Another good year for EM bonds

By Jan Dehn

All three segments of EM fixed income delivered strong returns in 2019, which proved to be a year of two halves with a happy ending. Martin Guzman was bearing gifts for bond holders in his first major policy speech since becoming Argentina's new finance minister. The US Senate advanced an important sanctions bill against Russia. China prepares for final approval of the revamped Securities Law. In the global backdrop, representatives of the American people in the US House of Representatives impeached President Donald Trump for abuse of power and obstruction of Congress.

This is the last Weekly of 2019. The next Weekly will be published on 6 January 2020. We wish all readers Happy New Year!

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.8	–	3.42%
MSCI EM Small Cap	11.9	–	2.22%
MSCI Frontier	12.4	–	0.81%
MSCI Asia	13.5	–	3.05%
Shanghai Composite	10.9	–	3.48%
Hong Kong Hang Seng	8.4	–	3.51%
MSCI EMEA	10.0	–	3.79%
MSCI Latam	13.8	–	3.41%
GBI-EM-GD	5.24%	–	0.59%
ELMI+	2.90%	–	0.48%
EM FX spot	–	–	0.60%
EMBI GD	4.94%	300 bps	0.57%
EMBI GD IG	3.53%	156 bps	0.16%
EMBI GD HY	6.89%	498 bps	1.06%
CEMBI BD	4.98%	312 bps	0.43%
CEMBI BD IG	3.68%	183 bps	0.13%
CEMBI BD Non-IG	6.79%	493 bps	0.82%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	17.8	–	1.19%
1-3yr UST	1.64%	–	0.13%
3-5yr UST	1.75%	–	0.15%
7-10yr UST	1.94%	–	-0.01%
10yr+ UST	2.37%	–	-0.40%
10yr+ Germany	-0.23%	–	-0.39%
10yr+ Japan	0.01%	–	-0.01%
US HY	5.16%	326 bps	0.86%
European HY	3.49%	367 bps	0.46%
Barclays Ag	1.46%	-48 bps	0.08%
VIX Index*	12.45	–	-0.18%
DXY Index*	97.55	–	0.38%
EURUSD	1.1095	–	-0.23%
USDJPY	109.36	–	-0.05%
CRY Index*	185.13	–	2.21%
Brent	66.3	–	1.64%
Gold spot	1478	–	0.14%

Note: Additional benchmark performance data is provided at the end of this document. *See last page for index definitions.

Emerging Markets

- Review of 2019: From an Emerging Markets (EM) fixed income perspective, 2019 will go down in history as a year of two halves with a happy ending. All the major EM fixed income segments delivered strong returns in early 2019 after the pullback in 2018, aided by brief US yield curve inversion and the start of the Fed cutting cycle. After June, sentiment turned sour as US protectionism resurfaced along with the risk of a disorderly Brexit in the UK. There were also powerful inventory adjustments in the semiconductor, shale oil and auto sectors and European growth weakened. The ECB effectively ran out of policy instruments after cutting the policy rate to -50bps and announcing open-ended Quantitative Easing (QE). US economic data also began to improve in H2 2019 and the Dollar surged higher, which did not help EM either.

In addition to these mainly non-EM negatives, EM bonds and currencies also gave up gains in response to a handful of idiosyncratic political crises within EM, including Ecuador, Bolivia, Chile, Argentina and Lebanon. The negative price action resulting from these events was amplified by low liquidity conditions over the summer and profit-taking following the strong performance in H1 2019.

By late November, however, EM markets were bouncing back. Better mood music around trade, the prospect of low Treasury volatility given the dovish Fed and a clearer outlook for the UK after a decisive General Election result worked hand in hand with improving data in a number of EM countries, including China. There was also a gradual normalisation of politics in some of the countries that had experienced trouble in Q3 2019.

