

# Candriam Sustainable Bond Emerging Markets

## Market Overview

In June political risk and election surprises drove market movements more so than macroeconomic data. Nevertheless, non-farm payrolls coming in stronger than consensus expectations (+272k vs +180k expected) caused a UST selloff, other data such as the unemployment rate rising to 4%, CPI (+0.0% MoM vs +0.1% exp, +0.3% prev) and Retail Sales (+0.1% MoM vs +0.3% exp, +0.0% prev) pointed to a gradually softening US economy, and as expected the FOMC left rates unchanged. There were a number of surprising election outcomes, however, and that was a much more important driver of credit markets.

In Mexico, the left-wing coalition managed to secure an absolute majority, opening the doors for implementation of some extremist policies that had been floated earlier, such as abolishing some regulators, justice system reforms, as well as a pension reform. All of these were deemed to put strain on the fiscal health of the state and put a question on the proposed fiscal consolidation post-election. The Mexican Peso sold off dramatically, triggering a carry trade unwind in FX. USDMXN was a consensus carry trade and significant overcrowding was visible before the vote, while the newly elected authorities failed to calm markets in the immediate aftermath.

In South Africa and India, the ruling parties and coalitions failed to secure a majority in the legislature, and while this was much less dramatic in India, in South Africa the two-week negotiations between the ANC and other parties (mainly the DA) focused the attention of markets. In the end, Cyril Ramaphosa (current president) was re-elected and managed to form a government of national unity, opening a new chapter for the country.

In the EU elections, the right-wing parties registered some gains, as expected, but the most dramatic situation was in France where the far-right National Rally secured a much bigger percentage of the EU Parliament vote and President Macron called snap elections. This put pressure on French Government Bond spreads, and the EU periphery widened in sympathy.

US assets posted a positive return overall, with S&P500 +3.47%, NASDAQ +5.96%, US 10YR Treasuries +1.38%, Brent +5.87%, and the dollar index DXY +1.14%. The Euro and EM FX sold off by -1.24% and -1.77% respectively, driven by the political risk events discussed above, while DAX and Hang Seng sold off by -1.42% and -2.00% respectively. Natural Gas (-2.29%) and industrial metals (Copper -4.75%, Iron Ore -5.67%) sold off, while precious metals either held steady (Gold -0.02%) or followed suit (Silver -4.16%).

## Portfolio Highlights & Strategy Review

In June the Fund slightly underperformed its reference index (I-Cap share class). The performance was driven by the investment grade part of the index, with total return of 1.10%, while the high yield portion delivered 0.14% for the month.

As expected, the biggest contributors of return for the Fund were structural underweights in Egypt (+0.09% Brinson excess return), Argentina (+0.09%), Ecuador (+0.06%), and Nigeria (+0.03%), as well as tactical overweights in the Dominican Republic (+0.04%) and Colombia (+0.04%).

Biggest detractors were overweight in Romania (-0.11%), which suffered from the widening of EU periphery on the back of the French snap elections, but since the risks were perceived to be idiosyncratic to France, the market was awash in “buy-the-dip” recommendations and we saw good two-way interest from market-makers. Kenya (overweight vs benchmark, but flat vs eligible universe) (-0.06%) and Ivory Coast overweight (-0.05%) suffered underperformance due to spread widening in African credits, with Africa the poorest performing region of the month. Our position in Mexico was cautious before the elections, as we are overweight vs the benchmark weight, but quite underweight vs the weights mandated by eligibility limitations. Still, the position underperformed by -0.04% on portfolio level for the month, but offers some value going forward.

## Fund Outlook

As we wrote last month, we expect the distressed part of the benchmark to see limited upside, due to the restructuring of debt having been largely arranged, with the significant exception of Ukraine. We have started to see already some of the performance of the Fund being driven by lack of exposure to downside price movements in these distressed credits, while duration effect in the higher credit quality part of the benchmark take over.

We expect this to continue, as the US economy is showing all signs of a gradual slowdown, which should give the FOMC comfort to gradually decrease rates. ECB has already started doing this, but we see more limited room for rate cuts in EM central banks for now, as running in front of the Federal Reserve could cause currency depreciation and widening of current account deficits.

