# AMUNDI FUNDS EMERGING MARKETS HARD CURRENCY BOND

Monthly Portfolio Update

**30/11/2022**

## Meet the Team

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### Market comments

November was a very strong month for markets, with broad-based gains across equities, credit, sovereign bonds and commodities. This positive momentum was propelled by a number of factors, including signs that inflation momentum was beginning to ease across the key economies, with downside surprises from both the US and the Euro Area in the latest data. In the US, the publication of the US CPI for October provided some positive news on the inflation front with a rare downside surprise across the board. The monthly growth in Core CPI was the slowest in over a year and below expectation (+0.3% versus +0.5%). This triggered a strong rally across assets with yields on 2-year treasuries seeing their biggest daily decline since 2008. The report led investors to anticipate a growing chance that the Federal Reserve would start reducing its pace of rate hikes. Powell's speech on the last day of the month was seen by the market as a sign that the central bank will slow down its aggressive tightening this month. In Europe, a similar trend was observed on the last day of the month with the flash CPI release showing lower inflation for the Euro Area (+10%) than expected. In The UK, the BoE mirrored the Fed, raising rates by 75bps and both the BoE and the ECB indicated that further hikes are necessary to deal with inflation. With a £50-£60bn hole in the UK's finances, UK Chancellor announced plans for steep public spending cuts and increased taxes in the Autumn Statement. The Reserve Bank of Australia (RBA) and the Reserve Bank of New Zealand (RBNZ) appear to be on different pathways but still tightening monetary policies. Early in the month, RBA lifted its cash rate by a second consecutive 25bp hike, and despite an upside surprise in the Q3 CPI print. The RBNZ delivered a 75bp rate hike after considering a 100bp move since New Zealand faces high inflation challenge.

Moving to Emerging markets, central banks usually remained on their hiking path in November. In Asia, central banks are catching up on the monetary policy-tightening path with the other regions. In the Philippines, Bangko Sentral ng Pilipinas surprised the market with an unexpected 75bps hike to fight against the sharp increase of core prices. In Indonesia, Bank Indonesia reiterated its front-loading action with 50bps hike while inflation is not peaking. Additional adjustments in the coming months are expected and we are revising the terminal rates at 6%. In Malaysia, Bank Negara Malaysia hiked by 25bps and the limited space from the new ruling coalition to push for bold fiscal measures should not call for a more aggressive tightening stance from the Central Bank. Elsewhere we are observing more signs for a downsizing of the hiking cycle and in some cases a pause such as in Brazil where the Banco Central do Brasil have been on hold for two consecutive meetings. In Peru, Banco Central de Reserva del Peru decided for a third consecutive 25bps rate hike in November after 12 consecutive 50bps increases, while both central banks from Mexico and Colombia are expecting to keep hiking at their next meeting. In CEEMEA, external factors are still pleading for further tightening amidst elevated food price and currency weakness. In the Czech Republic, Czech National Bank defends its currency while keeping rates unchanged while in Poland, the central bank governor announced a pause but not an end to the tightening cycle. In Romania, rates hikes slowed to 50bp while South Africa central bank decided for a 75bps rate hike. Inversely, Turkey has reduced its policy rates by 150bps but announced the end of the easing cycle at 9%.

Following recent elections in China and Brazil, the political agenda was lighter and world leaders met in Sharm El Sheikh to attend the Climate Change Conference (COP 27). Following days of debates, countries have finally decided on a historic conclusion for responding to the loss and damage funding for climate-vulnerable countries. The JETP (Just Energy transition Partnership) was launched, as well as an initiative between emerging nations and developed countries to accompany them in their transition to a low carbon economy. South Africa and Indonesia are the first two emerging countries to benefit from this partnership. In China, China's PBOC and CBIRC jointly released a notice with 16 points of policy measures guiding the financial institutions to support the property market. Many of the policies have already been carried out previously but the notice reinforces them with more guidance for implementation. In the meantime, the Chinese National Health commission announced adjustment to the dynamic clearing policy paving the way to some relaxation of some COVID rules (Quarantine, travel and mobility rules). The central government, on month end, following protests wide spreading across various cities, announced additional measures. Russia's war on Ukraine shows no sign of abating, as G20 leaders ended the summit in Indonesia with a joint declaration that "most members strongly condemned the war in Ukraine". Fears rose further in the week as a missile struck Poland following the intensification of Russia's hostilities in Ukraine, with increased missile attacks targeting Ukraine's energy. Another talking point in Ukraine was the 120-day extension to the Black Sea grain export deal that was set to expire, softening some fears for food importers.

