Emerging Market Debt
Politics left, right and center

- Flat returns in EM sovereigns in Q2 (+0.3%), while EM corporates outperformed (+1.5%), thanks to spread compression and lower interest rate sensitivity. Some YTD outperformers corrected during the quarter (Ecuador -3.83%, Ukraine -4%).
- A correction in popular carry trades in Latin America led to a sharp selloff in currencies - BRL (-10.4%), MXN (-9.2%) and COP (-7.2%) in Q2.
- Elections in South Africa, Mexico and India led to subtle but significant changes in the countries' political landscapes. While Mexico and India should see more populist-leaning policies going forward, in South Africa a historic alliance between the ANC and business friendly DA leaves hope for accelerated reforms.
- In Brazil, fiscal woes threaten to derail the central bank's easing cycle started in August 2023. Populist governments, sometimes faced with an election year (Mexico, Romania) have come under more scrutiny over public spending agendas. Indonesia, Colombia or Hungary are faced with more currency volatility and the prospect of delaying rate cuts.
- Venezuela re-enters EM bond indices following a lifting of restrictions on secondary trading by OFAC. Presidential elections to be held on July 28th open the way to a possible regime change, although significant uncertainties remain.
- Our favourite reform stories of Argentina and Ecuador continue to remain on track. In general, we now see more value across ratings in EM sovereigns than corporates. Corporates should remain a reliable carry proposal for the remainder of the year.

Magda Branet, CFA
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What's happening?

- **Emerging Markets Debt continued to perform positively** in Q2 2024, with EM Corporates up 1.5% outperforming EM Sovereigns +0.3%. EM Corporate High-Yield (HY) returned 2.1% in Q2, outperforming Investment-Grade (IG) counterparts +1.1% as well as US HY +1.2%. EM corporate spreads tightened by -11bp to 219bp during the quarter. The best performing countries were Venezuela (+10.7%) and Maldives (+9.5%), while Gabon (-7.8%) and Kenya (-4.6%) underperformed in Q2.
- Rebounding EM GDP growth in Q3 vs. Q2 and resilient external balances point to EM macro strength, which should be bolstered by the start of Fed cuts in September in our base case.

- In Latin America, a general election was held in Mexico on 2 June. Claudia Sheinbaum was elected as the first female president, with enough majority in Congress to implement certain controversial reforms. This led to a sell off in Mexican assets, with 5y CDS widening around 20 bps, and a more pronounced sell off in local markets, where 10y bond yields rose 60 bps in early June. In Argentina, President Javier Milie finally had his key reform legislation passed by the Argentinian congress. This will allow greater changes to be made to Argentina's economic direction to aid its recovery. Brazil has recently paused its easing cycle which started last August. This decision comes in response to higher inflation expectations, a negative market reaction to the country's fiscal struggles, and an outlook for more distant US rate cuts.
- In Asia, Indian general elections saw the incumbent, Narendra Modi, win but fail to achieve an outright majority. Modi was re-elected as President and will rely on minorities to continue business friendly policy reforms. The country joined local currency indices at the end of June, attracting high portfolio inflows which helped dampen currency volatility. China released mixed economic data. Housing statistics, credit growth and government revenues showed a negative trend. In contrast to subdued consumer spending, the industrial sector has shown strong momentum recently, growing at its fastest average pace over the past two years.
- In Africa, South African elections result showed the ANC failing to win a majority. Markets were initially concerned with the political uncertainty, but were subsequently encouraged by the formation a unity government with the business friendly Democratic Alliance and re-election of Cyril Ramaphosa as president. Zambia completed its debt restructure on 12 June. Defaulted bonds will be replaced with two new instruments which will be eligible for inclusion in EM bond indices. Moody's subsequently upgraded the county's credit rating to Caa2 from Ca. Ghana also reached an agreement to restructure its debt with bond holders. The agreement comes after the country defaulted almost two years ago.
- In EM Europe, a consumer-led recovery is in the making across Central Europe. Consumer confidence is visibly turning a corner, improving from its post-pandemic doldrums supported by positive real income growth. The very gradual improvement in the Eurozone economy could support exports, while investment weakness may remain protracted. Ukraine failed to reach an agreement with bondholders after a first round of negotiations-more progress is expected over the summer.

