Portfolio Manager Perspectives
BlueBay Emerging Market Debt Update

Weekly Update July 8, 2021

It was a difficult week for equity markets, with most of the leaders from the reflation trade giving back some of their recent gains. This led to underperformance from the Russell 2000 (-1.2%) and emerging-market (EM) equities (-1.8%). Meanwhile, the S&P 500 outperformed as strength in the technology sector supported overall index returns. US Treasury yields rallied by around 10 basis points (bps) in the longer tenors in a bull-flattening move.

The major data release last week was non-farm payrolls in the US, which came in close to consensus, with the headline number showing an 850,000 jobs gain. Average hourly earnings were up 0.3% as wage pressures in the leisure and hospitality sectors continued. These numbers should leave the Federal Reserve (Fed) comfortable in continuing on its course to announce tapering at some stage this year.

EM fixed income had divergent performance this week. In credit markets, spreads were wider, with high yield decompressing and widening out more than investment grade. However, total returns were actually positive across the board because of the tailwind provided by the rally in US Treasuries. In local markets, performance was much weaker (-75bps) as foreign exchange (FX) sold off close to 1% and the rally in EM rates was rather muted, providing gains of only 20bps despite the solid performance in core rates markets.

Market review

- Colombia's credit rating was cut to junk by Fitch given concerns around the fiscal outlook. The market reaction was rather muted, as the market had already priced in the worsening fiscal situation. However, it does serve to highlight the difficult balancing act the government has in managing social unrest at the same time as pushing through fiscal reform.

- The OPEC+ alliance showed signs of stress as the United Arab Emirates blocked a proposal to increase production by 400,000 barrels per day as it sought to readjust its own production quota. The ultimate outcome of OPEC+ negotiations will be closely followed given the potential knock-on impact to inflation.

Market outlook

The economic data continues to show a solid bounce in activity, particularly in the reopening sectors as reflected by the wage pressures we are seeing come through in the US jobs data. When looking at year-to-date performance, it is clear that equity markets, on the whole, have reacted positively to this improving growth outlook. Commodities have also staged a positive rally while credit markets are generally tighter. The vaccine drive is also making excellent progress in many developed economies and, in our view, this is helping to bolster confidence in the sustainability of the reopening of economies.

On the other side of this narrative is the rapid spread of the delta variant globally, particularly in those countries where vaccine rollouts have been slow. There is also some sense that the peak of positive economic surprises is behind us and while the economy will continue to make gains, we think these will be more incremental from here. In our opinion, these perhaps explain some of the performance in US rates of late where yields have been heading lower, despite what appears to be reasonable solid data.

We believe EM fixed income continues to lack a clear direction, as many of the themes described above combine to create a mixed picture. For example, slower vaccine rollouts have hurt growth in EMs while, on the other hand, it leaves some easy gains to be made when vaccine rollouts do progress, likely in the second half of the year. Similarly, a Fed that is looking to taper will tighten financial conditions; however, we think the Fed is also likely to keep rates on hold for the next 12 months at least. At the same time, there has been a hawkish turn by some EM central banks that has helped to restore more relative value in certain local markets. In our view, it is therefore likely that performance will be differentiated within EM without there being a clear directional trade for now.

Index Review – Weekly Market Snapshot as of 07/02/2021

	Total return			Spread / yield change (bps)				
	Weekly	MTD	YTD	Weekly	MTD	YTD	Spread (bps)	Yield (%)
Hard Currency Sovereign	0.02%	0.69%	-0.71%	11	12	-7	344	4.92
Hard Currency Corporate	0.24%	0.85%	1.19%	8	2	-28	288	4.20
Local Currency Corporate	-0.43%	-1.34%	-1.30%	8	-2	-56	141	5.63
Local Currency Sovereign	-0.75%	-1.37%	-3.74%	-4	6	78		5.00

Source: Bloomberg, JP Morgan