Emerging Markets Blended Debt

Market background

It was a solid quarter for EM fixed income and currency markets. The global rally in government bond yields, together with an improved appetite for risk among market participants, provided a supportive backdrop for the asset class. In the US, falling inflation and expectations of rate cuts led to a sharp drop in Treasury yields. The Federal Reserve subsequently reduced interest rates for the first time in four years in its September meeting; after much debate across markets around its potential size, the 50bps cut reflected a slowing labour market and increased confidence around inflation dynamics.

Local currency markets had a particularly strong quarter, primarily driven by EM FX but local bonds also added to returns. Bond prices gained across the EM regions, while in EM FX markets gains were most apparent in Asia, as these currencies tend to benefit more from the US dollar weakening and the gap between domestic yields and US Treasuries falling. In contrast, currencies in Latin America suffered from a sharp rally in the Japanese yen after the Bank of Japan turned more hawkish than expected. This caused an unwinding of carry trades in the region, which were funded by the lower-yielding Japanese currency.

Hard currency sovereign debt markets also posted strong returns, benefiting from falling US Treasury yields and the global rally in risk assets. High-yield markets gained the most, but investment-grade market returns were also strong. Within EM corporate debt, it was another strong quarter. Both the high-yield and investment-grade segments performed in a similar fashion from a total return perspective, with the high-yield market benefiting more from credit spread tightening (reflecting improved sentiment) and carry, while investment-grade bonds were boosted by the fall in US Treasury yields.

Performance

The Strategy outperformed its benchmark over the quarter, gross and net of fees*.

Political noise in Mexico weighed on the currency over the quarter; the controversial reform was passed in September, weakening judiciary independence. This led to a statement from Moody's that the country's credit rating may be negatively affected. Underweight positioning in the peso added to relative returns.

Exposure to local bonds in Peru helped relative performance. Falling global yields and easing domestic inflation allowed the central bank to resume its rate-cutting cycle during the quarter and this benefited the bond market.

Further rate cuts from the Hungarian central bank, plus the global rally in duration, helped Hungarian local bonds. Overweight exposure added to the performance.

Exposure to South African local and hard currency bonds boosted performance. The former were helped by the more constructive global rates backdrop and improving domestic inflation data. In the hard currency space, the risk premium on South African debt continued to dissipate following the market-friendly election result, while the global rates rally also helped these market-sensitive bonds.

Exposure to Argentinian hard currency bonds added to performance. This market gained from the rally across more risk-sensitive assets. In addition, the government announced a tax amnesty whereby individuals can bring offshore assets back into the country without tax penalties; this provided a further boost to sentiment.

Turning to detractors, the Thai baht's close correlation with the gold price, combined with weakness in the US dollar, led to a rally in the

*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. 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.

currency. The portfolio's underweight positioning early in the quarter held back performance. We have since moved to a neutral position.

The Chinese renminbi was also a beneficiary of the broader US dollar weakness, and underweight exposure held back performance.

The portfolio's underweight positioning in Bahrain and the Philippines' hard currency debt markets detracted from performance, with both bond markets beneficiaries of the rally in US Treasury yields.

The central bank in Chile was more dovish than expected, hurting the peso and weighing on the portfolio's exposure over the quarter.

Portfolio activity

The portfolio increased exposure to Asian currencies. We closed our short in the Philippine peso due to a narrowing in the country's trade deficit and an increase in foreign direct investment, and we closed our underweight in the Thai baht. We moved overweight the Indonesian rupiah as it is relatively sensitive to moves in the US Treasury market, thus we expect it to benefit from the lower US yield environment and a weaker US dollar. In Malaysia, the central bank continues to believe the ringgit is undervalued, and we expect further repatriation flows to continue to support the currency; we increased exposure to overweight. In contrast, we moved to a short position in the Korean won – we expect US dollar buying by the country's large National Pension Service to continue to weigh on the currency. Turning to local bonds, the market is pricing in a large amount of rate cuts in South Korea but we expect a delay given the central bank's concerns over financial stability, so we moved underweight.

In Latin America, we moved underweight the Colombian peso due to concerns about a weaker US growth outlook, risks to commodity prices, and the possibility that the central bank may accelerate its rate-cutting cycle, thereby reducing carry. After a dovish pivot from the central bank in Chile, we closed out of both the overweight in the peso and underweight in local bonds. We took off our short in the Peruvian sol given stronger growth data, plus external accounts are performing well. Additionally, we increased our exposure to local bonds in Mexico to overweight due to supportive inflation dynamics, weaker growth, and the central bank signalling it would start cutting rates at a more regular cadence. Also in Mexico, we added exposure to state-owned oil producer Pemex; we expect more direct government support for the company from the new administration, relating to potential changes to Pemex's legal status. We closed our exposure to Ecuadorian hard currency bonds. This was partly to reduce the portfolio's top-down credit exposure, and also related to risks to the country's growth outlook.

In CEEMEA, we reached our target levels in the Polish zloty and reduced exposure to neutral. We moved underweight the South African rand as it performed well year-to-date and is exposed to a potential slowdown in global growth or commodity prices. Following the underperformance in the Czech koruna, we halved the portfolio's underweight. In the hard currency space, we topped up exposure to Turkey via a new issue with attractive value; we believe that if the authorities continue with orthodox monetary policy, there is potential for a credit rating upgrade.

In Africa, we increased exposure to hard currency bonds in Ivory Coast, which continues to demonstrate progress on its macroeconomic story with fiscal consolidation and a narrowing current account deficit.

