

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 rose by c. 10 bps to 6.40% in December, while the 10-year UST yield rose by c. 40 bps to 4.47%. The USD strengthened further following Donald Trump's election victory, with most emerging market currencies losing ground against the USD during the month.

A number of EMs continued their easing cycles in December, with rate cuts by central banks in Mexico, Chile and the Philippines. The tightening cycle in Turkey, which had seen interest rates climb to 50% in March 2024, ended with a first rate cut of 2.5% to 47.5%.

Brazil was again an outlier, with another hike to support the weak currency. The benchmark rate was hiked by 100 bps to 12.25%.

Performance

Emerging bond yields in local currency rose slightly in December but outperformed USTs in local terms. As most EM currencies lost ground against the USD in December, the return of the JP Morgan Global EM Diversified index was negative in USD terms.

The Philippines (1.19%), Thailand (1.01%) and China (0.88%) were the best performers in the Fund, while Brazil (-5.99%), South Africa (-4.52%) and Colombia (-3.81%) fared worst.

Our overweight in the Philippines and underweight in South Africa had a substantial positive impact on relative returns, while the underweight in Malaysia and overweight in Brazil detracted.

Outlook

While control of both Congress and the White House gives the incoming US administration a clear mandate, the extent and timing of the rollout of Trump's flagship policies remain unclear. Given the uncertainties, the risk of non-linear outcomes is higher than usual.

The unusual degree of uncertainty will have inevitable implications for fixed income markets. Of the Trump administration's four key policy priorities – tariffs, immigration, tax cuts and deregulation – all but deregulation will tend to be inflationary. Tariffs are particularly likely to put upward pressure on prices, even if they are ultimately used as a negotiating tactic and not implemented as severely as threatened on the campaign trail. A boost to business confidence and animal spirits could initially be supportive for US growth. However, were tariffs to lead to a global trade shock and the need for a return to restrictive monetary policy from the Fed, consumer confidence and economic activity could falter.

For EM economies, a trade shock would at least come in a context of normalising economic cycles, with monetary tightening already having brought inflation under control and commodity prices supportive. However, EM central banks will need to tread a fine line to balance the impact of tariffs and the imported upside inflation risk created by higher US policy rates and a strong USD. For specifically targeted countries such as China, the growth shock from increased tariffs is likely to dwarf inflation concerns when deciding monetary policy.

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