

Newsletter

Emerging Market

February 2024

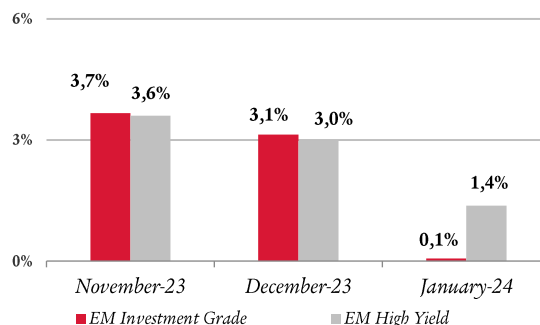
January witnessed significant volatility in EM credit returns. Policy-wise, most EM central banks persisted in their monetary easing cycles, with inflation gradually converging towards their target ranges. The supply side in the Emerging Markets was notably active, marking one of the highest primary issuance volumes for January. Sovereign issuances were especially prominent, leaning towards Investment Grade issuers.

Monthly highlights

Performances: Investment Grade vs High Yield

High Yield credit significantly outperformed Investment Grade credit during the month. The former was more resilient to rates volatility and benefitted more from the positive risk sentiment driving spread tighter.

Performance EM Investment Grade and High Yield Bonds

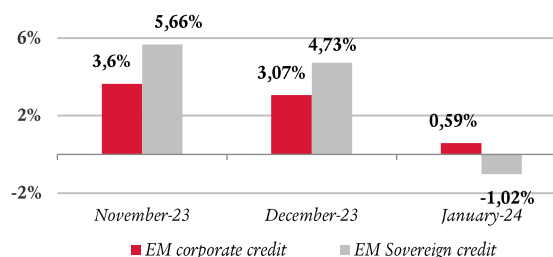


Source: Swiss Life Asset Managers, data as of 31.01.2024

Performance: Corporate vs Sovereigns

Sovereign bonds significantly underperformed corporate credit, primarily due to the sovereigns' exposure to longer duration and a large supply that resulted in wider spreads over the month.

Performance EM Hard Currency and Local Currency Corporates



Source: Swiss Life Asset Managers, data as of 31.01.2024

Disclaimer: Source: Swiss Life Asset Managers France, Bloomberg. This presentation contains historical market data. Historical market trends are not a reliable indicator of future market behavior. These data are provided for illustrative purposes only. Depending on the date of publication, the information presented may differ from the updated data.

Regional Performance

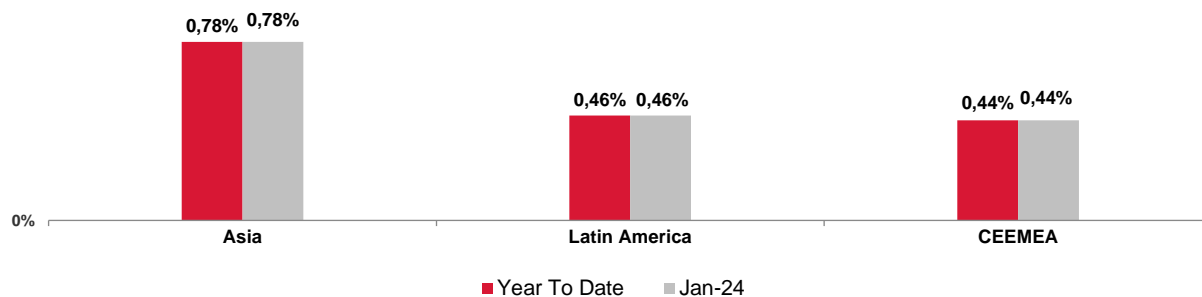
Over the month, credit markets in Asia outperformed those in other Emerging Market regions, with spreads in Asia tightening significantly, largely driven by China. Conversely, escalating tensions in the Middle East adversely affected credit spreads in that region. Meanwhile, credit spreads in Latin America remained relatively stable.

Regional Credit Spreads - EM Hard Currency Corporate Bonds



Source: Swiss Life Asset Managers, data as 31.01.2024

Regional Performance – EM Hard Currency Corporate Bonds



Source: Swiss Life Asset Managers, data as 31.01.2024

Blue Bonds: financing projects to preserve the oceans

The theme of water is gaining traction among investors with ESG concerns, highlighting the growing interest in sustainable investments. However, Sustainable Development Goals (SDGs) related to water remain among the least funded. In this context, "blue bonds" emerge as a potential solution to bridge the funding gap in water-related projects. These financial instruments have primarily been utilized in Debt-for-Nature Swaps, programs designed to alleviate a country's debt while simultaneously aiding in the protection of marine resources. Notably, such swaps have been executed in Gabon and Ecuador in 2023.

Despite their benefits, the widespread issuance of more conventional blue bonds has yet to materialize, indicating an opportunity for growth in this area to meet the financing needs of the blue economy. This need is increasingly urgent, considering United Nations reports predict that by 2050, over half of the global population will reside in water-stressed regions, facing heightened risks of flooding.

