Emerging Market Debt Market Commentary

Quarter 1, 2020

Figure 1 - Emerging Market Debt Performance – As of 31 March 2020[1]

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	-11.07%	**-15.21%**	-10.80%	-15.21%	-6.52%	-0.80%	0.25%
EMBI GD (EM Hard Currency)	-13.85%	**-13.38%**	-11.81%	-13.38%	-6.83%	0.42%	2.82%
CEMBI BD (EM Corporates)	-11.52%	**-10.17%**	-8.18%	-10.17%	-3.39%	1.56%	3.20%
In EUR							
GBI-EM GD (EM Local Currency)	-10.98%	**-13.26%**	-11.37%	-13.26%	-4.34%	-1.64%	-0.18%
EMBI GD (EM Hard Currency)	-13.75%	**-11.39%**	-12.38%	-11.39%	-4.66%	-0.43%	2.38%
CEMBI BD (EM Corporates)	-11.42%	**-8.10%**	-8.77%	-8.10%	-1.14%	0.70%	2.76%

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.

Having started 2020 on a firm footing with expectations of a pick-up in global and EM growth and a pause in the US-China trade war, the outlook and performance for many asset classes, including EMD, has been upended. The shock to the global economy brought about by the spread of COVID-19, along with the extreme drop in oil prices (WTI down -66% over Q1) have led to a significant increase in volatility and a sharp sell-off in risk assets, many of which rapidly reached levels not seen since the global financial crisis. Coordinated and aggressive easing measures by almost all developed market (DM) and emerging market (EM) central banks have since alleviated liquidity pressures in most parts of the market.

The negative returns in EM Local markets were driven immediately through the repricing of their currencies as investors rushed to the safety of the US dollar. For EM Hard Currency, the strong rally in US Treasuries was quickly overshadowed by the violent widening in EM Hard Currency spreads and a complete evaporation of market liquidity. The sell-off was also accompanied by very significant outflows from EM bond and equity funds alike, putting further pressure on valuations.

Figure 2: Estimated outflows from EMD Funds as of 31 March 2020

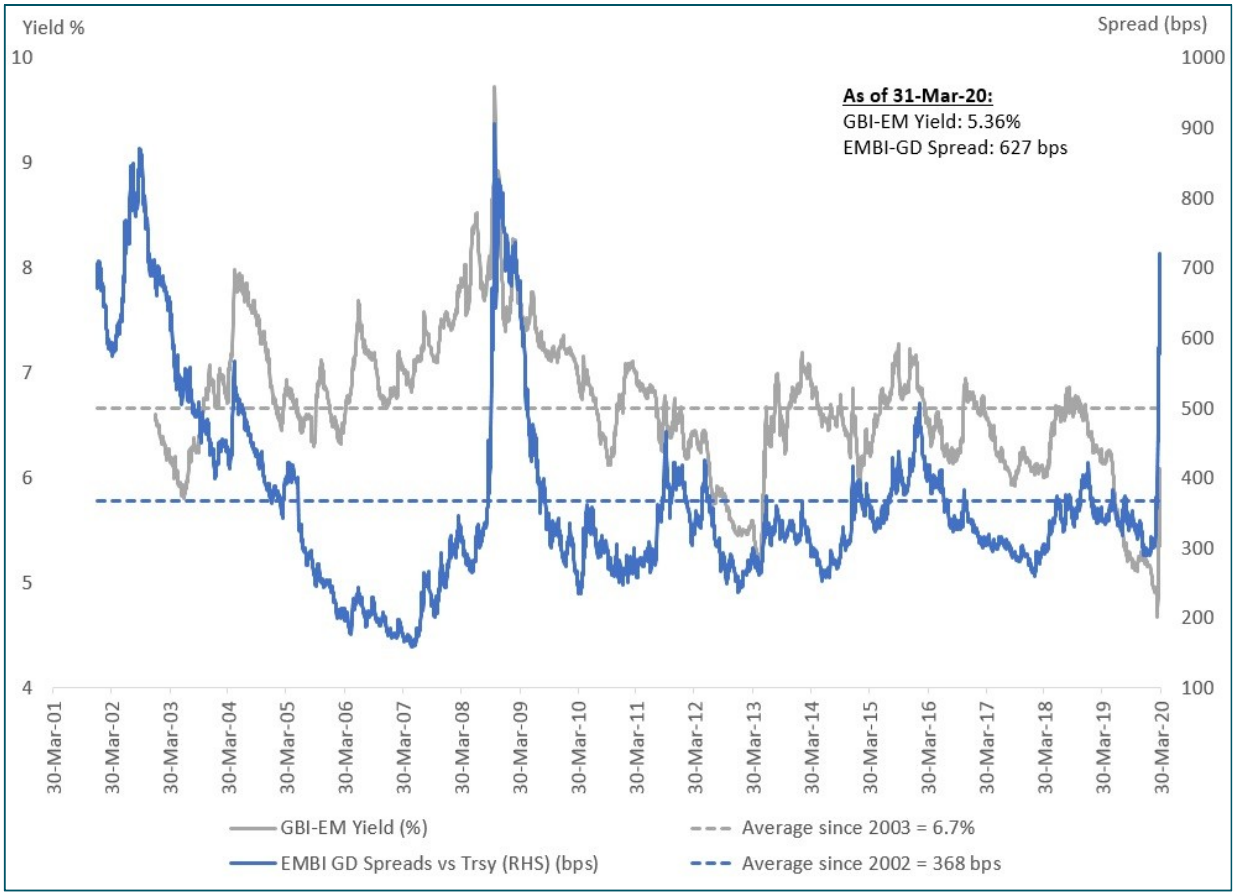
	Flows, $bn		% of AUM	
	Last 4 Weeks	YTD	Last 4 Weeks	YTD
EM LC	-19.8	-15.3	10.5%	8.1%
EM HC	-24.9	-15.9	10.2%	6.5%

