Emerging Market Debt Market Commentary

Fourth Quarter 2020

EM debt (in USD terms) saw strong positive returns in Q4, aided by the announcement of effective vaccines for COVID-19, the potential benefits to EM as a result of a prospective Biden administration, continued USD weakness, and increased demand for risk assets amid ample global liquidity. Returns for 2020 were positive overall (in USD terms) following a V-shaped recovery from the lows of March. This was supported by improving EM economic activity as lockdowns were gradually eased, and availability of abundant fiscal and monetary policy support. EM currencies recorded a strong rebound in Q4, a catch-up move from historically cheap FX valuations earlier in the year, but still ended 2020 in negative territory versus the US dollar. EM fundamentals, particularly fiscal deficits and gross government debt experienced a weakening trend overall in 2020 – while consolidation is expected as the global backdrop improves through 2021, these are expected to remain weak in the near term. Even as flows into EM local currency (LC) debt picked up in Q4, flows into hard currency (HC) significantly outpaced local currency for the full year, with HC inflows of +$14.1bn versus LC outflows of -$11.3bn (Source for flows: Morgan Stanley Research).

Figure 1 - Emerging Market Debt Index Returns – As of 31 December, 2020

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	3.48%	9.62%	10.29%	2.69%	2.69%	3.01%	6.72%
EMBI GD (EM Hard Currency)	1.90%	5.80%	8.25%	5.26%	5.26%	5.05%	7.08%
CEMBI BD (EM Corporates)	1.47%	4.44%	7.30%	7.13%	7.13%	6.02%	7.12%
In EUR							
GBI-EM GD (EM Local Currency)	1.17%	5.06%	1.24%	-5.79%	-5.79%	2.36%	4.21%
EMBI GD (EM Hard Currency)	-0.38%	1.40%	-0.64%	-3.43%	-3.43%	4.39%	4.56%
CEMBI BD (EM Corporates)	-0.80%	0.09%	-1.50%	-1.71%	-1.71%	5.36%	4.60%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 December 2020. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Performance returns for periods of less than one year are not annualized.

Figure 2: Key EM and Macro levels as of 31 December 2020

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	-14 bps	-26 bps	-100 bps	4.22%
EMBI GD Yield	-21 bps	-60 bps	-37 bps	4.55%
EMBI GD Spread	-28 bps	-81 bps	+61 bps	352 bps
CEMBI BD Yield	-15 bps	-55 bps	-93 bps	4.04%
CEMBI BD Spread	-22 bps	-74 bps	+12 bps	322 bps
CDX.EM 5y	-13 bps	-79 bps	-22 bps	152 bps
10y UST	+7 bps	+23 bps	-100 bps	0.91%
Dollar Index (DXY)	-2.10%	-4.21%	-6.69%	
DOW 30	+3.27%	+10.17%	+7.25%	30,606
Oil (WTI)	+7.01%	+20.64%	-20.54%	$ 48.52

Source: JP Morgan, Bloomberg as of 31 December 2020

Local Currency Market Highlights

Figure 3 - Key return drivers of EM local government bond markets

GBI-EM GD (EM Local Currency)	Monthly Return	3 Month Return	YTD Return
In USD			
Total Return (in $)	**3.48%**	**9.62%**	**2.69%**
FX Return (vs $)	2.20%	6.67%	-5.23%
Price Return (Local currency)	0.81%	1.48%	2.83%
Interest Return (Local currency)	0.45%	1.29%	5.45%
In EUR			
Total Return (in €)	**1.17%**	**5.06%**	**-5.79%**
FX Return (vs €)	-0.09%	2.29%	-14.07%
Price Return (Local currency)	0.81%	1.48%	2.83%
Interest Return (Local currency)	0.45%	1.29%	5.45%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 December 2020. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Performance returns for periods of less than one year are not annualized.

EM Local Currency debt was up +9.62% in US dollar terms in Q4, as measured by the JP Morgan GBI-EM Global Diversified Index, driven by the rally in EM FX (+6.67%). EM FX was stronger in Q4 amid inflows into pro-cyclical and higher-yielding EM assets following reduced market volatility after the US elections, as well as the economic recovery narrative of vaccine support. Most of EM FX's strength in Q4 was in Latin American (LatAm) and Central and Eastern Europe (CEE) FX, largely reflecting a catch-up from earlier in the year, as well as the strength in EUR/USD. Local currency rates' returns contributed positively as well, as most EM central banks maintained an accommodative bias to support growth amid benign price pressures.