By year-end, EM investors could look back upon a volatile, but strong year in terms of market performance.[1] Local currency government bonds ended the year up 11.9% in USD terms, while EM currencies were marginally up versus the Dollar (+6bps). The local currency asset class has therefore delivered 7.7% in USD terms annualised since the start of 2016, which is neck and neck with external debt. External debt delivered a solid return of 14.6% in 2019, while EM corporate high yield bonds were up 12.8% for the year. All segments of EM fixed income have outperformed developed market fixed income in the past four years and, in the case of government bonds, by a factor of 2.5-3.5 times.

[1] The returns reported in this paragraph were as at close of business 19 December 2019.

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Emerging Markets

Fig 1: **EM bonds returns over different time periods: 2019 ytd, cumulative (2016-2018) and annualised (2016-2019 ytd)**

	2016-2018	2019 YTD	Annualised since start of 2016
Government bonds			
EM local currency bonds	**18.80%**	**11.89%**	**7.73%**
3-5 year UST	*3.56%*	*5.00%*	*2.15%*
EM external debt (USD)	**16.20%**	**14.60%**	**7.76%**
7-10 year UST	*4.13%*	*8.40%*	*3.16%*
Corporate high yield			
EM corporate debt (USD)	**15.97%**	**12.80%**	**7.25%**
EM HY (USD)	**23.74%**	**12.78%**	**9.20%**
US HY	*22.23%*	*14.06%*	*9.14%*
EU HY	*8.21%*	*10.84%*	*4.80%*
Currencies			
EM spot FX	**-2.97%**	**0.06%**	**-0.73%**
EM FX forwards	**11.77%**	**4.49%**	**4.10%**
DXY Index	*-4.79%*	*1.43%*	*-0.85%*
EURUSD	*8.91%*	*-3.26%*	*1.42%*
USDJPY	*-4.74%*	*-0.31%*	*-1.27%*
Stocks			
EM stocks	**34.02%**	**17.70%**	**13.03%**
EM Small cap	**15.22%**	**9.45%**	**6.21%**
Frontier Markets	**13.74%**	**15.91%**	**7.47%**
US stocks	*28.56%*	*30.39%*	*14.85%*

Source: Ashmore, Bloomberg. Data as at 19 December 2019.

- Argentina: Martin Guzman came bearing gifts to foreign bond holders in his first major policy speech as Argentina's new finance minister. He announced significant new local taxes, which improves the public finances by as much as 2% of GDP, while capital controls will be maintained to ensure that the government holds onto enough Dollars to be able to service debt. Moreover, local media reports that payments of local law t-bills in Dollars will be delayed to August 2020, which frees up USD 9.0bn, which can be used to service external debt. It would appear that the government is going to try to obtain debt relief primarily through re-profiling of IMF and local law debt, although details of the government's plans for external bond holders are still not available in full. So far, however, the measures announced by Guzman signal an awareness of Argentina's tight financial constraints, which is very welcome news. The new fiscal measures include higher export taxes and new taxes on Dollar purchases as well as suspension of a mechanism for automatic increases in retirement benefits. In a very significant indication of the government's willingness to service external debt, the government is issuing a bond worth USD 4.6bn to the central bank. The Dollars raised in this transaction will be used specifically to service external debt, thus dramatically reducing the near-term risk of default. In other news, MSCI, the equity index provider, has decided to keep Argentina in the index at least until June 2020, while it decides if capital controls warrant the exclusion of Argentinian equities from the index. Most Argentinian stocks are listed overseas or trade as ADRs. Index exclusion would trigger at least USD 0.5bn of forced selling by passive investors.
- Russia: The US Senate Foreign Relations Committee voted 17-5 in favour of a bill known by the acronym DASKA ('Defending American Security from Kremlin Aggression Act'). If passed, DASKA would sanctions Russian individuals, cyber operations and liquid natural gas export facilities. From a fixed income investment perspective, the bill is important because it would call on President Donald Trump to define sanctions against Russian sovereign debt issuance. As noted in the last Weekly, Russia has significantly scaled back its use of the Dollar, including financing in Dollar, so Russia would not have any problems coping with this bill, but bond holders could find it difficult to transact in Russian bonds. The DASKA bill now advances to a second reading in the Senate provided that Senate Majority Leader Mitch McConnell decides to bring the bill forward, which is unclear at this stage. The constant escalation of sanctions against Russia is a way for members of the US Congress to exert pressure on Trump, who is suspected in some quarters of being under the influence of Russia's President Vladimir Putin.
- China: The NPC Standing Committee is due to undertake a 4th and final reading of the Securities Law this week, which means that the law can be enacted early next year. The law modernises China's securities laws, including greater investor protections. In other news, the People's Bank of China (PBOC) lowered the 14-day reverse repo rate to 2.65% from 2.70% and kept the 7-day rate unchanged at 2.50%. Reverse repo operations resumed in order to inject some RMB 200bn into money markets in preparation for tighter year-end liquidity conditions.

