Emerging Market Debt Market Commentary

February 2020

Figure 1 - Emerging Market Debt Performance – As of 28 February 2020[1]

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	-3.41%	-0.71%	1.27%	-4.65%	3.73%	3.95%	2.01%
EMBI GD (EM Hard Currency)	-0.97%	2.57%	1.90%	0.54%	9.68%	5.67%	5.98%
CEMBI BD (EM Corporates)	-0.01%	2.51%	4.43%	1.53%	10.58%	5.90%	5.86%
In EUR							
GBI-EM GD (EM Local Currency)	-2.55%	-0.34%	1.53%	-2.57%	7.53%	2.80%	2.44%
EMBI GD (EM Hard Currency)	-0.09%	2.95%	2.16%	2.74%	13.70%	4.51%	6.42%
CEMBI BD (EM Corporates)	0.87%	2.90%	4.69%	3.75%	14.64%	4.74%	6.31%

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.

Emerging markets (EM) saw a sharp sell-off in February along with other risk assets, as new cases of COVID-19 infections spread around the globe. These significant moves across asset classes were due to fears of a broader and potentially deeper global slowdown from economic disruption brought about by the rapid spread of the virus. The more sensitive EM foreign exchange (FX) and EM Local Currency asset classes were hardest hit, returning -3.4% over the month. Meanwhile, EM Hard Currency Sovereign and Corporate total returns were partially sheltered by the underlying rates rally.

Expectations of monetary policy easing have started to build across the board for both EM and DM, and markets are now pricing in up to three rate cuts by the US Federal Reserve this year. In EM, with a few exceptions, interest rates are expected to decline by year-end. However, the nature of the current COVID-19 shock means that monetary policy is likely to be less effective in stimulating real economic activity; hence, risk sentiment is likely to remain fragile in the near term and vulnerable to headlines about the spread of the virus.

Figure 2: Key EM-related levels as of 28 February 2020

Item	Δ 1 Month	Δ YTD	Current Level
GBI-EM GD Yield	-5 bps	-27 bps	4.95%
EMBI GD Yield	20 bps	5 bps	4.98%
EMBI GD Spread	59 bps	83 bps	373 bps
CEMBI BD Yield	-2 bps	-31 bps	4.66%
CEMBI BD Spread	36 bps	47 bps	358 bps
CDX.EM 5y	57 bps	81 bps	255 bps
10y UST	-36 bps	-77 bps	1.15%
DXY	0.76%	1.81%	
DOW 30	-10.07%	-10.96%	25,409
Oil (WTI)	-13.19%	-26.70%	$ 44.76

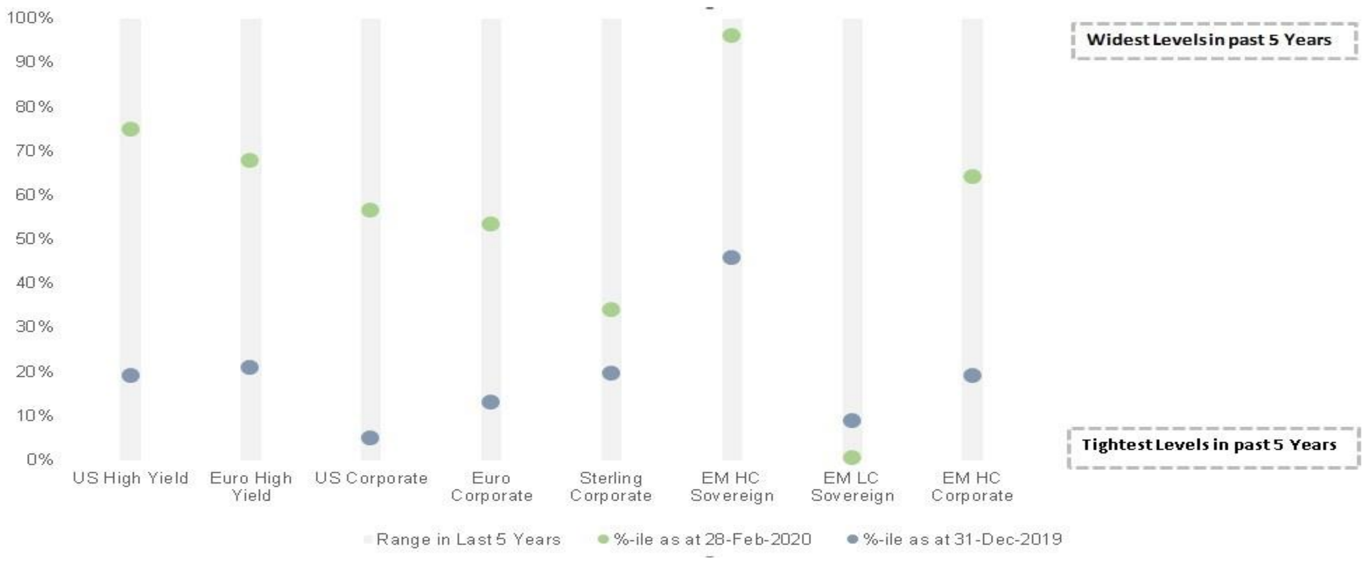
Source: JP Morgan, Bloomberg Finance LP as at 28 February 2020