Source: Morgan Stanley

[1] Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 March 2020.

In EM local bond markets, yields have been partially supported by local investor demand; however, in hard currency markets, spreads have gapped out significantly.

Figure 3: EM HC Spreads have repriced to levels not seen since GFC



Source: Bloomberg Finance LP. Past performance is not a guarantee of future results.

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Local Currency Market Highlights[2]

Figure 4 - Key return drivers of EM local government bond markets in USD[1]

GBI-EM GD (EM Local Currency)	Monthly Return	3 Month Return	YTD Return
In EUR			
Total Return (in €)	**-10.98%**	**-13.26%**	**-13.26%**
FX Return (vs €)	-8.49%	-12.20%	-12.20%
Price Return (Local currency)	-2.95%	-2.44%	-2.44%
Interest Return (Local currency)	0.47%	1.38%	1.38%
In USD			
Total Return (in $)	**-11.07%**	**-15.21%**	**-15.21%**
FX Return	-8.83%	-14.30%	-14.30%
Price Return	-2.95%	-2.44%	-2.44%
Interest Return	0.47%	1.38%	1.38%

EM Local Currency debt fell 15.2 % in USD terms in Q1, as measured by the JP Morgan GBI-EM Global Diversified Index. Most of the negative returns were passed through EM FX (-14.3%) given the outflows from EM bond and equity markets. Commodity-exporting Latin American countries were notably hit as other commodities (e.g. copper) fell in tandem with oil. In addition, private sector confidence weakened as social distancing and already-existing political frictions could delay reforms progress. New infections in China have fallen and the country's March PMI numbers provide some relief; however, unprecedented challenges to the governance and healthcare infrastructures of EM economies, varying effectiveness of lockdown measures and the high exposure of some EM countries to global supply chains means the timeline and speed of any recovery remains very uncertain.

