Newsletter

Emerging Market

August 2024

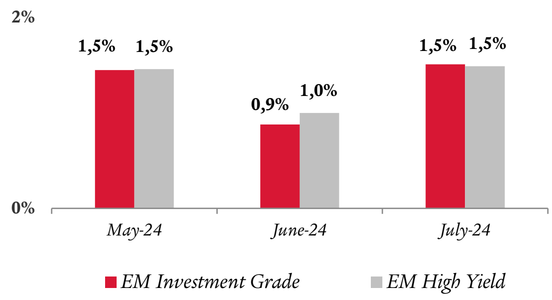
In July, Emerging Markets hard currency bonds were influenced by US rates again. With the market anticipating more FED cuts due to weakening data, the US 10-year Treasury yield neared 4%, and EM spreads widened as global growth expectations slowed. Toward the end of the month, tensions escalated in the Middle East following the assassination of Ismail Haniyeh, the political leader of the Iran-backed group Hamas, in Tehran. This spike in tension mirrored levels seen four months ago when Iran and Israel engaged in direct fire exchange for the first time. Weaker US and China data, combined with Middle East tensions, increased EM spread volatility. By month-end, EM corporate spreads widened by 10 bps, and sovereign spreads by 9 bps.

Monthly highlights

Performances: Investment Grade vs High Yield

During the month, both High Yield and Investment Grade credit delivered consistent positive returns. Investment Grade credit benefited more from the decline in UST rates than the High Yield segment, however the High Yield credit segment benefited more from its' higher carry as spread only widened a few basis points and thereby performed in line with the Investment Grade credit segment.

Performance EM Investment Grade and High Yield Bonds

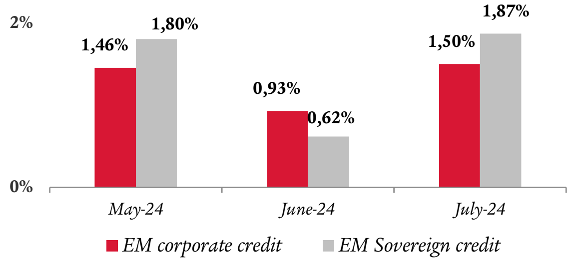


Source: Swiss Life Asset Managers, data as of 31.07.2024

Performance: Corporate vs Sovereigns

Sovereign bonds outperformed Corporate bonds, primarily due to longer duration as spread behaved similar for both asset classes.

Performance EM Hard Currency and Local Currency Corporates



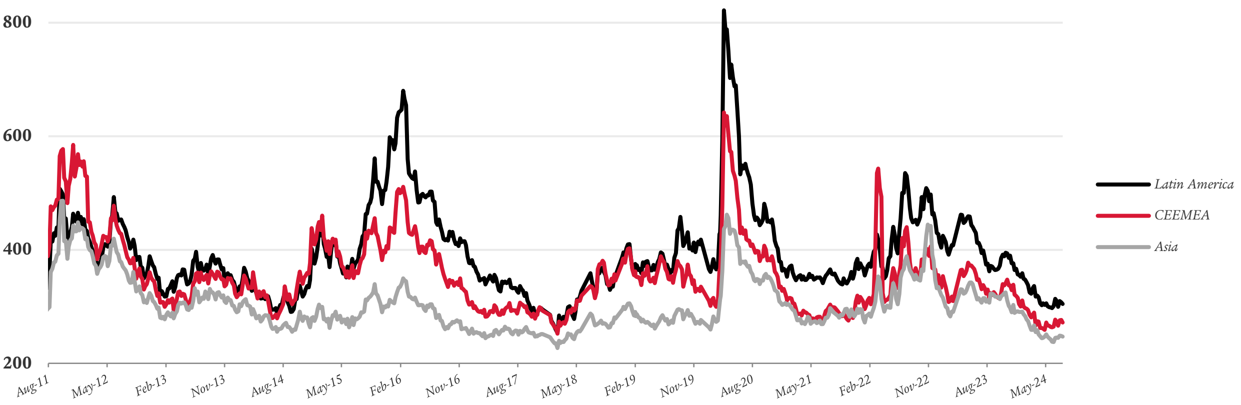
Source: Swiss Life Asset Managers, data as of 31.07.2024

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

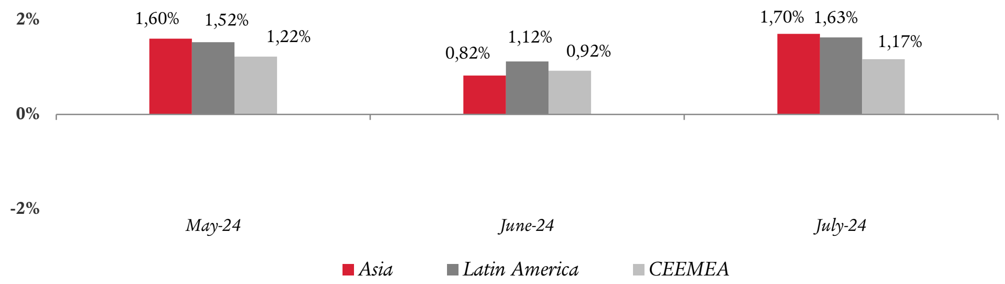
Absolute performance was positive across all regions over the month, due to the decline in UST rates. Asia led the way, driven by neutral spread development, whereas spread widened over 20 bps in CEEMEA region and thereby underperformed the other two regions.