Figure 4 - Best and worst performers across EM local government bond markets in USD*

Q4 2020	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight	Index Impact (bps)**
GBI-EM GD		**9.62**	**2.76**	**6.68**		
Top 5 Performers	South Africa	21.3	6.8	13.6	7.6%	162
	Mexico	15.5	4.3	10.8	9.4%	146
	Colombia	15.4	2.4	12.7	5.6%	86
	Indonesia	13.0	6.7	5.9	9.5%	123
	Brazil	11.8	3.0	8.5	8.4%	99
Bottom 5 Performers	China	4.9	0.7	4.1	10.0%	49
	Poland	4.6	0.8	3.8	8.1%	37
	Malaysia	4.1	0.7	3.3	6.8%	28
	Uruguay	2.5	2.5	0.0	0.1%	0
	Philippines	1.3	0.4	1.0	0.2%	0

Source: State Street Global Advisors, JP Morgan as at 31 December 2020. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. * Country and currency performance of JP Morgan GBI-EM Global Diversified Index. **Index impact is calculated by multiplying the period end weight by total return.

South Africa was the best performer, returning 21.3% and contributing the most to index returns (+162 bps). Even though both Moody's and Fitch downgraded the country's local currency long-term debt rating to Ba2 and BB-, respectively, during the quarter due to its deteriorating fiscal situation, high-frequency data suggesting a significant macro rebound, particularly in the mining sector as companies took advantage of the ongoing rally in gold and platinum prices to step up output, has supported investor sentiment towards South African assets. At 3% (year-on-year), inflation is currently at the floor of the central bank's 3-6% target band, allowing monetary policy to remain accommodative and supportive of local currency rates.

Mexico delivered returns of +15.5% for Q4 and was the second-largest contributor to index returns (+146 bps). Mexican assets were supported by the search-for-yield flows amid the Q4 environment of low volatility and ample global liquidity. Investors believe the MXN to be attractive from both a carry and valuation perspective and continued to add bullish MXN longs. In its December meeting, Mexico's central bank left the reference rate unchanged at 4.25% in a split decision, an outcome that has resulted in higher market expectations of a rate cut in February.

Colombia was among the best performers, returning +15.4% for the quarter and contributing +86 bps to index returns. Colombia has been more successful in containing the damage from the COVID-19 shock than other LatAm peers, with activity and demand data recovering to pre-virus levels more quickly. Fiscal risks have remained relatively contained and market participants expect the country's negative output gap to keep inflation below target, allowing the central bank to keep the policy rate low in the medium term.

Indonesia was among the best performers, returning +13.0% over Q4 to be a significant contributor (+123 bps) to index returns. Among EM Asia's most sensitive and highest yielding local bond markets, Indonesian assets were supported by strong foreign inflows as the hunt for yield continued through the last quarter. Even though Bank Indonesia (BI) left its 7-day reverse repo rate unchanged at 3.75% in its December meeting following a 25bp cut in November, market participants continue to expect more policy easing as the economic recovery remains challenging and CPI inflation continues to stay below the central bank's target range.

Philippines and **Uruguay** were the worst performers, returning +1.3% and +2.5%, respectively, over Q4 with no impact on index returns. Elevated uncertainty amid natural disasters on the domestic front (in the case of Philippines), the rise in COVID-19 cases and the steady removal of fiscal support (in the case of Uruguay) limited their participation in the EM rally.

Malaysia lagged the EM rally, returning +4.1% in Q4 as heightened political risks from the likelihood of an early general election, a resurgence of COVID infections resulting in renewed restrictions, falling real rates and a weak growth backdrop all affected sentiment.

Hard Currency Market Highlights

Figure 5 - Key return drivers of EM hard currency government bond markets in USD

EMBI GD (EM Hard Currency)	Monthly Return	3 Month Return	YTD Return
Total Return	**1.90%**	**5.80%**	**5.26%**
Spread Return	2.40%	7.36%	-2.94%
Treasury Return	-0.49%	-1.46%	8.44%
IG Sub-Index	0.77%	2.96%	8.92%
HY Sub-Index	3.24%	9.32%	0.80%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 December 2020. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Performance returns for periods of less than one year are not annualized.

