RBC Global Asset Management

Bullish or Bearish: considering opportunities in EM Debt

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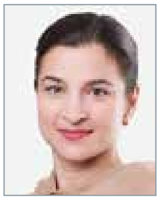
In a world dominated by volatility and uncertainty, investors would do well to consider taking an active unconstrained approach to investing.



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Such an approach is particularly pertinent to emerging markets (EM) where the universe of securities is so great (making up 25% of the global bond market1) and the growth trajectory remains higher than developed markets countries. In these unprecedented times, where dispersion is so high, it is more important than ever to focus on identifying the 'winners' and 'losers' to optimise the return profile of investment holdings.

Investing through an unconstrained vehicle gives investors the agility and flexibility to invest anywhere and use any type of instrument in order to access a broad universe of opportunities and capitalize on mispriced assets, using bottom-up credit selection on both the positive and negative side. This flexibility also permits managers to construct portfolios that can capture the upside of the potential returns while also protecting on the downside during market downturns.

Investors are understandably cautious about the EM asset class given recent nervous headlines and market volatility. But opportunities emerge from tough times and at current levels, following such an aggressive sell-off, we believe some of the most compelling opportunities could be hiding in plain sight.

Bullish

One area where we see value is in issuers exposed to commodities such as energy and agriculture. Here we have seen some of the commodity exporting credits, such as issuers in the Middle East and Latin America, sell off in line with the commodity importers, even though high prices have helped their credit profiles.

Not an investment recommendation, but an example of an issuer within this space would be Oman, which is benefitting from high commodity prices and implementing reform.

Bearish

Times of rapid US dollar strengthening have historically led to a drag on performance for EM assets, in particular EM currencies, which tends to struggle through a combination of risk aversion as well as stronger dollar. One benefit of an unconstrained portfolio construction is to be able to take advantage of such weakening themes; for example by implementing a net short EM currencies position. This can help to protect downside and has proven successful for us on multiple occasions, such as in late 2016, during 2018 and even in 2020 amid Covid-19 shocks. Hedging or avoiding exposure to significantly weak ESG stories is another way to protect downside in portfolios. For example, before the Russian invasion of Ukraine we implemented a CDS protection position which was beneficial.

Ultimately, taking a fluid and flexible asset allocation approach can come into its own in volatile markets, when the universe offers a multitude of investment opportunities that can allow investors to achieve outsized returns without taking excess credit risk.

See more from Polina and the Emerging Market Debt team
See more insights from the BlueBay Fixed Income Team

[1] *JP Morgan as of December 2020*

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