6%.

Performance analysis

The institutional share class I gained 0.45% in US dollar terms, outperforming the GBI-EM Global Diversified Index by 25bps over the month, bringing the half-year performance of the Fund to +2.03% in absolute terms, or 0.51% bps over benchmark.

The main regional contributors to outperformance were Central Europe, where our FX underweight benefited from the euro's weakness against the US dollar; the Middle East, where our positioning in the Egyptian pound profited from a strong post-war relief rally; Latin America, where we benefited from the weakness of the Chilean peso and the post-election relief rally in Peruvian rates, despite underperformance in Brazil and Argentina; and Southern Africa, where our defensive positioning added value as Botswana government bonds outperformed their South African counterparts.

The main detractor was Asia. The continued widening of the Indian rupee basis weighed on performance, causing supranational bonds to underperform the Indian government bond curve. Performance in Asia was further negatively affected by our off-benchmark positions in the Korean won and Taiwanese dollar, both of which suffered from US dollar strength and sustained foreign equity outflows.

Outlook

The US and Iran have agreed on a memorandum of understanding, although a comprehensive peace agreement has yet to be reached, and the rules governing the transit of commodities and other goods through the Strait of Hormuz remain unclear. Nevertheless, trade flows have recovered at a healthy pace, roughly tripling during the first three weeks of June. As a result, while further disruptions that would pose upside risks to both oil prices and inflation cannot be ruled out, any market reaction is likely to be more subdued than the already remarkably sanguine response observed in recent months.

Turning to inflation and the broader fixed-income outlook, price pressures have so far been considerably more contained than in 2022, despite similarities in the underlying oil shock. Less expansionary fiscal policy, tighter monetary conditions, lower global excess savings, and less constrained labor markets have likely all contributed to a more limited pass-through to inflation. Moreover, with oil prices having fallen by roughly 40% over the past two months and inflation data surprising to the downside across Eastern Europe and several other emerging markets, this inflation episode appears likely to be far more short-lived than that of 2022. We believe this environment is supportive for fixed income in general, and particularly for local-currency rates.

Elevated risk appetite also continues to support local-currency carry strategies. That said, the AI-driven resilience of the US economy and the resulting resurgence of US exceptionalism have created headwinds for EM local assets over the past two months. Unlike last year, when EM local markets delivered returns of nearly 20%, local-currency debt has lagged hard-currency debt this year. Even so, several high-carry Latin American currencies have generated double-digit returns during the first half of the year. Furthermore, while hard-currency credit spreads remain historically tight, local-currency real rates are still close to one standard deviation above their 10-year median. Consequently, although the return of US exceptionalism has weighed on relative performance in the short term, we believe the strategic case for the asset class remains compelling. In our view, the combination of elevated carry and supportive risk sentiment is likely to outweigh the impact of moderate US dollar strength over the medium term.

Fund characteristics

Fund name	Vontobel Fund – Sustainable Emerging Markets Local Currency Bond
ISIN	LU0563307981
Share class	I USD
Benchmark	J.P. Morgan GBI-EM Global Diversified Composite USD
Inception date	25.1.2011

Historical performance (net returns, in %)

Time period	Fund	Benchmark
MTD	0.4%	0.2%
YTD	2.0%	1.5%
1 year	8.8%	7.8%
3 yrs p.a.	7.5%	7.3%
5 yrs p.a.	3.6%	2.1%
10 yrs p.a.	3.4%	2.7%
ITD p.a.	1.6%	1.5%

Time period	Fund	Benchmark
2025	20.4%	19.3%
2024	-3.5%	-2.4%
2023	14.3%	12.7%
2022	-7.8%	-11.7%
2021	-8.2%	-8.7%
2020	8.3%	2.7%
2019	9.5%	13.5%
2018	-7.6%	-6.2%
2017	12.9%	15.2%
2016	11.3%	9.9%

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, e.g. due to changes in rates of exchange between currencies. The value of the money invested in the fund can increase or decrease and there is no guarantee that all or part of your invested capital can be redeemed.
Since fund inception until 28.2.2018, the fund had different characteristics and performance was achieved under circumstances that no longer apply.

Investment risks

— 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.
— The sub-fund also includes sustainability criteria in its investment process. This may mean that the sub-fund's performance is more positive or negative than a conventionally managed portfolio.
— Distressed securities have a higher credit and liquidity risk as well as uncertainty in any potential bankruptcy proceedings.
— Investments in securities with a lower credit quality means there is an increased risk that an issuer may fail to meet its obligations. The value of this investment 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.
— The sub-fund’s investments may be subject to sustainability risks. The sustainability risks that the sub-fund may be subject to are likely to have an immaterial impact on the value of the sub-fund’s investments in the medium to long term due to the mitigating nature of the sub-fund’s ESG approach. The sub-fund’s performance may be positively or negatively affected by its sustainability strategy. The ability to meet social or environmental objectives might be affected by incomplete or inaccurate data from third-party providers. Information on how environmental and social objectives are achieved and how sustainability risks are managed in this sub-fund may be obtained from vontobel.com/sfdr.

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