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Emerging Markets

- Chile: A government tax reform, which is making its way through parliament, is likely to raise USD 2.0bn in net revenues through a 40% increase in taxes for high earners (those earning more than USD 20,000 per month) and surcharges on property taxes for properties worth more than half a million Dollars. However, the tax reform is structured such that tax revenues will temporarily be lower in the 2020-2022 period, when capital is granted more rapid depreciation in order to stimulate investment and growth.
- Angola: Total, the oil company, has acquired an interest in off-shore oil blocks, which are likely to net the government some USD 0.5bn, including USD 100m of foreign direct investment (FDI).
- Poland: Industrial production was 1.4% higher in November than in the same month a year ago. This was better than expected (0.3% yoy). Retail sales were also stronger than expected in November after rising at a 5.9% yoy rate versus 4.8% yoy expected.
- Serbia: S&P raised the sovereign credit rating of Serbia by one notch to BB+ with a positive outlook on solid growth, fiscal discipline. Serbia is now just one notch away from investment grade.

Snippets:

- Czech Republic: The Czech National Bank left the policy rate unchanged at 2.00%.
- Gabon: The Board of the International Monetary Fund (IMF) approved the 4th and 5th review of Gabon's program with immediate disbursement of USD 123m.
- Hungary: The National Bank of Hungary left the policy rate unchanged at 0.90%.
- India: Imports declined by 12.7% on a yoy basis in November, while exports were down 0.3% yoy. This resulted in a narrowing of the trade deficit of USD 12.1bn relative to the same month last year.
- Indonesia: Bank Indonesia left the policy rate unchanged at 5.00%.
- Mexico: The government is raising the minimum wage by 20% next year compared to 16.2% in 2018. The inflationary impact is expected to be minor.
- Singapore: Non-oil domestic exports rose sharply (6.5% mom) in November due to a pickup in electronics exports.
- Thailand: Bank of Thailand left the policy rate unchanged at 1.25%.
- South Korea: The government introduced further macro-prudential measures to curb the rise in property prices. Property prices are rising because interest rates are very low. Higher property prices tend to worsen the distribution of income.
- Taiwan: The central bank left the policy rate unchanged at 1.375%.
- Zambia: The Zambian parliament approved a budget for 2020 with 20% higher spending that the preliminary budget estimate. There is no clarity about how this additional spending will be financed.

Global backdrop

The President of the United States of America, Donald J. Trump, was impeached, when a majority in the House of Representatives voted that he abused power and obstructed Congress. Trump will now be tried in the Senate, but the timing is unclear, because House Speaker Nancy Pelosi understands the time value of options. She knows that the Senate, which is partial to Trump, would kill the impeachment process immediately, so she has refrained from committing to a firm timeline for sending the articles of impeachment to the Senate. In addition to keeping the impeachment issue alive, this also enables her to wait for new information, which could further incriminate Trump, such as potentially damaging information of financial impropriety from Trump's financial records, whose release is currently subject to an appeals process in the courts.

