LOMBARD ODIER
INVESTMENT MANAGERS

LO Funds
Emerging Local Currency Bond Fundamental
Newsletter

Global Fixed Income • Fixed Income

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REVIEW

The average yield of the JP Morgan Global EM Diversified index declined by about 150 bps to 6.11% in September, while the 10-year UST yield fell by around 10 bps to 3.78%. Most emerging currencies strengthened against the USD.

Emerging market bonds and currencies were supported by an interest rate cut of 50 bps by the US Federal Reserve in September, and therefore outperformed developed markets.

A number of EMs started or continued their easing cycles in September, with rate cuts by central banks in Mexico, Chile, Peru, Colombia, Czech Republic, Hungary, Poland, South Africa and Indonesia. China announced a comprehensive monetary policy support package which exceeded expectations and included cuts in several official interest rates.

Brazil was the sole outlier with its first interest rate hike this year on September 18, after cuts earlier in 2024. The central bank now has a more hawkish stance because of the worsening fiscal and inflation outlook.

South Africa was again a top performer as the new coalition government is riding high on a wave of positive sentiment, with inflation falling and the central bank starting its rate-cutting cycle in September.

Performance

As emerging bond yields in local currency declined in September, the index saw a positive return in local terms. In USD terms, the JP Morgan Global EM Diversified index achieved a very positive return due to the strengthening of most emerging currencies.

South Africa (6.98%), Thailand (6.52%) and Chile (5.64%) were the best performers in the portfolio. As all emerging markets had a positive return, there were no detractors from absolute performance.

The underweight positions in the CEE countries – the Czech Republic, Poland and Romania – had a positive impact on relative returns as these markets lagged the rally in emerging markets. The large overweight in India and the underweight in South Africa had a negative effect.

Outlook

For emerging markets, the normalisation of economic cycles globally has improved the scenario for sovereign debt. Having begun their tightening cycles sooner, most emerging economies have inflation under control, and commodity prices are supportive.

At the Jackson Hole Economic Symposium in August, Chair Jerome Powell signalled a shift in focus to the labour market aspect of the Federal Reserve's dual mandate. The FOMC's September decision to cut rates by 50 bps underscored the bank's commitment to its maximum employment objective. The proactive stance of the Fed should be broadly positive for EMs, supporting local currencies and enabling some EM central banks to deliver additional monetary policy easing.

Investors should, however, keep in mind that the US elections in November will be significant for inflation prospects and thus for bond markets, with a Republican 'red sweep' of the presidency and Congress the most bearish outcome due to proposed tariff increases and tax cuts. While Kamala Harris now appears to be the favourite, mixed polling results in battleground states such as Georgia indicate the race remains a close call.

PRODUCT SPECIALISTS

GENEVA Christelle Curt-Cognac +41 22 709 93 06

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