For Professional Investors Only

Global Asset Management

Emerging market debt

Opportunities hide in plain sight

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Emerging markets (EM) have had a tough run so far this year. While global markets have been rocked by well-documented geopolitical shocks, alongside monetary policy tightening efforts, it's fair to say EM went into freefall during the first four months of 2022.

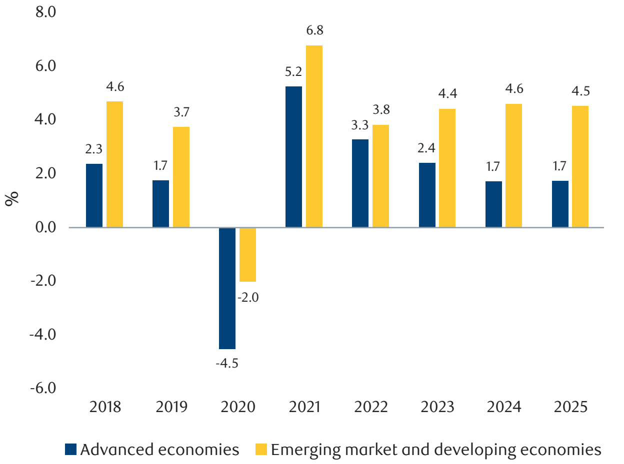
The EM sovereign index was perhaps the standout sub-sector, down some 15% on the year[1], but it was by no means alone – local currency, corporates and even EM equities have all underperformed year-to-date to varying degrees.

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

> **"Capturing this upside potential means being exposed to the right investment manager and the right strategy for the current market conditions."**

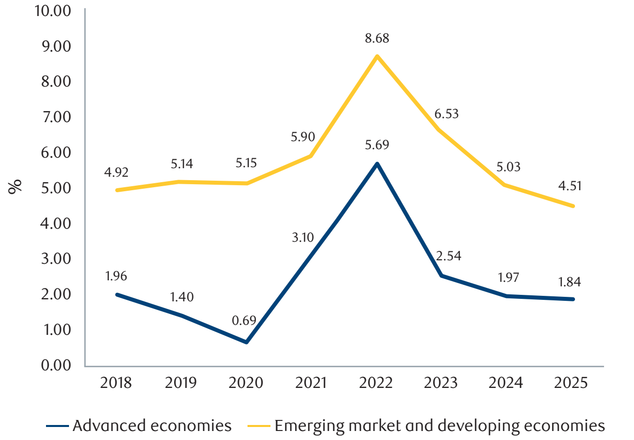
[1] JP Morgan EMBI Global Diversified Index, as at 30 April 2022

Chart 1: EM still expected to grow faster than DM



Source: JPMorgan, Goldman Sachs Research, IMF WEO as of April 2022

Chart 2: Headline inflation likely to peak in EM and DM this year



Source: JPMorgan, Goldman Sachs Research, IMF WEO as of April 2022

What's driving our positioning?

1. Growth

Even in the challenging macro environment, EM growth is likely to continue to outperform developed market (DM) growth this year (see chart 1).

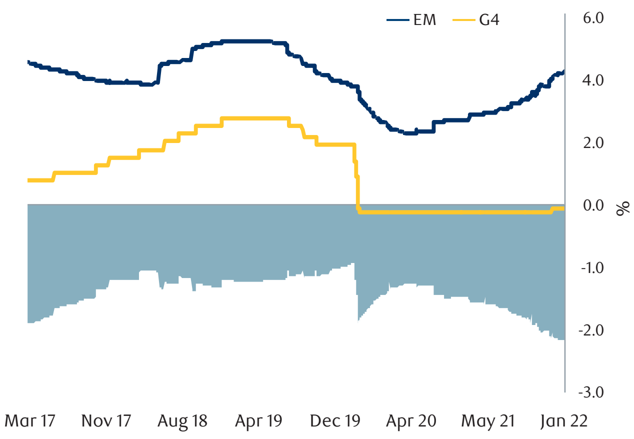
'Growth alpha' – the growth differential between DM and EM, has the potential to expand in favour of EM countries. However, differentiation within EM is also crucial; China growth is likely to suffer this year more than it did in 2020 due to highly restrictive zero-Covid policies.

