Emerging Markets Debt - Insights

A Happy Eid Mubarak to all our readers. In this update, we provide an update on the current events within the emerging markets fixed income space and positioning for the Emirates Emerging Market Debt Fund.

Risk assets during the second half of July continued to stage a strong recovery on the back of a gradual re-opening of global economies, positive news flow on vaccine and loose fiscal and monetary policies. The US Fed committee members left rates unchanged at the July FOMC meeting while stating their commitment to using full range of tools to support growth and calling on fiscal policy makers to provide additional support (market talk of at least USD 1 trillion – positive for Emerging Markets (EM)). However, markets have turned cautious towards the last few days of the month on the back of delay around the renewal of the enhanced unemployment benefit support package that expired on 31st July, plateauing initial jobless claims and US China tensions. The US Treasury curve flattened as a result with long end of the curve rallying 22 basis points for the month and the US 10 year yield close to 0.50% (even lower than levels seen in March 2020). Emerging market credit spreads (JBBSCOMP) compressed by 27 basis points for the month. Year to date, spreads are still wide by 92 basis points giving room for further spread compression supported by loose policy, ample liquidity and a gradual improvement in economic data.

Asia:

Asian economies are normalizing, despite the region's infection rate climbing. China continues to post positive economic data as manufacturing PMI picked up from 50.9 to 51.1 in July. Non-manufacturing PMI also continued in growth trajectory. China's Politburo met on 30th July to review Q2 economic performance and set policy goals for H2 2020. It noted that Q2 GDP growth was better than expected and the H2 2020 focus will be on the effectiveness of the fiscal policy and targeted support via monetary policy. We expect the positive trend in China's economic data to continue as activity normalises and the global economy recovers.

In India, results calls from some of our top picks like Tata Steel and Tata Motors showcased mixed results (as expected) due to the impact of COVID 19 on their business. Tata Steel highlighted that as of June operations were starting to ramp up again in some of its plants. Tata Motors stated that they expect a recovery in the coming months, contingent to the lockdowns opening up. The company's focus will be on cost improvement and cash management for H2 2020 with a focus on turning free cash flow positive in 2021. Yes Bank, which has been one of our top weights, was upgraded by Moody's to B3 from Caa1 after an equity capital raising exercise. From Indonesia, a follow up investor call with industry analyst covering PT Bukit Makmur Mandiri Utama (BUMA), resulted in increased interest to add and build a bigger position in the company after getting comfort with management's strategy to conserve cash, reduce CAPEX and focus on debt reduction. Sri Lanka was a stronger performer in the fund as economic activity picks up and it's expected recover in H2 2020. The focus in Sri Lanka will be on the budget presentation, elections and the progress of the IMF negotiations which we anticipate to go well post upcoming elections.

CEEMEA:

We have started reducing our underweight in CEEMEA as we added more to the Romania sovereign (taking it into top 5 weights), along with Turkish subordinate bank debt where we see value in some of the fundamentally strong names which have been oversold.

While increasing the Romanian position in the fund, we spoke to Radu Delicote who is a Senior Political Strategist who works with the PR firm Smartlink Communications known for being an international Romanian consultant and analyst. The conversation was predominantly about the elections in Romania which seem to be quite contentious with a fragmented political landscape and a potential no confidence vote in the pipeline. As this is an election year, it seems like the local elections will dictate how the national elections will go and this resulted in the relatively weak ruling coalition to pass through a series of economic packages which would increase the debt burden on the sovereign in order to buy goodwill with the people. While this could increase the Debt/GDP of the country, we think the valuations are attractive compared to peers and it would be one of the main beneficiaries of the new ECB EUR 750billion support package.

We spoke to a high level delegation out of Cameroon, including the Minister of Finance, General Director of Treasury, General Director of Economy and the President of Technical Follow-Up Committee for Economic Programs from whom we drew comfort regarding Cameroon's fiscal position and the general health of the diversified economy. Cameroon has extended the IMF's program till September 30th 2020, after which they will renegotiate with the IMF in 2021 and to bridge the gap for 4Q20 they will engage the IMF for a Rapid Funding Facility. We think it remains one of the most defensive names within the African space.

S&P removed Metinvest (core fund holding) from credit watch negative to stable on July 22nd as iron ore prices were relatively strong given the early signs of recovery on the demand side of the equation. The Central Bank of Russia has also indicated that it will revise its methodology for determining D-SIBs (Domestic Systematically Important Banks) which could bode well for the Sovcombank perps position.

Latin America:

In LatAm we attended several second quarter earnings calls for the key players in the region, many of which we hold in our portfolio. One theme that became clear is that the commodities industry in Latin America has been supported by international demand, which has allowed for many stronger than expected results.

CEMEX, a Mexican multinational building materials company, which manufactures and distributes cement, ready-mix concrete and aggregates in more than 50 countries beat most analyst predictions with their strong second quarter performance. A seemingly unaffected level of concrete demand in the United States was the main contributor to the strong EBITDA, with +6% cement volume YoY. In Brazil, CSN released their Q2 results which as expected reflected high levels of cash due to the strong prices of iron ore and steel from which they are benefitting. Management emphasized that they are committed to deleveraging and reaching a leverage level of <3.75x by the end of 2020 and <3.0x by the end of 2021. Strong cash generation prevented further increases in debt that would have otherwise occurred due to exchange rate variation and brought liquidity at CSN to its highest level in 4 years.