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The Figure of the month



Josipa Markovic
Emerging markets economist

5.2%

Chinese annual real GDP growth for 2023

Macroeconomic environment

A lukewarm Chinese growth

China's economy grew by 5.2% in 2023, which was in line with expectations and above the government's growth target of "around 5%". Nevertheless, the underlying data revealed some weakness. For instance, economy-wide prices marked the longest decline since 1999, as the GDP deflator – the difference between nominal and real GDP – has been in contraction for three quarters in a row, showing that the economy has been under deflationary pressure. There are two main reasons for that weakness. First, ongoing weakness in the housing sector as investments as well as sales continue to decline. Second, weak consumer confidence triggered by the downturn in the housing market that is unable to rebound. We expect the housing market weakness to remain a drag on the economy this year as a further downturn in investments is targeted by the government, while sales will remain weak as confidence will not be easily restored. We therefore revise down our 2024 GDP forecast to 4.5%. For 2025, our forecast of a 4.4% GDP expansion is slightly above consensus, as we expect housing investments to continue to slow, but demand to have stabilized by then, which should lift overall sentiment.

Middle East conflict disrupts transportation, but renewed inflationary pressure remains limited

Since the war in Gaza erupted on 7 October 2023, tensions in the wider Middle East have intensified. Violence has spread towards a vast number of countries, including Lebanon, Syria, Iraq, Pakistan and Yemen. Human loss is the most severe consequence of these events, while economic implications are at play too. The attacks by the Houthis on cargo ships willing to pass through the Suez Canal have already pushed transportation costs up by more than a third compared to December. Nevertheless, the impact on global inflation will likely be significantly more moderate this time compared to the Covid disruptions on transportation. First, this time around, there is no container shortage, but rather an excess supply of container ships. Moreover, global demand keeps shifting towards services away from goods that are shipped across the globe, while also the production of goods globally is not hampered; instead China is even generating excess supply. Therefore, the transportation disruptions are so far having only a limited impact on goods inflation and do not impede the overall disinflationary process. Should the conflict, however, escalate towards a war into, for instance, a major oil-producing country in the region, our current assessment would need to be revised.

OUR STRATEGY

“We maintain a positive outlook on the asset class over the medium term ”

Gabriele Bartoletti, CFA
Emerging Market Senior Portfolio Manager

Dorthe Fredsgaard Nielsen
Emerging Market Senior Portfolio Manager

Strategy for Emerging Markets

- We maintain a positive outlook on the asset class over the medium term. January experienced some volatility in returns due to the repricing in UST yields, yet the spreads in emerging market credit have remained stable, even with a significant increase in supply within the asset class. The macroeconomic environment appears favorable for risk assets, including emerging market credit, largely due to the robust nature of the US economy, which points to a potential soft landing this year. Furthermore, central banks in both developed and emerging markets are either indicating the end of their tightening cycles or have begun easing, which is beneficial for global financial conditions.
- The primary risk to the asset class is geopolitical, as the conflict between Israel and Hamas has escalated tensions in the Middle East. This situation not only poses risks from a potential military escalation but also disrupts global trade and economic growth. However, we consider the scenario of this conflict leading to a full-scale war involving countries like the US and Iran to be a tail risk.
- Finally, we believe technical factors will continue to support the asset class throughout the year. Valuations have become somewhat more attractive, and the asset class is still underinvested by international investors.

Taiwan Elections Review

- On January 13, Taiwan elected Lai Ching-te of the Democratic Progressive Party (DPP) as its next president, securing the party's unprecedented third consecutive victory. In the legislative elections, the DPP won 51 of the 113 available seats, losing its parliamentary majority for the first time since 2012 and leading to Taiwan's first divided government since 2004.
- The highly anticipated elections concluded without significant surprises, as the pro-independence DPP maintained its leadership, albeit facing increased opposition in parliament. These election outcomes did not introduce drastic changes to Taiwan's stance on independence from China; however, we anticipate that tensions between Beijing and Taiwan will likely continue to be elevated.
- The financial markets have shown limited response to these developments, indicating that, for now, the geopolitical risks associated with China and Taiwan are being temporarily sidelined.

About Swiss Life Asset Managers

Swiss Life Asset Managers has over 165 years' experience in managing the assets of the Swiss Life Group. This close link with the insurance industry underpins its investment philosophy, whose main objectives are to invest with a responsible approach to risk, and to act in the interests of its clients every day. Swiss Life Asset Managers also offers this proven approach to third-party clients in Switzerland, France, Germany, Luxembourg, the UK and the Nordic countries.

As of June 30, 2023, Swiss Life Asset Managers managed 265.8 billion euros in assets for the Swiss Life Group, including over 114.8 billion euros in assets under management for third-party clients. Swiss Life Asset Managers is a leading property manager in Europe¹. Of the 265.8 billion euros in assets under management, 91.7 billion euros are invested in real estate. In addition, Swiss Life Asset Managers jointly administers 21.6 billion euros of real estate with Livit. As of June 30, 2023, Swiss Life Asset Managers thus managed 113.3 billion euros of real estate assets. Swiss Life Asset Managers' clients benefit from the commitment and expertise of more than 2,200 employees across Europe.

Life with freedom of choice

Swiss Life enables people to live their lives with freedom of choice and to look to the future with confidence. This is also the aim of Swiss Life Asset Managers: we think long-term and act responsibly. Drawing on our expertise and experience, we develop forward-looking savings and investment solutions. We support our customers in achieving their long-term investment objectives, so that they in turn can consider the needs of their own clientele and build a financial future with complete freedom of choice.

¹ INREV 2021 survey of fund managers (based on assets under management at 31.12.2021).

Swiss Life Asset Managers data at 31.01.2024.

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