RBC Global Asset Management

# The rising resilience of emerging markets

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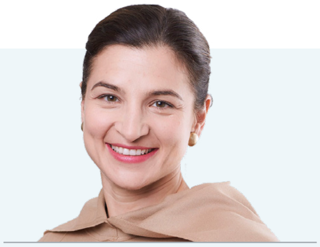

**Polina Kurdyavko**
Head of Emerging Markets
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> **"After a 10-year pause, this is precisely the time when it is worth looking at this asset class again."**

**Combining the advances of emerging economies with close to double-digit yields, is creating diverse emerging opportunities for investors for the year ahead, with BlueBay's EM Unconstrained Bond and EM Select Bond strategies poised to benefit.**

With so much geopolitical and macroeconomic uncertainty this year, investors could be forgiven for wanting to take a breather from markets. Yet, even as developed economies continue to grapple with inflation and experience turmoil from bank weakness, emerging economies are poised to remain resilient amid the turbulence.

In emerging markets broadly, central banks have already done their part of the heavy lifting. They started interest rate hiking cycles, on average about 18 months, before developed economies started to raise rates. This precautionary action helped to control inflation, gave confidence to domestic investors, and helped to support currencies across emerging economies.

"Most of the central banks have been pre-emptive, which has paid off. We have seen inflation in most emerging market countries already peaking and, in some places, we are seeing inflation surprising on the downside as it starts a downward trajectory," says Polina Kurdyavko, Head of Emerging Markets, at RBC BlueBay Asset Management.

Meanwhile, robust commodity prices have improved balance of payments for several emerging economies, removing some of the vulnerability associated with the asset class.

"If you put those two tailwinds together and then marry them with close to double-digit yields on emerging market hard currency debt, suddenly you are seeing very interesting investment propositions," Kurdyavko says.

"If I look at the sovereign index today, we started 2023 with yields close to 9%; and while yields peaked at 10% in October last year, a 9% yield for hard currency sovereign debt is quite appealing," she explains.

## Is local currency due for a revival?

After years as an overlooked and unloved asset class, local emerging market currencies may be due for a comeback.

"After a 10-year pause, this is precisely the time when it is worth looking at this asset class again. We see not only alpha opportunities but there is a beta argument for it as well," she says.

"This tide started turning last year because local currency was the best performing emerging market asset class in 2022 and particularly EM FX on a relative basis. For once, we have double-digit rates in emerging sovereigns and supportive valuation because FX has devalued by 50% to 60% over the last decade," she explains.

Kurdyavko says: "It's not only hard currency that will be most exciting in the space, but it is also going to be best ideas across hard and local currency; and we think this opportunity will continue."

## Why BlueBay EM Unconstrained and EM Select?

Opportunity remains across the emerging market asset class, despite geopolitical uncertainty stemming from the war in Ukraine and a re-emergence of US-China tensions, the looming threat of a global recession and conditions of tight liquidity show no signs of abating.

"The more uncertainty you have in the world, the more optionality you want. The EM Unconstrained strategy gives you the maximum amount of optionality because you look at the 40 best ideas in emerging markets across corporates, sovereign, local currency, hard currency. Investors are not constrained by the benchmark, by universe segment, or by duration," explains Kurdyavko.

The beauty of the product is that it looks at the best ideas across all segments but is also constructed in a way to reduce volatility by using different segments of emerging market fixed income to manage volatility down.

"Every investor in emerging markets wants a portfolio constructed in a way to reduce volatility and they want to maximise the alpha opportunities in the asset class because we know it is an alpha-rich asset class," she says.

**"The more uncertainty you have, the more optionality you have."**

"If you look at the returns from our EM Unconstrained strategy over any time period, we have always run lower volatility than the index. We are in the top quartile, or decile, versus our peers because, on the return profile, we have had one year in the last 13 when we did not beat the index," Kurdyavko explains.

EM Unconstrained does not have a benchmark, rather it targets a LIBOR plus 4% to 6%. EM Select on the other hand, does have a benchmark, which is a 50:50 hard currency sovereign and local currency sovereign.

"Both allow for the best ideas across local and hard currency sovereign debt that we feel are most interesting in this part of the cycle," says Kurdyavko.

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