2. Inflation & monetary policy

The US Federal Reserve has been raising rates alongside providing a hawkish narrative, which has contributed to the EM sell-off. Although inflation is a big focus for EM in general, a number of EM central banks have been proactively raising rates (such as Brazil, starting from early 2021) and are now arguably ahead of the curve in terms of monetary policy tightening (see chart 3). The result of these progressive efforts is a clear real rates differential versus DM (see chart 4).

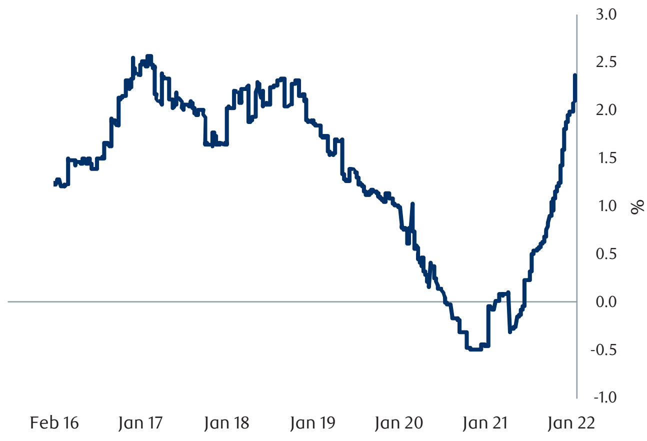
Favourable EM real rates relative to DM have, in part, contributed to the relatively better performance of EM currencies year-to-date, which are down some 3% for the first four months of the year. There is plenty of differentiation within FX though, which provides a source of potential relative value generation.

Chart 3: Nominal policy rates differential EM vs DM



Source: Bloomberg, BlueBay Asset Management as at January 2022

Chart 4: Real policy rates differential EM vs DM



Source: Bloomberg, BlueBay Asset Management as at January 2022

3. Commodity supply disruption

Energy shortages are the dominant talking point today, but it is worth noting that despite the rally in oil prices, a number of oil-exporting EM credits have sold off aggressively and offer good value, in our view.

At the same time, agricultural and food shortages arising out of supply disruptions for wheat and fertiliser exports from Russia/Ukraine/Belarus could quickly become as serious an issue, potentially triggering widespread social unrest and adding fuel to the inflation fire.

We believe correct positioning around commodity disruption will define alpha generation opportunities.

4. Stressed issuers

Stressed issuers could offer an opportunity to generate positive returns but timing will be key. We are closely monitoring for signs of turnaround in sovereign names, such as Sri Lanka, and corporate sectors, such as Chinese real estate.

Capturing upside

Attractive investment solutions for today's EM debt landscape

Illiquid & hedge fund strategies	High conviction & blended strategies	Hard currency aggregated strategies
▪ Capitalising on dispersion and dislocation across the entire EM credit market ▪ Maximum flexibility and return from potential shorts or illiquid positions ▪ Bottom-up fundamental analysis driven across a broad range of countries / sectors	▪ Dynamic and broad management of investment themes in EM interest rates, currencies and credit ▪ As we move past the EM hiking cycle, local markets could be a leading source of returns	▪ Pure hard currency credit exposure, primarily US dollars ▪ High conviction ideas across EM sovereign and corporate universe with significant macro input
We believe, alternative and illiquid opportunities could potentially see double-digit returns in 2022	**EM local markets have notably outperformed EM hard currency YTD. We expect this theme to continue**	**Muted beta environment, but plenty of differentiation opportunities across regions and sectors**

More info on BlueBay's investment solutions

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