25 years' experience provides platform for outperformance in Emerging Market Debt sector

Global growth, undervalued currencies and high real yields means EMD offers solutions amid rising interest rates

Marcelo Assalin,
Head of Emerging Market Debt, NN Investment Partners

Marco Ruijer,
Lead Portfolio Manager EMD Hard Currency, NN Investment Partners

Investors were given a wake-up call in February on the challenges posed by normalising monetary policy when strong economic data in the US sparked fears that interest rates would rise faster than expected, causing the global equity correction.

Equity markets subsequently calmed down. But rising rates still present headwinds to fixed income investors. We believe one potential solution for them is Emerging Market Debt (EMD). The support afforded to this asset class by broad-based global growth, undervalued currencies and high real yields all provide good reasons for inclusion in any fixed income portfolio this year.

However, it is a tricky sector to navigate, and experience is key to generating outperformance. In this respect NN Investment Partners has a long track record of 25 years, navigating multiple cycles across the most dynamic and diverse universe of debt markets.

To mark this quarter-century, we wish to share with investors some of the benefits from that experience by exploring our 10 most useful insights into the sector.

No 1 - There's nearly always a silver lining

Countries may default on their credit obligations but unlike companies, they are unlikely to fail completely. Recently, the international community, with the help of multilateral organisations such as the World Bank and International Monetary Fund (IMF), have shown significant political will to support ailing countries in the face of full-scale defaults, making it highly unlikely that creditors will suffer a total capital loss. For the more committed investor, investing in distressed countries can present excellent opportunities to invest in a country's bonds at highly discounted levels.

No 2 - Simple thinking just won't make the cut

Investors often attempt to simplify the world by thinking in terms of large economic blocs, such as the 'BRICs' identified by Goldman Sachs in 2001. At that time, these countries boasted enormous growth potential on lower production costs, comparatively young workforces and considerable natural resources. Two decades later these beliefs proved to be unfounded as falling commodity prices, declining global trade and mounting debts took their toll. The emerging market universe is extremely diverse and investors must not lose sight of the idiosyncrasies within countries.

No 3 - Never lose faith, the cavalry will come in the end

Since the Global Financial Crisis there have been several examples of cooperation between central banks, multilateral entities such as the IMF and private investors to rescue over-indebted nations. No investment is entirely risk-free but the political will demonstrated to rescue these nations is a positive factor for EMD investors.

No 4 - Sleeping dragons become crouching tigers

For over two decades, China's emergence as an economic superpower has been immensely positive for emerging economies and globally. China has recently begun to increase its influence on emerging economies more directly by funding infrastructure projects across Asia, Europe and Africa. But China's growth rate will likely decelerate in the medium term because of structural reforms it must make as its economy matures and this could have far reaching negative implications. Investors will therefore need to closely monitor China's progress over the longer term.

No 5 - The IMF has competition!

The IMF has played a vital role in the development of emerging markets since the 1990s. China may now supersede it though as the go-to provider of economic support. Unlike the IMF, China's support does not come with the same demands for structural reform and emerging countries may therefore be less incentivised to implement the kinds of changes that the IMF is prescribing. But the IMF and China can both make important contributions to growth and countries should leverage support from both.

No 6 -You can't move forward with the brakes on

Protectionist rhetoric will often appear when a country is concerned about the possibility of economic decline. However, high import tariffs and other protectionist policies used to insulate domestic workforces from international competition may only work in the short term. The best-performing countries are those that open their economies, join the global market and reap the benefits of a more dynamic business climate and foreign direct investment.

No 7 - Big ships don't turn easily

After decades of structural and institutional reform across the emerging world, larger, non-specialist funds and ETFs that tend to invest opportunistically are beginning to make significant allocations to EMD. This means growing investor demand will gradually reduce risk premia. Large benchmarked vehicles such as ETFs often need to adjust their investment positions regardless of price or liquidity, thereby distorting prices. These distortions create excellent opportunities for investors with expertise and dynamism.

No 8 - You can't hide the scars of corrosive corruption

Corruption is a stealth tax on an economy, hampering growth and dampening investor sentiment. With less foreign investment, external revenues fall and corruption is highly correlated with fiscal deterioration. The battle against corruption is gaining strong momentum globally, as evidenced by measures taken in Brazil, Peru and South Africa. Environmental, Social and Governance considerations are core to NN IP's investment process, ensuring we unlock the value of improved governance and stronger institutional quality.

No 9 - Do what I do, not what I say

There is often disparity between political campaign rhetoric and actual policies. However, markets remain easily spooked by potentially radical political changes and this is particularly true during elections. In practice, government policies are often more moderate and pragmatic, creating opportunities for shrewd investors.

No 10 - Nimble are those who are focused

Emerging markets require a constant and disciplined focus on fair value. Sell-offs/corrections can often overshoot on bad news, creating excellent buying opportunities in high conviction names. Equally, investors must reserve a healthy level of caution in rising markets. It is crucial they are aware of all the risks their portfolios are carrying and that they de-risk their portfolios in anticipation of corrections.

Knowledge breeds success

The investors most likely to succeed in EMD are those with considerable knowledge of local and regional macroeconomic and political dynamics, enabling them to monitor fast-moving market conditions and risk dynamics. NN IP's investors can rest assured that the above insights are all incorporated into the investment processes of our EMD strategies.

KEEP LEARNING

Register for our webinar on the 19th of March at 14.00 CET and learn more about our insights in EMD and our Outlook for the future. During the webinar you can directly ask our portfolio managers anything about EMD.

Go to **25yearsemd.nnip.com** to register for this unique webinar and receive the special publication '25 years of EMD'.

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