EM strategies positioning and performance

Global Emerging Markets Bonds strategy

In Q2, relative performance was negatively impacted by exposure to Ukraine, as the country suffered set backs in negotiations with bondholders over the restructuring of debt. The exposure to local markets equally shaved off relative performance, whereas the overweight in Argentina, South Africa, El Salvador and Turkey contributed positively.

We maintain our OW in Latin American distressed credits, and in Ukraine, where we think current bond prices underestimate the potential recovery value. We also maintain an exposure to local currency bonds, although with increased FX hedges given the pressures for a stronger dollar coming from delayed fed easing and a potential Trump presidency. The portfolio remains OW carry with roughly 1% higher yield to maturity versus benchmark.

Strategy in focus – representative account (28/06/24)	
Assets under management	$379mn
Duration (in years)	6.96
Yield to maturity	8.99%
OAS Spread	421
Average rating	BB
Number of holdings	173
Launch date	25/08/2008
SFDR Article	8

Source: AXA IM as at 28/06/2024. The data is based on a representative account that follows the strategy and is not intended to represent actual past or simulated past performance of the strategy. **Return may increase or decrease as a result of currency fluctuations.** Performance calculations are net of fees, based on reinvestment of dividends.

Emerging Markets Short Duration Bonds Low Carbon strategy

During the quarter, the portfolio benefitted from exposure to Colombia, where some distressed credits like Telefonica or Canacol recovered from low price levels. Ukraine corporates fared well, as did Turkish corporates, where we increased exposure following a large jump in new issuance as investors become more confident with the government's reform agenda.

The sovereign exposure detracted from performance, as some distressed credits (Gabon, Kenya) sold off.

We remain exposed to Mexico, India and Turkey. In Mexico, the nearshoring theme remains, although question marks about the USMCA trade agreement can rise closer to US elections. We also continue to like CEE financials, where growth remains robust especially driven by consumer demand. We are prudent still in China, due to more trade tariffs and restrictions, but remain confident on India as the Modi administration is likely to continue to pursue a business friendly agenda.

Strategy in focus – representative account (28/06/24)	
Assets under management	$277mn
Duration (in years)	2.35
Yield to maturity	7.36%
OAS Spread	334
Average rating	BB+
Number of holdings	120
Launch date	05/09/2012
SFDR Article	8

Source: AXA IM as at 28/06/2024. The data is based on a representative account that follows the strategy and is not intended to represent actual past or simulated past performance of the strategy. **Return may increase or decrease as a result of currency fluctuations.** Performance calculations are net of fees, based on reinvestment of dividends.

ACT Emerging Market Bonds strategy

The strategy delivered positive return and it outperformed the reference index. Our overweight exposure to BB bucket was beneficial for the overall performance together with the preference for corporates over sovereigns in the IG space. The reduction in cash position in the end of April helped the strategy to take advantage of the strong market in May. Duration was extended slightly via sovereigns preparing for the potential start of easing monetary policy in the US later in the second half of the year.

We see the BBB- and BB segment attractive from a valuation standpoint with fundamentally stable or improving stories in both sovereign and corporate space. Fund's allocation to green, social, sustainability and SL bonds remained significant, above 70%, with good diversification across different regions and sectors.

Strategy in focus – representative account (28/06/24)	
Assets under management	$70mn
Duration (in years)	5.78
Yield to maturity	5.54%
OAS Spread	146
Average rating	BBB
Number of holdings	65
Launch date	16/09/2021
SFDR Article	9

Source: AXA IM as at 28/06/2024. The data is based on a representative account that follows the strategy and is not intended to represent actual past or simulated past performance of the strategy. **Return may increase or decrease as a result of currency fluctuations.** Performance calculations are net of fees, based on reinvestment of dividends.

Outlook

A soft landing scenario for the global economy could translate into attractive returns for EM in 2024, continuing the year-end positive trend. DM rate cuts have started prudently, and should provide some tailwind for the asset class.

For corporates, earnings growth YTD has been healthy and has been revised higher for 2024 as disinflation has helped temper input costs. We expect the default rate to be significantly lower in 2024 versus last 2 years.

Generally, we see more value across ratings in EM sovereigns than corporates, where distressed sovereigns have cheapened up again and retain significant repricing potential. Corporates should remain a reliable carry proposal for the remainder of the year.

invested. Exchange-rate fluctuations may also affect the value of their investment. Due to this and the initial charge that is usually made, an investment is not usually suitable as a short term holding.

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