### Performance analysis

Within this environment, EM fixed-income asset class delivered strong positive returns. In USD terms, EM Hard Currency Sovereign (JPM EMBI Global Diversified) returned +7.59%. Geographically, all regions delivered positive returns, with Africa being the best monthly performer by far followed by Latin America. The fund (I EUR Share) delivered its best monthly returns since May 2020 with a performance of 7.25% net of fees in November, outperforming its benchmark by 0.15% with a mixed but positive contribution from our EM debt strategies while our duration positioning detracted as explained below:

On duration, our underweight Modified duration positioning in USD relative to the benchmark detracted to returns following a better than expected inflation print in the US which pushed US treasuries yields lower across the curve with 10y treasuries yield dropping by 44bps to 3.61%. This was partially offset by an overweight exposure to Euro duration even if the downward move on yields was more contained.

Moving to our emerging market debt strategies, a positive exposure toward the asset class contributed positively as credit spreads kept on tightening for a second consecutive month across a majority of sovereign issuers with the exception of a limited number of countries including Poland or Bolivia. Our geographical allocation was source of marginal detraction. Among investment grade countries, our relative value strategy in Latin America was the key performance detractor in November. Mexico, where we hold an overweight exposure, underperformed countries such as Chile and Panama that are more likely to benefit from the reopening of the Chinese economy. Lower oil prices in November limited the performance of the energy sector in Mexico where we our overweight exposure is concentrated. In Asia, the decision to ease the Zero Covid Policy, combined with the release of the 16 points of policy measures from China's PBOC and CBIRC, guiding the financial institutions to support the property market, had a positive impact in our Asian allocation. This is includes an overweight exposure to Quasi issuers in Indonesia, as well as an allocation that we maintained across Chinese Real estate sector. Moving to our allocation across high yielding countries, our overweight exposure to Argentina kept performing well despite an outlook that remains challenging between macro-economic instability and highly polarized political scenario ahead of the election head. Recent successful debt obligation offer on its local bonds (for ARS 931Bn) to extend the maturity and receive new financing and latest data showing an increase of Oil production, mainly through non-conventional fields was some positive factors. Overweight exposure to some African countries such as Egypt where the COP 27 was organised, Ivory Coast or Nigeria, was source of returns as those countries performed strongly in November on the back of potential easing on financial conditions.

## Positioning and outlook

With the year-end approaching, we are focusing on 2023 and we maintain a cautious outlook against a backdrop of weaker global growth and elevated inflation. The global growth outlook remains challenging and we keep revising down our forecast for next year with real GDP growth within emerging countries expected at 3.4%. We do not expect a global recession in our central scenario; instead, we see stagflationary episodes with rising divergences across key economic blocs. The shape of the economic rebound will depend on three key factors: potential pivot from the US Federal Reserve, softening energy crisis in Europe and Chinese economy reopening. In China, following the recent announcements from the government of the 16-point policy pack for property market as well as further easing regarding the zero Covid-19 policy following recent protests, we are a bit more constructive and expect housing sales to stabilize near year-end and become less of a drag on growth in 2023. A full reopening remain uncertain but we now anticipate it to happen by mid-2023, rather than in 2024. As for the inflationary environment across emerging markets, we see the trend stabilizing and expect to see some peaking in several countries by year-end with fewer rising inflation on 2023, however elevated inflation should remain through 2023 and beyond. Position-wise, we remain modestly defensive on duration as, despite the recent rally in the US treasury market that may be too extreme, we expect terminal rates in the US to remain at 5.25% on the back of a tight labour market. In the current environment where the willingness of Central banks to further tighten financial conditions is unclear, an active stance to manage duration and tactically take advantage of current volatility is key. Going forward, we expect divergence in central bank monetary policies depending on their room to adjust and looming recessionary risks. Deteriorating macro momentum and high inflation are two elements, which are calling to keep a cautious stance in our allocation across emerging markets. Within the asset class, we keep favouring hard currency bonds where we still see value within the high yielding space versus Investment grade segment, as spreads will provide a cushion against Fed rate hikes. Specifically, we hold a preference for commodity exporters in Latin America and MENA on the view that energy/commodity prices will remain elevated in medium term despite recent price correction.

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