[1] Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 28 February 2020.

Markets are likely to begin to differentiate between regions and countries according to the likely economic effects from the virus spread, potential disruption from containment measures, trade dependence on other affected countries and domestic policy responses to the negative shock.

After such a strong year in 2019, valuations across fixed income sectors have become significantly cheaper from these levels. For investors who expect the effects to be transitory, and a V-shaped recovery likely in the second quarter, then this could be a buying opportunity. For other investors concerned that this could be a catalyst for a more prolonged and deeper global slowdown, then caution is advised. For us, it is too early to tell, but previous situations have proven to be temporary and transitory.

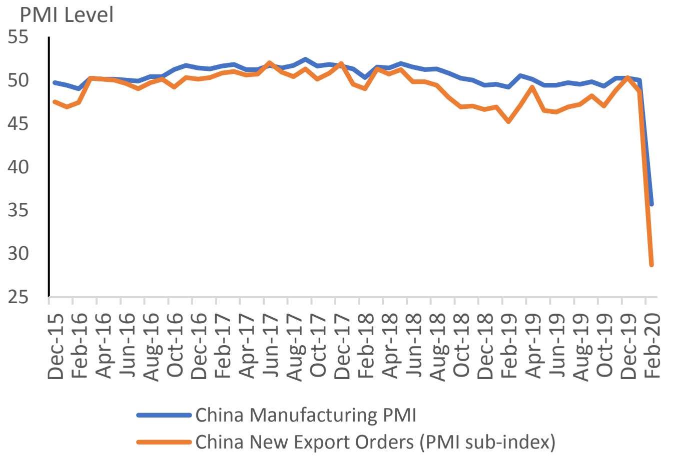
Figure 3: Valuations cheapen



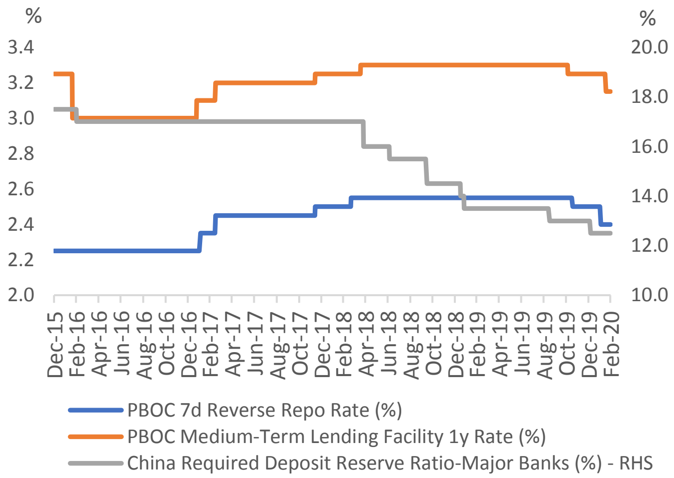
Source: State Street Global Advisors, Bloomberg, JP Morgan as of 28 February 2020.

Figure 4: The China Experience

China, the epicenter of the outbreak saw steep decline in activity indicators and business confidence…



…leading to unprecedented outbreak-control measures, as well as policy support from the Central Bank to lower borrowing costs, easing strain on companies hit by the virus



Source: State Street Global Advisors, Bloomberg Finance LP, as of 28 February 2020.

