
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 fell by about 10 bps to 6.26% in August, while the 10-year UST yield also declined around 10 bps to 3.90%. Most emerging currencies strengthened against the USD.

Emerging market bonds and currencies remained relatively stable in the first week of August despite the sell-off in equities and the rally in USTs.

A number of EMs continued their easing cycles in August, with rate cuts by central banks in Mexico, Peru and the Philippines.

Indonesia was the best performer during the month as Indonesian authorities scrapped controversial changes to election laws. There had been widespread pro-democracy protests against the proposed changes and the cancellation of these plans had a positive impact on Indonesian financial markets.

In Mexico, the 2 June landslide victory of presidential candidate Sheila Sheinbaum and the Morena party continued to weigh on sentiment in August. Investors fear that the large majority will enable the current and incoming president, who will take office on 1 October, to implement radical reforms that are less market-friendly.

Performance

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

Indonesia (7.17%), Malaysia (6.52%) and Thailand (6.13%) were the best performers in the portfolio, while Mexico (-3.96%) and Turkey (-1.49%) were the only detractors from absolute performance.

The overweight position in the Philippines and the underweight in Mexico had a substantial positive impact on relative returns, while the overweight in India and underweight in Malaysia had a negative impact.

Outlook

Emerging market central banks are mostly ahead of their developed market counterparts in their easing cycles, which is supportive of local EM sovereign bond markets. An improving global growth outlook also represents a tailwind for EMs, particularly a soft landing for the US economy, which is increasingly becoming the baseline scenario.

If Federal Reserve rate cuts go ahead in the second half of 2024, the impact should be broadly positive for EMs. However, if the Fed proves a little less dovish than anticipated, a stronger USD could put additional pressure on EM currencies and make it harder for their central banks to continue easing.

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