Regional Credit Spreads - EM Hard Currency Corporate Bonds



Source: Swiss Life Asset Managers, data as 31.07.2024

Regional Performance – EM Hard Currency Corporate Bonds



Source: Swiss Life Asset Managers, data as 31.07.2024

Labelled Bond Issuance Trends

In the first half of the year, global labelled bond issuance totaled USD 549 billion, which is consistent with the same period in 2023. Bank of America has increased its 2024 forecast for labelled bond issuance to USD 1 trillion from USD 850 billion. Green bonds made up 62% of this issuance, maintaining their dominance over other labelled bonds. However, sustainability-linked bonds saw a 40% decline in issuance compared to the previous year, pressured by ambitious targets lacking relevance and/or insufficient incentives for issuers in the form of step-ups or penalties for missing targets

Within the EM corporate hard currency bond market, labelled bonds now represent about 15%, up from 14% at the end of 2023. Of these labelled bonds:

- 62% are rated investment grade
- South Korea leads with 21% of issuance, followed by China (18%) and Brazil (8%)

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The Figure of the month

Josipa Markovic
Emerging markets economist

4.7%

China's Q2 2024 GDP growth rate

Macroeconomic environment

China's Q2 2024 GDP growth rate

China's GDP growth for the second quarter 2024 has been reported at 4.7%, falling short of expectations. Consequently, we've adjusted our forecast for the year from 4.9% to 4.7%. The primary factor hindering growth is subdued consumer spending, rooted in a widespread confidence crisis regarding the property market's future. Despite stimulus efforts in mid-May, property market indicators have continued to underperform, impeding economic expansion. Exports, however, have bolstered the economy, with June witnessing a record trade surplus. Yet, the global economic environment poses challenges, particularly with the prospect of cooling US demand and escalating trade tensions with the US, which could intensify if Donald Trump is re-elected. A potential downward revision to China's GDP in 2025 would therefore be inevitable, but any adjustments will likely be limited. First, we find Trump's announced 60% tariff on all Chinese goods as not feasible and expect a lower tariff rate – given America's reliance on essential Chinese goods like rare earths, lithium-ion batteries, and pharmaceutical ingredients, and the likely domestic backlash due to inflationary pressures. Second, the ongoing redirection of trade through intermediary economies is expected to continue, which so far maintained China's global export share. Third, there is bipartisan support for a tough stance on China, with a democratic president that would likely favour sustained technological restrictions and stronger anti-China alliances, potentially exerting a more detrimental long-term effect on China's economic growth.

Emerging markets to implement more cuts in the fourth quarter 2024

Since mid-2023, central banks in emerging markets have embarked on an easing cycle, with a recent shift toward caution in ongoing rate cuts. Having already implemented various rate reductions, particularly in Latin America and Eastern Europe, emerging markets central banks are increasingly focusing on foreign exchange volatility and the pace of disinflation. Looking ahead, we anticipate that the US Federal Reserve will begin cutting interest rates in September of this year due to lower inflationary pressures and weakening economic dynamics. As a result, the door may reopen for further rate cuts, especially in the Asian region, which has not yet fully participated in the easing cycle.

OUR STRATEGY

“We maintain our optimistic outlook on EM credit, but we acknowledge that (geo)-political risk and the path of UST could introduce some volatility in spreads, particularly for “crowded” part of the market”.

Gabriele Bartoletti, CFA
Emerging Market Senior Portfolio Manager

Dorthe Fredsgaard Nielsen
Emerging Market Senior Portfolio Manager

Strategy for Emerging Markets

We maintain an optimistic outlook on emerging market credit, driven by robust fundamentals, supportive technical indicators, and a positive growth outlook. However, we recognize that recent geopolitical factors remain unpredictable, especially considering the upcoming US presidential election and the potential impact of US Treasury yields on volatility in EM spreads.

Credit rating trend turns positive

In July, Paraguay achieved its first investment-grade (IG) rating ever from Moody’s, while Azerbaijan regained its first IG rating since 2016 according to Fitch. Sovereign ratings had a negative impact on corporates from 2013 to 2022, but they have become a positive driver again in 2023 and continue to be so in 2024 with Qatar and Turkey also contributing to the positive trend as well.

During the first half of this year, sovereign-driven rating actions contributed positively, while challenges persisted in China’s real estate sector and with Pemex. The net rating action volume for emerging market corporate credit turned positive (USD 117 billion in upgrades vs. USD 108 billion in downgrades). If this trend continues, it could lead to the first positive net rating action year since 2012.

Despite the persistently negative rating actions, the average credit rating of CEMBI BD reached a low point in 2019 and has been improving since. This improvement is partly due to new issuances being skewed towards higher-rated bonds and the exit of defaulted bonds from the index.

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 december 31, 2023, Swiss Life Asset Managers managed 275.4 billion euros in assets for the Swiss Life Group, including over 120.4 billion euros in assets under management for third-party clients. Swiss Life Asset Managers is a leading property manager in Europe1. Of the 275.4 billion euros in assets under management, 91.9 billion euros are invested in real estate. In addition, Swiss Life Asset Managers jointly administers 22.9 billion euros of real estate with Livit. As of december 31, 2023, Swiss Life Asset Managers thus managed 114.9 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 31.07.2024.

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