In other US news, industrial production increased by 1.1% in the month of November. This higher than expected monthly increase was due to the resumption of auto production following strikes in October. Meanwhile, sales of new houses improved, but sales of existing homes softened in November.

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Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	6.50%	10.85%	17.70%	17.82%	12.21%	6.13%
MSCI EM Small Cap	3.93%	7.28%	9.45%	9.68%	6.51%	3.21%
MSCI Frontier	2.51%	4.77%	15.91%	15.84%	8.91%	3.65%
MSCI Asia	5.67%	10.75%	17.31%	17.21%	12.80%	7.06%
Shanghai Composite	5.06%	3.87%	23.94%	21.24%	1.20%	1.51%
Hong Kong Hang Seng	6.66%	7.73%	12.63%	11.85%	9.60%	3.09%
MSCI EMEA	5.76%	8.63%	14.76%	13.86%	7.98%	3.40%
MSCI Latam	9.59%	9.77%	16.95%	19.19%	12.93%	4.51%
GBI EM GD	2.68%	3.73%	11.89%	12.55%	6.96%	2.42%
ELMI+	1.61%	3.04%	4.49%	4.82%	4.18%	1.56%
EM FX Spot	2.20%	2.61%	0.06%	-0.05%	-0.98%	-4.60%
EMBI GD	1.63%	1.43%	14.60%	14.47%	6.84%	6.22%
EMBI GD IG	0.52%	1.04%	16.42%	16.33%	7.66%	5.67%
EMBI GD HY	2.95%	1.89%	12.78%	12.60%	5.98%	6.92%
CEMBI BD	0.71%	1.95%	12.80%	12.92%	6.39%	5.94%
CEMBI BD IG	0.30%	0.79%	12.41%	12.69%	6.08%	5.01%
CEMBI BD Non-IG	1.27%	3.58%	13.30%	13.20%	6.92%	7.47%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	2.16%	8.16%	30.39%	30.45%	14.57%	11.38%
1-3yr UST	0.06%	0.35%	3.43%	3.78%	1.85%	1.37%
3-5yr UST	-0.23%	-0.18%	5.00%	5.66%	2.64%	2.07%
7-10yr UST	-0.83%	-1.32%	8.40%	9.22%	4.22%	2.85%
10yr+ UST	-2.35%	-3.69%	15.34%	15.42%	7.50%	4.27%
10yr+ Germany	-2.24%	-5.86%	10.32%	10.23%	4.71%	4.82%
10yr+ Japan	-0.56%	-1.68%	4.40%	5.13%	2.41%	3.64%
US HY	1.77%	2.39%	14.06%	12.69%	6.46%	6.20%
European HY	0.97%	1.97%	10.84%	10.51%	4.23%	4.72%
Barclays Ag	0.05%	-0.05%	6.27%	6.89%	4.37%	2.17%
VIX Index*	-1.35%	-23.34%	-51.02%	-56.13%	8.73%	-24.50%
DXY Index*	-0.74%	-1.84%	1.43%	1.32%	-5.56%	8.87%
CRY Index*	4.79%	6.43%	9.02%	7.22%	-2.86%	-22.96%
EURUSD	0.69%	1.79%	-3.26%	-3.07%	6.80%	-9.27%
USDJPY	-0.12%	1.18%	-0.31%	-1.73%	-7.21%	-8.53%
Brent	6.18%	9.07%	23.22%	21.97%	19.77%	8.00%
Gold spot	0.99%	0.41%	15.28%	17.34%	30.57%	23.58%

*VIX Index = Chicago Board Options Exchange SPX Volatility Index. *DXY Index = The Dollar Index. *CRY Index = Thomson Reuters / CoreCommodity CRM Commodity Index.

Source: Bloomberg, JP Morgan, Barclays, Merrill Lynch, Chicago Board Options Exchange, Thomson Reuters, MSCI, total returns.
Figures for more than one year are annualised other than in the case of currencies, commodities and the VIX, DXY and CRY which are shown as percentage change.

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