Outlook and strategy

The global economy had shown some signs of slowing, with the US labour market cooling and the manufacturing sector weakening. In September, the US Federal Reserve (Fed) began its rate-cutting cycle with a reduction of 50 basis points (bp). Chair Powell signalled that the Fed was more comfortable with the US economy's inflation trajectory and that a 'recalibration' of monetary policy was needed. More recently, however, US labour data has surprised to the upside; this, combined with other economic activity data releases and commentary from Powell, has caused the market to price out the chance of further 50bp cuts this year. We believe there could be further rate-market volatility. But this should not distract from the main underlying theme that the US and global economy is cooling, inflation is close to targets, and monetary policy is easing. Furthermore, the recent stimulus announcement from China has boosted sentiment and may prove to have a fundamental longer-term positive impact on growth, consumption and investment, with possible spillover to the broader EM universe. That said, our base case expectation is that the Chinese stimulus will not materially impact the trajectory of global growth or inflation.

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, and the more fragile economies continue to receive plenty of support from the IMF and other multilaterals. EM bond market valuations look attractive – with some markets still pricing in significantly more risk than we believe is justified.

From a top-down perspective, we continue to have a positive overall risk target. We have reduced our overweight position in local rates to neutral, increased our FX position from slightly underweight to neutral, and remain overweight hard currency.

Regarding local rates, modest improvements in global growth are less supportive of duration, and the recent oil price rebound could pose risks to inflation in EM economies. Therefore, we're reducing local rates risk to lock in positive performance ahead of the US elections, which could cause volatility to rise. However, from a longer-term perspective, we remain constructive; falling inflation across EM economies means that real (inflation-adjusted) yields remain attractive, which is a key driver of long-term returns. Furthermore, the US monetary policy outlook suggests that EM central banks will be able to continue cutting rates.

In EM FX, we have a neutral top-down target. A slightly stronger global growth outlook, coupled with lower US dollar yields, highlights attractive carry differential opportunities in the asset class.

In EM hard currency, our top-down target is overweight as the recent front-loading of interest rate cuts by the Fed should be supportive for higher-yielding EM bond markets in the short term.

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. Equity investment: The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. insolvency), the owners of their equity rank last in terms of any financial payment from that company. Interest rate: The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise.

Important information

This communication is provided for general information only. Nothing herein should be construed as an offer to enter into any contract, investment advice, a recommendation of any kind, a solicitation of clients, or an offer, marketing or solicitation with respect to any particular strategy, security, derivative, services or investment product. The information may discuss general market activity or industry trends and is not intended to be relied upon as a forecast, research or investment advice. The economic and market views presented herein reflect Ninety One's judgment as at the date shown and are subject to change without notice. Views and opinions presented herein will be affected by changes in interest rates, general market conditions and other political, social and economic developments. There is no guarantee that views and opinions expressed will be correct and may not reflect those of Ninety One as a whole, different views may be expressed based on different investment objectives. Although we believe any information obtained from external sources to be reliable, we have not independently verified it, and we cannot guarantee its accuracy or completeness. Ninety One's internal data may not be audited. Ninety One does not provide legal or tax advice. Reliance upon information in this material is at the sole discretion of the reader. Investors should consult their own legal, tax and financial advisor prior to any investments. Past performance should not be taken as a guide to the future. Investment involves risks; losses may be made.

Any decision to invest in strategies described herein should be made after reviewing the offering document and conducting such investigation as an investor deems necessary and consulting its own legal, accounting and tax advisors in order to make an independent determination of suitability and consequences of such an investment. This material does not purport to be a complete summary of all the risks associated with this Strategy. A description of risks associated with this Strategy can be found in the offering or other disclosure documents. Copies of such documents are available free of charge upon request.

This is not a buy, sell or hold recommendation for any particular security. Individual security performance does not represent the Strategy performance. There is no guarantee that the Strategy is currently investing and/or will invest in the securities in the future. The portfolio may change significantly over a short period of time. Forecasts are inherently limited and are not a reliable indicator of future performance.

In the US, this communication should only be read by institutional investors, professional financial advisers and their eligible clients, but must not be distributed to US persons apart from the aforementioned recipients. In Australia, this document is provided for general information only to wholesale clients (as defined in the Corporations Act 2001). For Funds within the Strategy that are registered for sale in Switzerland, copies of the Prospectus, latest annual and semi-annual Report & Accounts, Articles of Incorporation and Key Investor Information Documents may be obtained from the Swiss Representative and Paying Agent, RBC Investor Services Bank S.A., Esch-sur-Alzette, Zurich Branch, Bleicherweg 7, CH-8027 Zurich, Switzerland.

For distribution into Asia, this material should only be sent to professional investors, institutional investors and other qualified investors as defined by relevant local laws and regulations, and not to be distributed to the public or within a country where such distribution would be contrary to applicable law or regulations. It is strictly for the recipient's use only and should not be reproduced or distributed to any other persons without prior written consent from Ninety One. If you are not an intended recipient you must ignore this material and take no action based on the information in it. In Hong Kong, it is for professional investors only, issued by Ninety One Hong Kong Limited and has not been reviewed by the Securities and Futures Commission (SFC). In Singapore, it is for institutional investors only, issued by Ninety One Singapore Pte Limited (company registration number: 201220398M) and has not been reviewed by the Monetary Authority of Singapore. In the People's Republic of China (the "PRC"), it can be directed only at certain eligible PRC investors as prescribed by applicable PRC laws. In Taiwan, it is for professional institutional investors only. In Indonesia, Thailand, the Philippines and Brunei, it is for institutional investors and other qualified investors only. This material has been issued to you upon your request, without any marketing or solicitation activities conducted by Ninety One.

Except as otherwise authorised, this information may not be shown, copied, transmitted, or otherwise given to any third party without Ninety One's prior written consent. © 2024 Ninety One. All rights reserved. Issued by Ninety One.