LGT Vestra Snapshot

Have recent developments in EM bond markets presented opportunities for investment?

22 August 2018

Emerging Market bonds have suffered significantly since Turkey's recent financial meltdown meaning that investors are getting paid more than 5% over US government debt for investing in EM HY corporate bonds. Importantly, this is now 1.7% more than at the end of April, less than six months ago. Now EM HY offers a premium of 1.6% over US HY, when it was trading at discount earlier this year. What we need to understand is whether this presents an unmissable opportunity to invest in Emerging Market debt or whether investors were not truly pricing in the risk of investing in this asset class in Q1.

Why there could be an opportunity…

Emerging Market corporate leverage levels are falling (China's leverage levels fell by 2.9x last year), there is clear evidence of global growth across EM and DM, commodity prices have rebounded and financial discipline has increased (e.g. in China). This could suggest that there is an opportunity to invest in EM bonds, and specifically the Chinese HY debt market.

Where the risks lie…

The potential effect of trade wars has been amplified since the start of the year in line with increased threats from Trump; as have geopolitical risk levels such as those we have seen recently in Turkey, Argentina and Brazil in Q1. These two factors have an impact on bond fundamentals and suggest to us for the time being that we should wait to see how one or both play out before adding exposure to Emerging Market debt to portfolios. The net effect of a fall in the oil price also needs to be considered, however this can be inconclusive as some countries are net exporters and some are net importers.

What needs to change…

Once we come through the other side of Turkey's current political and economic turmoil, it will be easier to assess the lasting damage and the impact on valuations. Turkey makes up a significant proportion of the EM benchmark. Even if the funds we invest in do not have significant weighting to the country, other EM country's debt are priced against Turkey; therefore, we want to see a recovery in the fortunes for the Lira before investing in EMD.

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