EM hard currency sovereign debt was up 5.80% in Q3, as measured by the JP Morgan EMBI Global Diversified Index. EM Sovereign HC spreads tightened by 81 bps over Q4. EM sovereign fundamentals remain challenged with high external funding needs keeping rating outlooks under downward pressure and the need for new IMF programs that would require difficult reforms and fiscal consolidations; however, investors have mostly overlooked these on expectations of a cyclical upswing and have typically maintained an overweight risk positioning in their search for yield and returns, leading to overall spread tightening and HY-versus-IG spread compression.

Figure 6 - Best and worst performers across EM hard currency government bond markets*

Q4 2020	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight	Index Impact (bps)**
EMBI Global Diversified		**5.80**	**7.36**	**-1.46**		
Top 5 Performers	Angola	22.5	24.1	-1.3	1.0%	23
	Ghana	19.6	21.3	-1.4	1.5%	29
	Venezuela	18.1	18.1	0.0	0.0%	0
	Cote D'Ivoire	16.3	17.6	-1.1	0.4%	7
	Nigeria	16.3	18.0	-1.5	1.5%	25
Bottom 5 Performers	China	-0.1	0.5	-0.6	4.1%	0
	Ecuador	-2.4	-1.0	-1.4	1.2%	-3
	Argentina	-2.8	-1.7	-1.1	1.2%	-3
	Sri Lanka	-13.1	-13.0	-0.2	1.0%	-13
	Lebanon	-21.9	-21.9	0.1	0.2%	-5

Source: State Street Global Advisors, JP Morgan as at 31 December 2020. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. * Country and currency performance of JPM EMBI Global Diversified Index **Index impact is calculated by multiplying the period end weight by total return.

Angola was the best performer with returns of +22.5% over Q4, contributing +23 bps to index returns. The government's pro-active move to privately renegotiate its debts with creditors, while also availing itself of the Debt Service Suspension Initiative yielded significant benefits in reducing its interest expenses in 2020. Also, investors saw efforts to diversify the economy away from oil and into sectors such as agriculture and basic manufacturing as a positive – along with the yields offered by Angola's bonds.

Ghana delivered returns of +19.6% and contributed the most to index returns (+29 bps). Despite the shocks of lower oil prices and COVID-19, the country's high level of diversification allowed it to absorb oil price shocks with less damage to the economy. Its gross external foreign exchange reserves have been flat, supported by the $1bn Foreign and International Monetary Authorities (FIMA) facility from the Fed.

Nigeria was among the best performers, returning +16.3% and contributing +25 bps to index returns. In addition to benefiting from investors' appetite for riskier assets over Q4, the country's change in policy on diaspora remittances, which became effective in December, is expected to help maintain its Balance of Payment (BOP) stability and mark the beginning of a liberalized remittance era.

Venezuela bonds rallied in Q4 as the market priced in the possibility of a Biden administration recalibrating US policy towards the country. The country continues to face multiple issues of macroeconomic distortions, mismanagement and sanctions, which had driven its oil production to extremely low levels; the country doesn't have enough resources to meet its existing debt service obligations. Negotiations between domestic and international stakeholders towards sanctions relief seems to be the most viable option, but progress towards such a solution seems unclear.

Cote D'Ivoire performed well on the back of investors' confidence in the frontier country's debt due to its continued adherence to fiscal prudence and reforms. It had managed to avoid a crisis, along with any significant disruption to the economy following its October presidential election. In December, Fitch affirmed Cote d'Ivoire's Long-Term HC Rating at B+ with a positive outlook, noting that its general government deficit trajectory is consistent with the authorities' goal of narrowing the budget gap to 3% of GDP in 2023, gradually reversing the deterioration from the pandemic shock, and in line with their track record of fiscal prudence since 2012. Cote d'Ivoire also benefits from strong official creditor support due to the government's satisfactory performance under successive IMF arrangements.

Lebanon was the worst performer, returning -21.9% over the quarter, with spreads continuing to suffer in due to concurrent crises of rising pressure on FX, ramping inflation and unemployment. A much-delayed restructuring plan has been agreed after the country defaulted on its debts (totaling $120.1bn as of August) amid spiraling current account and budget deficits. Mismanagement of the economic crisis, tourism downturn and falling remittances from Lebanese diaspora led to central bank FX reserves (ex-eurobond holdings) falling to $20.2bn by mid-November.

Sri Lanka was the among the worst performers, returning -13.1% over the quarter, and detracting the most from index returns (-13 bps) after S&P cut the nation's credit rating to CCC+ from B- in December. The ratings agency cited the government's weakened capacity to generate earnings through sectors such as tourism.

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