Local Currency Market Highlights[2]

Figure 5 - 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 €)	**-3.41%**	**-0.71%**	**-4.65%**
FX Return (vs €)	-3.42%	-3.03%	-6.00%
Price Return (Local currency)	-0.42%	1.00%	0.54%
Interest Return (Local currency)	0.42%	1.39%	0.90%
In USD			
Total Return (in $)	**-2.55%**	**-0.34%**	**-2.57%**
FX Return	-2.55%	-2.73%	-4.00%
Price Return	-0.42%	1.00%	0.54%
Interest Return	0.42%	1.39%	0.90%

EM Local Currency debt was down by -3.4% in US dollar terms in February, as measured by the JP Morgan GBI-EM Global Diversified Index, with the FX component detracting -3.4%. The bond component of local currency markets remained resilient. This is due to market participants expecting weakening demand and falling oil prices to result in a disinflationary impulse, which would open room for more policy easing, especially in EM Asia. Any coordinated global growth upturn in late Q4 2019 / early Q1 2020, which could have supported EM FX, was quickly overshadowed by a negative impact from the coronavirus – including supply chain disruptions and worsening business sentiment.

Figure 6 - Best and worst performers across EM local government bond markets in USD*

February 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	Thailand	0.81	1.97	-1.13	9.8%	8
	Philippines	0.28	0.56	-0.29	0.2%	0
	Czech Republic	-0.21	1.87	-2.04	4.3%	-1
	Poland	-0.33	1.31	-1.62	9.0%	-3
	Dominican Republic	-0.38	0.06	-0.44	0.2%	0
Bottom 5 Performers	Mexico	-4.94	-0.53	-4.44	10.0%	-49
	South Africa	-5.19	-0.56	-4.64	8.3%	-43
	Russia	-5.33	-0.46	-4.89	8.9%	-47
	Indonesia	-5.36	-0.56	-4.82	10.0%	-54
	Turkey	-11.38	-7.47	-4.25	3.3%	-37

Source: State Street Global Advisors, JP Morgan as at 28 February 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.

Turkey was the worst performer returning -11.4%, detracting -37 bps from index returns. Both the bond and FX components sold off as markets returned their focus to the country's negative real policy rates. This has been driven by CBRT easing even at a time of lira weakness, sticky inflation expectations and increased geopolitical tensions. Investment remains weak and well below its long-term trend, and might pressure the central bank to extend the easing cycle further.

Indonesia was the second-worst performer (-5.4%) and the largest detractor from index returns (-54 bps), almost all of it from performance of the Indonesian rupiah (-4.8%). Even though the economic impact of the COVID-19 outbreak on Indonesia should be relatively limited compared with other Asian economies, the risk-off sentiment seen across broader financial markets still took hold. Bank Indonesia cut its policy rate by 25bps to 4.75% as a pre-emptive measure and reduced its 2020 GDP growth forecast by 10bps to 5.0-5.4% from 5.1-5.5%. It expects a V-shaped recovery on the quarterly GDP growth path in 2020 and its base case is for two months of airline shutdowns and six months of weak tourism.

Russia also lagged, returning -5.3% to be a significant detractor from index returns (-47 bps). A sharp fall in oil prices and overhang of long positions led to a sell-off in Russian assets. Even though the correlation between oil prices and Russia's economic growth has declined, lower oil prices still cuts into gross investment spending through the reduction of corporate profitability. China is Russia's single largest trading partner and expectations of slow broader economic activity due to disruption in imports from China also contributed to the weakness.

South Africa was among the worst performers as well, returning -5.2%. The country's February 2020 budget fell short of delivering the necessary net improvement in fiscal accounts needed to stabilize the country's debt dynamics. Tax revenues are also forecast to decline over the next few years due to lower GDP growth, lower inflation and lower tax buoyancy. Recent weak prints of the South African Reserve Bank's leading indicator, low business and consumer confidence indices, lower disposable income growth in the public service, as well as the negative impact of COVID-19 on the growth outlook of South Africa's largest trading partners (Europe and Asia) weighed on the country's return.

Mexico returned -4.9%, driven by the USDMXN selloff that was in part due to risk-off sentiment and the usage of the currency as a hedge against risk-off moves. Banxico upwardly adjusted its short-term inflation forecasts and confirmed that wage dynamics are the main upside risk for inflation. It also downgraded its 2020 growth forecast to 1.0% (0.5-1.5% range) from 1.3% year-on-year previously, due to potential effects from COVID-19.