Figure 5 - Best and worst performers across EM local government bond markets in USD[*]

Quarter 1, 2020	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight	Index Impact (BP)**
GBI-EM GD		**-1.29**	**1.43**	**-2.67**		
Top 5 Performers	China	1.8	3.6	-1.8	1.0%	2
	Romania	-3.6	-0.5	-3.2	2.9%	-11
	Philippines	-3.9	-3.5	-0.4	0.2%	-1
	Malaysia	-4.3	1.0	-5.3	7.0%	-30
	Peru	-6.2	-2.6	-3.7	3.9%	-24
Bottom 5 Performers	Mexico	-19.2	0.3	-19.5	10.0%	-192
	Russia	-21.0	-0.7	-20.5	8.6%	-181
	Brazil	-21.5	1.3	-22.4	10.0%	-215
	Colombia	-21.5	-2.9	-19.2	5.6%	-120
	South Africa	-30.7	-9.0	-21.7	7.3%	-225

Source: State Street Global Advisors, JP Morgan as at 31 March 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.

[2] The returns stated in this section are based on the local currency returns according to JP Morgan GBI-EM Global Diversified. Returns calculated in USD.

China was somewhat of a safe-haven and the only country in the index with a positive total return in Q1. Even though it was the epicenter of the outbreak, very strict containment measures appear to have brought its new infection rates under control. Slow but steady recovery in activity, implementation of a countercyclical FX policy, targeted fiscal response and monetary easing measures to support risk sentiment have also all led to relative stability of its bonds and currency.

South Africa was the worst performer over Q1, returning -30.7% and was also the largest detractor from index returns (-225 bps). The effect of the COVID-19 shock on economic growth and public finances has negatively impacted the outlook for the country, which was already struggling from large fiscal deficits, sharply rising public debt, loss-making state-owned entities, persistently weak business confidence, unreliable power supply and structural labor market rigidities. Moody's and Fitch downgraded the country's local currency ratings to Ba1 and BB from Baa3 and BB respectively, which led to further investment outflows from foreign investors, who own a considerable 35-40% of its local currency debt.

Colombia, **Brazil** and **Mexico** were among the worst performers, with their negative returns driven primarily through the FX channel. The sharp fall in asset prices in these countries were driven by: the shutdowns and domestic demand shock caused by the COVID-19 outbreak, as well as the significant decline in oil prices (oil represents ~35% of Colombia's exports); exposure to China (30% of Brazil's total exports are to China); economic dependence on manufacturing; travel and tourism (34% of Mexico's GDP); and political issues that have the potential to delay Brazil's reform agenda further.

Russia also performed poorly (-21.0%), with all negative returns through depreciation of the RUB. The underperformance was driven by the huge dependence on oil (energy sector makes up ~35% and ~50% of its budget revenues and exports, respectively) and weak global risk sentiment leading to foreign investors unwinding long positions in its bonds. China is the single largest trading partner for Russia and expectations of slower economic activity due to disruption in imports from China was also a factor. Its foreign policy developments surrounding Syria continues to remain fluid and a tail-risk.

Indonesia was a particularly weak performer (-17.5%) and a significant detractor from index returns (-175 bps). Shock from the COVID-19 outbreak on the growth outlook and vulnerabilities from outflows due to a large foreign ownership of its local bonds (~40%) were among the reasons for its currency to be one of the most volatile in Asia FX. Travel and tourism contribution to GDP and exposure to China had a relatively much lesser effect.

Hard Currency Market Highlights[3]

Figure 6 - Key return drivers of EM hard currency government bond markets in USD[1]

EMBI GD (EM Hard Currency)	Monthly Return	3 Month Return	YTD Return
Total Return	**-13.85%**	**-13.38%**	**-13.38%**
Spread Return	-17.04%	-21.57%	-21.57%
Treasure Return	3.84%	10.45%	10.45%
IG Sub-Index	-8.07%	-5.44%	-5.44%
HY Sub-Index	-20.74%	-22.44%	-22.44%

EM Hard Currency sovereign debt returned -13.4% in Q1, as measured by the JP Morgan EMBI Global Diversified Index. Among the reasons for a significant widening in EM HC spreads were the high share of oil exporters in the EM HC market as well as sharp downgrades to growth in several larger EM economies such as Brazil, South Africa, Indonesia, and Mexico. Also driving spread-widening was the weakness in EM FX, making hard currency borrowing more expensive to repay. The increased dependence on external and IMF funding for some smaller African economies, along with expected credit deterioration and overall risk-off sentiment, added to the negative performance. As a consequence, EM hard currency bonds fell sharply and market conditions remained very challenged amid a wave of selling. Bonds from some of the weaker countries began trading at distressed levels, suggesting restructuring and defaults may lie ahead.

