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# Emerging Market Debt Hope springs eternal

- EM Central Banks continue to cut rates as Developed Markets show a more prudent stance.
- Returns of +52% in Ecuador, +21% in Egypt, +27% in Argentina in the first quarter of 2024<sup>1</sup>, remind us why we like Emerging Markets Debt in the first place: strong repricing opportunities and diversification benefits.
- Positive idiosyncratic stories steal the spotlight: Argentina undergoes shock therapy under Milei, Egypt gets a jumbo bail out from the UAE, Ecuador gets closer to an agreement with the IMF, Kenya comes back to the bond market and alleviates fears of default in 2024.

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## What's happening?

- **Emerging Markets Debt continued to perform positively** this quarter, with EM Sovereigns up 3.09% since the end of January outperforming EM Corporates +1.72%. EM Corporate High-Yield returned 4.22% in Q1 2024, outperforming Investment-Grade counterparts +1.04% due to robust continued spread tightening.
- The Emerging Market - Developed Market growth differential is expected to increase this year, from 2.3% in 2023 to 2.7%, as **EM growth remains robust at 3.9%, more than triple the rate of growth in DM economies**, expected this year at 1.2%<sup>2</sup>.
- **China has maintained a growth target of 5% but continues to struggle with the spectre of the three Ds: Debt, Deflation, Demographics.** Policy responses have been underwhelming, but oriented towards investment, which is beneficial to other EMs via higher imports, and supportive for commodity prices, just as a booming technology sector has benefitted Asian regional trade and growth.
- **Central and Eastern Europe is recovering** from the shock of the Russian invasion of Ukraine. After an initial surge in inflation in early 2023, Central Banks are seeing inflation targets within reach and are **cutting rates**; -475 bps for Hungary, since the peak, to 8.25% and -125 bps for Czechia to 5.75%. **CEE cutting rates ahead of DM Central Banks signals that domestic financial conditions are slowly easing**; this is positive for growth and for fiscal accounts, which have been plagued by an increase in interest costs.
- In Latin America, **Argentina and Ecuador have stood as stellar performers, as investors are increasingly pricing out near-term default expectations.** Argentina's 2 consecutive monthly fiscal surpluses at the beginning of 2024

<sup>1</sup> Source: Bloomberg, JPM Indices, from 31/12/2023 to 31/03/2024.

<sup>2</sup> Source: AXA IM forecasts as at 31/03/2024.

demonstrate commitment to a deep macro adjustment program, while Ecuador's market-friendly leadership has secured fiscal tightening measures and boosted bond prices.

- In Africa, **Egypt stole the show by securing a US\$150 billion investment package from the UAE**, followed by several other foreign direct investment pledges from the region and a US\$8bn extended credit facility programme from the IMF.

## EM strategies positioning and performance

### Global Emerging Markets Bonds strategy

The EM sovereign bond market performance was strongly driven by distressed credits in 2023, and the first quarter of 2024. The strategy's relative performance benefited by our overweight to B-rated and lower credits, as High-yield credits outperformed investment-grade counterparts due to robust spread tightening. We continue to remain overweight to sovereigns in this risk category such as Ecuador, Argentina, Ghana, and Egypt.

We continue to benefit from a recovery in Ukraine bond prices, as the sovereign progresses towards a potential restructuring this year. We started the year with a slight underweight duration in USD, following the aggressive pricing of Fed cuts at the end of last year. Our underweight in UST-sensitive credits, such as Malaysia, Philippines, and Saudi Arabia, positively contributed to performance.

### Emerging Markets Short Duration Bonds Low Carbon strategy

We remain prudent on China and steer away from the property sector, which we believe to be in a secular downtrend. We executed our strategy of preferring distressed credits in the sovereign space by increasing our exposure to El Salvador, Kenya, and Pakistan.

Sovereigns were the main drivers of performance in Q1, with Ecuador, Argentina, and Ghana having a net positive contribution. We benefited from our increased exposure to Turkish high yield corporates. We continue to benefit from a recovery in Ukraine bond prices, as the sovereign progresses towards a potential restructuring this year.

#### Strategy in focus – representative account (31/03/24)

Assets under management	\$401mn
Duration (in years)	6.5
Yield to maturity	8.60%
OAS Spread	407
Average rating	BB
Number of holdings	168
Launch date	25/08/2008
SFDR Article	8

Source: AXA IM as at 31/03/2024. 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.

#### Strategy in focus – representative account (31/03/24)

Assets under management	\$321mn
Duration (in years)	2.3
Yield to maturity	6.90%
OAS Spread	290
Average rating	BBB-
Number of holdings	120
Launch date	05/09/2012
SFDR Article	8

Source: AXA IM as at 31/03/2024. 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 performed well in both absolute and relative terms versus the reference index. Our higher allocation to corporates vs sovereigns had a positive contribution, as well as the dynamic management of the BB bucket. We also benefited from our exposure to investment grade Real Estate.

We see attractive value in EM corporates BB space and have recently increased the allocation to this bucket close to maximum to capture some returns on fundamentally stable issuers that benefited from spread tightening.

### Strategy in focus – representative account (31/03/24)

Assets under management	\$65mn
Duration (in years)	5.7
Yield to maturity	5.30%
OAS Spread	145
Average rating	BBB
Number of holdings	64
Launch date	16/09/2021
SFDR Article	9

Source: AXA IM as at 31/03/2024. 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

- In 2024, **Emerging Markets appear promising**, with the potential for double-digit returns, continuing the positive trend seen in the end of last year and first quarter of 2024. **Soft landing in the US along with a Chinese recovery would broadly support EM growth, where central banks have already pivoted towards the easing cycle.** DM rate cuts appear to be aggressively priced in against a resilient US economy with a tight labour market, putting a cap to potential gains from core rates. Spreads could continue to grind tighter, especially if inflows into the asset class resume, but we would expect to see some widening in higher rated segments as valuations ex-distressed appear rich.
- The Emerging Market - Developed Market growth differential is expected to increase, from 2.3% in 2023 to 2.7%, as **EM growth remains robust at 3.9%, more than triple the rate of growth in DM economies**, expected at 1.2%<sup>3</sup>, allowing for renewed capital inflows into EM after a period of outflows, that affected bond funds in particular.
- We don't see delays in Fed fund cuts as materially derailing the EMD recovery story this year. With the potential upside to the asset class coming from idiosyncratic factors, **EMD should display lower correlation to global factors.**
- **Hard currency debt – particularly sovereigns – retain the greatest potential for repricing.** EM corporates have equally turned the corner with an upgrade/downgrade ratio that has risen from the bottom and default rates falling.

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<sup>3</sup> Source: AXA IM forecasts as at 31/03/2024.

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