Thailand bounced back from the previous month, returning +0.8% and contributing +8 bps to index returns. While the Thai economy continues to be on a decelerating trend, declines in manufacturing production, agricultural production and visitor arrival growth were not as bad than expected. Export volumes grew by 2.8% y/y in January, after falling by 2.8% in December. However, this is due to the jump in gold exports and hence unsustainable. Market participants expect the Bank of Thailand to wait until May to decide on a rate cut, as the data released so far has not shown a particularly sharp deterioration in economic activity.

Hard Currency Market Highlights[3]

Figure 7 - 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	**-0.97%**	**2.57%**	**0.54%**
Spread Return	-3.99%	-2.71%	-5.47%
Treasure Return	3.15%	5.42%	6.36%
IG Sub-Index	0.56%	3.53%	2.86%
HY Sub-Index	-2.77%	1.42%	-2.15%

EM Hard currency sovereign debt returned -0.97% in February, as measured by the JP Morgan EMBI Global Diversified Index. EM HC sovereign spreads widened by 59 bps amid investor concerns about the greater scope for regional and global spillovers from a shock emanating in China compared to previous instances of outbreaks such as SARS. Other contributing factors included potential growth downgrades for EM economies, as well as negative news around idiosyncratic high yield (HY) EM such as Lebanon and Ecuador. However, the strong rally in underlying treasury yields due to investors moving into safe-haven assets partially offset the spread widening.

Figure 8 - Best and worst performers across EM hard currency government bond markets*

February 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	Venezuela	24.69	23.89	0.64	0.0%	0
	Suriname	4.05	2.07	1.94	0.1%	0
	Paraguay	2.08	-2.09	4.26	0.8%	2
	China	1.89	-0.21	2.10	4.1%	8
	Belize	1.49	-1.70	3.24	0.1%	0
Bottom 5 Performers	Argentina	-4.14	-5.95	1.93	1.3%	-5
	Angola	-4.34	-7.22	3.10	1.3%	-5
	Turkey	-6.31	-8.80	2.73	3.3%	-21
	Ecuador	-14.23	-15.69	1.74	1.8%	-26
	Lebanon	-28.07	-29.00	1.31	0.6%	-18

Source: State Street Global Advisors, JP Morgan as at 28 February 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.

Lebanon was the worst performer, returning -28.1% and was a significant detractor from index returns (-18 bps). One of the world's most indebted countries with debt at ~150% of GDP, Lebanon continued to see credit spreads soar after months of economic slowdown and a dollar liquidity squeeze pressured the government's capacity to service debt. Market participants believe that its debt burden is unsustainable, with maturities of US$1.2 billion due on the 9th March, and other bonds worth US$700 million and US$600 million maturing in April and June. There is little clarity on whether Lebanon would default or announce a form of restructuring with extended maturities, neither of which is good news for bondholders.

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

Ecuador return -14.2% and was the largest detractor from index returns (-26 bps). The announcement of a coalition break by the opposition party CREO with the ruling party Alianza Pais has increased the challenges the administration will face in passing reforms required by the International Monetary Fund. Also, Finance Minister Richard Martinez's comments about debt re-profiling in March triggered a sell-off. Even though bonds recovered some of their losses after an eventual press release by the Finance Ministry clarifying that his comments were misconstrued, disappointment on the speed of implementation of the IMF program, and heavy long positioning of its bonds in the market impacted the country's return in a risk-off month.

Turkey delivered a negative return of -6.3% and was a significant detractor from index returns (-21 bps). Turkey spreads have had an impressive rally since September 2019 up until the month under review. However, the first two weeks of February saw spreads widen sharply back to September levels due to renewed investor concerns on the geopolitical risks that Turkey faces as it launched a military offensive against the Syrian regime near the month-end. Many also believe that the aggressive cutting of interest rates by the central bank has been overdone.

Venezuela, **Suriname** and **Paraguay** had strong total return numbers of +24.7%, +4.0% and +2.1%, but with negligible impact on index returns.

Hard Currency Corporate Bond Markets[4]

Figure 9 - Key return drivers of EM hard currency corporate bond markets[1]

CEMBI BD (EM Corporates)	Monthly Return	3 Month Return	YTD Return
Total Return	**-0.01%**	**2.51%**	**1.53%**
Spread Return	-2.05%	-1.08%	-2.40%
Treasury Return	2.08%	3.64%	4.02%
IG Sub-Index	0.88%	3.00%	2.47%
HY Sub-Index	-1.22%	1.85%	0.24%

[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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