Strategy commentary

Ninety One Emerging Market Local Currency Dynamic Debt

Month ending 30 April 2024

The following commentary gives the views of the investment manager at the time of publication.

Market background

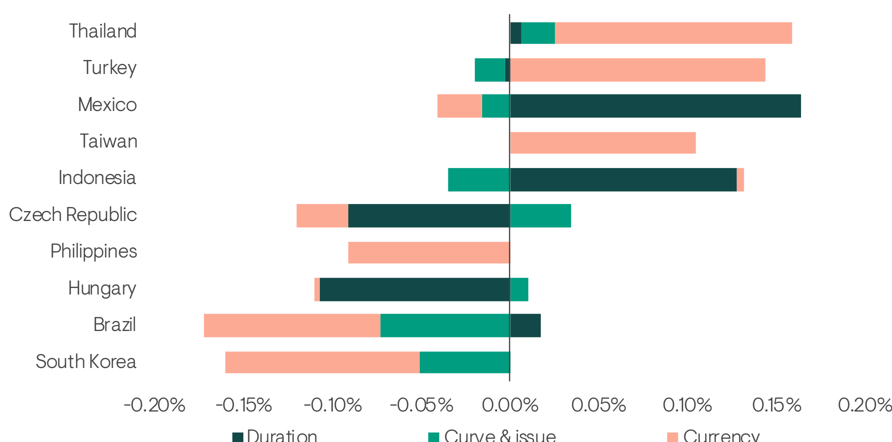
A combination of sticky inflation, labour-market resilience, and hawkish comments from the US Federal Reserve (Fed) caused a sharp rise in US Treasury yields over April. The US Consumer Price Index (CPI) revealed higher-than-expected inflation (3.5% year on year), while core inflation – which strips out food and energy prices – was higher still at 3.8% over the same period. Responding to this, Fed Chair Jerome Powell was notably more hawkish in his statements. Powell reiterated that recent economic data suggests it is likely to take longer than expected to bring inflation down to target, and that the Fed can keep interest rates at their current elevated levels for longer if needed. This led to a repricing in the US Treasury yield curve and a reset in the market's expectations of interest rate cuts. In Europe, sovereign bond yields across the continent rose over the month, although not as significantly as in the US. The European bond market sell-off was partly driven by the correlation with the US, but also a result of market participants removing rate cuts from their 2024 expectations.

April was a difficult month for emerging market (EM) sovereign debt, with the broader asset class coming under pressure from the sell-off in sovereign bond yields across developed markets. Starting with local bonds and currencies, the JP Morgan Government Bond Index-Emerging Markets fell by 2.1% over April, with both EMFX (-1.2%) and hedged local bonds (-1.0%) weakening, with the former impacted by the stronger US dollar. In hard currency debt, the sovereign index (JP Morgan EM Bond Index) also fell by 2.1%, with the more interest rate-sensitive investment-grade portion of the index falling by 2.8%, while the high-yield segment fell by 1.4%.

Performance review

The Strategy underperformed the JP Morgan GBI-EM over the month[1], gross and net of fees.

Figure 1: Top 5 contributors and bottom 5 detractors



[1]Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.

Not all securities held have been discussed. Attribution is shown gross of fees. Fees are deducted at the portfolio level which is where their impact is shown. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Past performance does not predict future returns; losses may be made.

Contributors to performance

Thailand: The portfolio’s underweight positioning in the Thai baht added to relative performance. The widening interest rate differential with the US caused some of the currency weakness, while trade and consumption data in Thailand was disappointing.

Turkey: Overweight exposure to the Turkish lira helped performance. With the local elections behind us, there were significant inflows back into the lira from both local and offshore investors. This stabilised the lira, helping the portfolio’s carry trade.

Mexico: Being underweight local bonds in Mexico provided a further boost to relative returns. This bond market is particularly sensitive to the US Treasury market, where yields rose, while higher inflation and a hawkish central bank also weighed on the market.

Detractors from performance

South Korea: The portfolio’s overweight exposure to the South Korean won detracted from performance. The strengthening of the US dollar led to a sell-off and the central bank did not intervene to support the won.

Brazil: The government in Brazil proposed a 0% primary fiscal balance for 2025, which is a small deterioration relative to the previous 0.5% surplus. The market reacted negatively to this, with the real weakening. In addition, the central bank began to sound more hawkish, and this weighed on the local bond market. The portfolio’s overweight in both the real and the local bonds hurt relative performance.

Hungary: In Hungary, the local bond market experienced a sell-off in April. This was driven by a combination of global bond market weakness, a modestly unfavourable inflation picture, and the market pricing out some rate cuts later in the year. Exposure detracted from returns.

Outlook and strategy

Recent data releases have led markets to become more confident of a ‘soft landing’ (rather than a recession) for economies, especially the US. Despite the messaging at the Fed’s May press conference being slightly more dovish than expected, sticky inflation and resilient economic growth mean the outlook for rates remains uncertain. The market is now pricing in the first rate cut for later this year but if the eventual pace at which the Fed unwinds its tight monetary policy undershoots expectations, further rate-market volatility could materialise.

While financial markets are likely to remain volatile, we continue to be constructive on the medium-term outlook for returns from the EM debt asset class. Many EM economies have solid fundamental foundations. The more fragile economies are receiving plenty of support from the IMF and other multilaterals. Furthermore, with much of the painful interest-rate hiking now behind them, most EM economies are in an enviable position relative to developed markets overall, with most EM central banks either having completed their hiking cycle or beginning to cut rates. EM bond market valuations look attractive – with some markets still pricing in significantly more risk than we believe is justified.

From a top-down risk perspective, we have moved to a neutral stance overall in EM assets. We are now neutral in EM currencies, and while we acknowledge strong underlying country fundamentals, the higher real rates in the US creates a more challenging environment for the asset class. We remain overweight local rates, as we note that inflation in EM economies continues to surprise to the downside, select markets continue to exhibit attractive real rates, and rate-cutting cycles have further to go in some EM economies.

Specific risks

Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. Default: There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss. Derivatives: The use of derivatives may increase overall risk by magnifying the effect of both gains and losses leading to large changes in value and potentially large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. Emerging market: These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. Interest rate: The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise. Liquidity: There may be insufficient buyers or sellers of particular investments giving rise to delays in trading and being able to make settlements, and/or large fluctuations in value. This may lead to larger financial losses than might be anticipated.

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