Figure 7 - Best and worst performers across EM hard currency government bond markets*

Quarter 1, 2020	Country	Total Return (%)	Spread Return (%)	TSY Return (%)	Index Weight	Index Impact (BP)**
EMBI Global Diversified		-0.48	-0.09	-0.39		
Top 5 Performers	Lithuania	2.3	-0.2	2.5	0.3%	1
	Slovakia	2.1	-1.0	3.1	0.3%	1
	China	2.0	-4.4	6.7	4.7%	9
	Poland	1.9	-2.2	4.3	2.0%	4
	Serbia	-2.1	-4.3	2.3	0.3%	-1
Bottom 5 Performers	Sri Lanka	-39.5	-43.1	6.3	1.5%	-57
	Zambia	-40.2	-42.9	4.7	0.2%	-9
	Lebanon	-61.5	-63.1	4.4	0.5%	-29
	Angola	-62.6	-66.5	11.5	0.6%	-36
	Ecuador	-67.0	-68.9	5.9	0.8%	-55

Source: State Street Global Advisors, JP Morgan as at 31 March 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.

Ecuador was among the worst performers, returning -67.0%, and was the second largest detractor from index returns (-55 bps). The sell-off in oil prices (oil forms 35% of total exports) has impacted its cashflows in an already tight liquidity position. Even though the government appears willing to work with creditors to avoid a hard default and implement a restructuring with the support of the IMF, significant political and implementation risks remain in place.

[3] The returns stated in this section are based on the hard currency returns according to JP Morgan EMBIG Diversified. Returns calculated in USD.

Angola was among the worst performers as well, returning -62.6% and detracting -36 bps from index returns. The country's heavy dependence on crude oil (96% of total exports), sizeable external and IMF financing needs (the IMF estimates a further external funding requirement of ~$8bn this year), and a high debt-to-GDP ratio have all been contributing factors in this pullback.

Lebanon was also a laggard, returning -61.5%, and a large detractor from index returns (-29 bps). It has already defaulted on its sovereign bonds and might implement formal capital controls in the near term. With a fully-funded IMF program appearing unlikely, weak parliamentary support for urgent government policy actions and social stability concerns, the country's bonds underperformed significantly.

Sri Lanka also featured among the worst performers, returning -39.5%; it was also the largest detractor from index returns (-57 bps). Low ranked health infrastructure, a high contribution of tourism and travel to GDP (~13%), further challenges to the weak growth outlook and fiscal position from COVID-19, and upcoming large interest expenses in 2020 have all led to outflows and poor performance.

Spreads of small Eastern European countries such as **Lithuania**, **Slovakia** and **Serbia** had been relatively resilient to the broader sell-off, but that has typically been due to lack of liquidity and did not have any significant impact on index returns due to their low weights

China and **Poland** were among a small handful of countries with positive total returns and a positive contribution to index returns (total of +13 bps), aided by investor demand for non-GCC higher-quality bonds (China rated A+ and Poland rated A-).

Hard Currency Corporate Bond Markets[4]

Figure 8 - Key return drivers of EM hard currency corporate bond markets[1]

CEMBI BD (EM Corporates)	Monthly Return	3 Month Return	YTD Return
Total Return	**-11.52%**	**-10.17%**	**-10.17%**
Spread Return	-13.80%	-15.87%	-15.87%
Treasury Return	2.65%	6.78%	6.78%
IG Sub-Index	-8.32%	-6.06%	-6.06%
HY Sub-Index	-15.96%	-15.76%	-15.76%

[4] The returns stated in this section are based on the hard currency returns according to JP Morgan CEMBIB Diversified. Returns calculated in USD

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