



EMERGING MARKET DEBT

THE SEARCH FOR YIELD IN HIGH BETA MARKETS

▶ The sanitary and economic crises have seriously hit Emerging markets, but growth is expected to be strong in 2021 in our view.

INTERVIEW



STÉPHANE MAYOR
Senior Portfolio Manager
Emerging Corporate Debt



ROMAIN BORDENAVE
Senior Portfolio Manager
Emerging Sovereign Debt

According to the International Monetary Fund (IMF), Emerging Markets' Gross domestic product (GDP) should reach 6% and 8.2% for China, on the back of vaccine deployments and accommodative central banks. Combined with attractive credit fundamentals, yield hunters will likely be drawn to the emerging market credit space in 2021, **boosting flows and high yield' issuance.**

Above all, this has lifted commodity prices like oil and metals. Emerging debt also tends to perform better in weak dollar environments and the Fed's accommodating stance has piled pressure on the US dollar.

HIGH COMMODITY PRICES SHOULD BENEFIT EMERGING MARKET CYCLICAL SECTORS

A recovery in demand in China, the US and Europe, among others, **should continue to support commodity players throughout Emerging Markets.** We expect cyclical sectors to outperform, with metals & mining, energy, transportation and infrastructure (especially in Africa) sectors leading the way.

Most base metal prices including iron ore, copper and nickel are now exceeding their late-2019 levels and led by a recovery in demand, we expect them to remain at these levels.

Angola sovereign debt, for instance, now looks relatively cheap against its peers. The country is politically stable with a solid financial support framework from three significant bilateral creditors:

- ▶ **China** with \$6.2 billion in **debt relief**²;
- ▶ the **suspension of a coupon payment** of \$1.78bn to the **G20** and;
- ▶ **IMF financial support deal** of \$4.5 billion over 3 years².

In addition, oil accounts for 95% of Angola's exports³. The sharp fall in oil prices at the start of the sanitary crisis had prompted Angola to recalibrate its budget and spending plans to account for oil at \$35 a barrel, down from \$55⁴. Now, at current oil prices of over \$55 a barrel, Angola should have fewer concerns over its deficit and may well profit as markets reopen.

CREDIT FUNDAMENTALS FAVOUR HIGH YIELD ISSUES

In a world where central banks are keeping rates low and the number of bonds yielding below 0% interest are skyrocketing, **appetite for emerging market debt should rise**. Spreads⁵ on emerging sovereign high yield issues are at historical highs, even trading roughly 100bps above pre-Covid crisis levels versus investment grade⁶. **So the potential to capture the remaining alpha is significant!** Sovereign names as well as corporates that survive the crisis, such as national airports for example, will likely shine.

Meanwhile, **credit fundamentals of emerging corporates** are still stronger than for their developed-market counterparts. Spreads on the EM Corporate High Yield segment also remain at a very attractive level. They are trading roughly 300 bps⁷ versus Investment Grade issues and above their pre-Covid levels. Also, default rates for EM High Yield corporates reached 2.7% in 2020⁸, according to JP Morgan, compared with 6.8% for US High Yield markets. Forecasts for 2021 suggest

this trend is likely to continue with the latter easing to 3.5% against 2.2%⁸ for defaults expected in emerging market corporates. With these low default rates, **high yield issues should outperform investment grade issues in our view**.

A HIGH CATCH-UP POTENTIAL IN HIGH-BETA MARKETS

We believe there is **a high catch-up potential in high-beta markets, notably Argentina, Ukraine, and Turkey**, which are still undervalued in our view.

Turkey has little debt and growth remains strong. It is one of the only countries to have recorded positive growth in 2020. The sharp fall in Turkish assets following the exit of the Central Bank chief Naçi Agbal should provide an interesting entry point for this country with a diversified economy. Indeed, today Turkey is trading at the same yields as Nigeria but with a more robust banking system and fundamentals.

These trends, which are good news for emerging markets in our view, could well last throughout 2021. **Key sectors like energy and mining/metals could benefit from any recovery**. As for emerging government debt, countries in high beta markets should make up for lost ground if their respective geopolitical risks fade. Note, however, that although high-risk countries should generate good returns, long-duration bonds could be hit by any rise in US long bond rates, potentially in the second half of the year.

HIGH BETA MARKETS: A high level of volatility and therefore risk. While high-beta investments tend to outperform the market when the market is going up, they also will accelerate their losses when the market moves down.

1. Corporate bonds with a higher default risk than investment grade bonds but which pay out higher coupons.

2. Source: Reuters. Data as of September 2020.

3. Source: IMF. Data as of September 2020.

4. Source: Reuters. Data as of 29 March 2020.

5. The spread is the difference between the actuarial rate of return on a bond and the rate of return on a risk-free loan with the same maturity.

6. Bonds rated as high quality by rating agencies.

7. Source: Bloomberg. Data as of 31 December 2020.

8. JP Morgan Global Credit Research data as at 06.01.2021. Corporate default rate refers to the CEMBI Index.

March 2021. This material has been issued by Edmond de Rothschild (Suisse) S.A. (hereinafter "Edmond de Rothschild") located at 18 rue de Hesse, 1204 Geneva, Switzerland, a Swiss bank authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA). It may be used by other entities of the Edmond de Rothschild Group and may be made available to their clients. However, it is not intended for persons who are citizens of, domiciled or resident in, or entities registered in a country or jurisdiction in which its distribution, publication, provision or use would infringe existing laws or regulations. This material has no contractual value and is provided to you for information purpose only and should not be construed as personalised investment advice or a recommendation or solicitation or offer to buy, sell or hold any security or financial instruments or to adopt any investment strategy. Some instruments and services, including custody, may be subject to legal restrictions or may not be available worldwide on an unrestricted basis. This material is based on information obtained from sources or third party materials considered reliable. Edmond de Rothschild uses its best effort to ensure the timeliness, accuracy, and comprehensiveness of the information contained in this document. Nevertheless, all information and opinions expressed herein are subject to change without notice. No guarantee is provided as to the exhaustiveness or accuracy of this material. The information contained within this material has not been reviewed in the light of an individual's specific circumstances, objectives or needs. Furthermore, tax treatment depends on the individual circumstances of each person and may be subject to change in the future. Therefore, a prospective investor is not released from the need to exercise his/her own judgment with regard to his/her specific investment objectives or to seek financial, legal or tax advice from professional advisers as appropriate. This document does neither constitute legal nor tax advice. Every investment entails risks, particularly the risk of fluctuating prices and returns. Past performance and volatility are no indication of future performance or volatility and are not constant over time. Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments. The investor may not receive back the full amount invested. When an investment is denominated in a currency other than the reporting currency, changes in exchange rates may have an adverse effect on the value of that investment. The liquidity of an investment is subject to supply and demand. Some products may not have a well-established secondary market or in extreme conditions may be difficult to value, resulting in price volatility and making it difficult to obtain a price to dispose of the asset. Furthermore, the instruments or investment strategies mentioned in this material may carry risks other risks. No entity part of the Edmond de Rothschild Group, neither its directors, officers nor employees, can be held liable for direct or indirect harm, losses, costs, claims, compensation or any other expenses that may result from the use or distribution of this material or from any decision to invest, divest or take no action on the basis of this material. Reproducing or distributing this material in whole or in part to any third party without the prior written consent of Edmond de Rothschild (Suisse) S.A. is prohibited. Copyright © EDMOND DE ROTHSCHILD (Suisse) S.A. – All rights reserved.

EDMOND DE ROTHSCHILD (SUISSE) S.A.
18 rue de Hesse
1204 Geneva
www.edmond-de-rothschild.com