We continue to focus on the recovery in Latin America. July manufacturing PMI revealed that Brazil is recovering at a much faster rate than Mexico. Brazil's Markit PMI Manufacturing increased to 58.2 in July (coming from 51.6 in the previous month. Mexican manufacturing trends, meanwhile, remained on the contractionary end: the July PMI edged up to 40.4 in July, from 38.6 in June. The PMI trends reveal that Brazil is leading in recovery, on the back of 1) much stronger fiscal stimulus (~7.5% of GDP in Brazil vs. 1.1% in Mexico) as well as 2) improved mobility levels, with Brazil's retail/recreation or transit station mobility down by some 33% versus pre-Covid-19 levels, while Mexico's are still down around 45% by the same metric. Bond-holders agreements on Argentina and Ecuador sovereign restructurings remove a significant overhang that has been the cause of Latam underperformance compared to Asia/CEEMEA.

Emirates Emerging Market Debt Fund:

We continue to expect spread compression for rest of the year which could drive further gains within the emerging markets fixed income space. Valuations look attractive compared to other asset classes. Emirates Emerging Market Debt Fund is well positioned to take advantage of the recovery that is expected to occur in the second half of 2020 and 2021. The fund is well diversified across 85-90 EM issuers and offers an attractive yield of above 8% with average portfolio quality of BB/Ba2 and duration of 6 years. The fund distributes cash dividend yield of 6% annually (paid 1.5% quarterly).

August 2020

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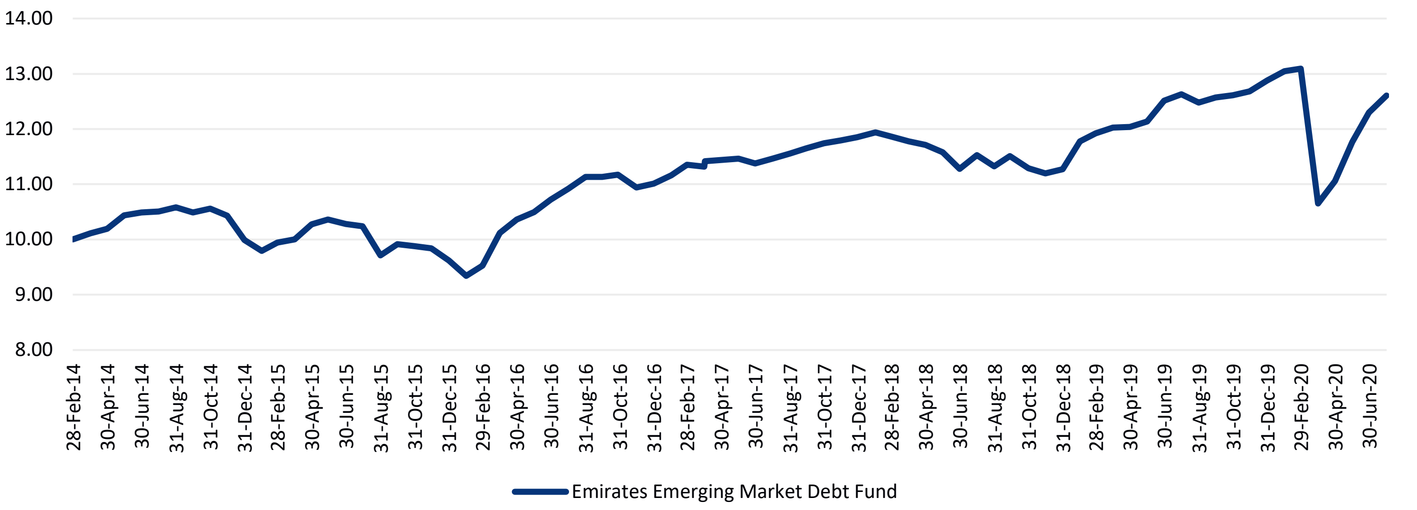
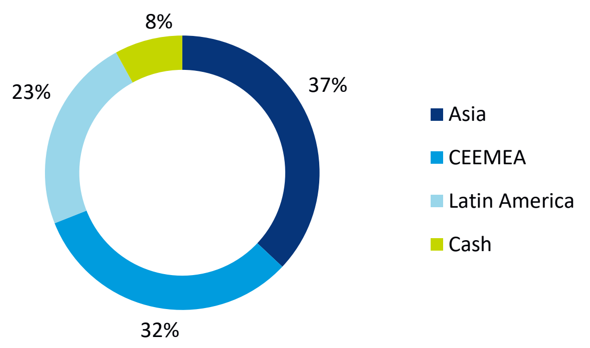
Emirates Emerging Market Debt Fund



	1 Month	3 Months	YTD	12 Months	Since Inception	Dividend Yield
Emirates Emerging Market Debt Fund	2.46%	13.97%	-2.15%	-0.19%	26.05%	6%

Key Metrics	
Yield to Maturity	8.24%
Current Yield	6.54%
Average Credit Rating	BB

Geographic Allocation



Source: Emirates NBD Asset Management, I Share Class, bid to bid, USD terms with net income reinvested. As at 30th July 2020.