The problem we see globally is on the fiscal side of the equation, as fiscal consolidation seems to be baked into risk premia of quite a few credits. Some, such as Indonesia, are starting from relatively low levels of Debt to GDP and have sustainable plans for expanding debt levels, investing in value-added activities, as well as in fiscal multiplier-increasing projects, such as free school meals for all schoolchildren. Others are not in the same position, so additional debt issuance could contribute to spread widening over the course of the year, offsetting some of the duration gains from a decrease in risk-free rates.

The Fund is positioned defensively by construction, so the strategy should benefit in such environment. We are seeking to maximise returns, based on relative-value trades to take advantage of sustainability factors benefitting or worsening the fiscal outlook.

On a one-year horizon, we expect risk premiums to rise but we expect carry and duration effects to support positive total returns. On an assumption of 10Y US Treasury yields between 3.5-4% and EM spreads between 400-450bps, EMD HC returns are likely to be around 5-12%.

This marketing communication is provided for information purposes only, it does not constitute an offer to buy or sell financial instruments, nor does it represent an investment recommendation or confirm any kind of transaction, except where expressly agreed. Although Candriam selects carefully the data and sources within this document, errors or omissions cannot be excluded a priori. Candriam cannot be held liable for any direct or indirect losses as a result of the use of this document. The intellectual property rights of Candriam must be respected at all times, contents of this document may not be reproduced without prior written approval.

Warning: Past performance of a given financial instrument or index or an investment service or strategy, or simulations of past performance, or forecasts of future performance does not predict future returns. Gross performances may be impacted by commissions, fees and other expenses. Performances expressed in a currency other than that of the investor's country of residence are subject to exchange rate fluctuations, with a negative or positive impact on gains. If the present document refers to a specific tax treatment, such information depends on the individual situation of each investor and may change.

In respect to money market funds, please be aware that an investment in a fund is different from an investment in deposits and that the investment's principal is capable of fluctuation. The fund does not rely on external support for guaranteeing its liquidity or stabilizing its NAV per unit or share. The risk of loss of the principal is borne by the investor.

Candriam consistently recommends investors to consult via our website [www.candriam.com](http://www.candriam.com) the key information document, prospectus, and all other relevant information prior to investing in one of our funds, including the net asset value ("NAV") of the funds. Investor rights and complaints procedure, are accessible on Candriam's dedicated regulatory webpages <https://www.candriam.com/en/professional/legal-and-disclaimer-candriam/regulatory-information/>. This information is available either in English or in local languages for each country where the fund's marketing is approved. According to the applicable laws and regulations, Candriam may decide to terminate the arrangements made for the marketing of a relevant fund at any time.

Information on sustainability-related aspects: the information on sustainability-related aspects contained in this communication are available on Candriam webpage <https://www.candriam.com/en/professional/market-insights/sdfr/>. The decision to invest in the promoted product should take into account all the characteristics or objectives of the promoted product as described in its prospectus, or in the information documents which are to be disclosed to investors in accordance with the applicable law.

Notice to investors in Switzerland: The information provided herein does not constitute an offer of financial instruments in Switzerland pursuant to the Swiss Financial Services Act ("FinSA") and its implementing ordinance. This is solely an advertisement pursuant to FinSA and its implementing ordinance for financial instruments.

Swiss representative: CACEIS (Switzerland) SA, Route de Signy 35, CH-1260 Nyon. The legal documents as well as the latest annual and semi-annual financial reports, if any, of the investment funds may be obtained free of charge from the Swiss representative.

Swiss paying agent: CACEIS Bank, Paris, succursale de Nyon/Suisse, Route de Signy, 35, CH-1260 Nyon. Place of performance: Route de Signy 35, CH-1260 Nyon. Place of jurisdiction: Route de Signy 35, CH-1260 Nyon.

Specific information for investors in France: the appointed representative and paying agent in France is CACEIS Bank, Luxembourg Branch, sis 1-3, place Valhubert, 75013 Paris, France. The prospectus, the key investor information, the articles of association or as applicable the management rules as well as the annual and semi-annual reports, each in paper form, are made available free of charge at the representative and paying agent in France.

Specific information for investors in Spain: Candriam Sucursal en España has its registered office at C/ Pedro Teixeira, 8, Edif. Iberia Mart I, planta 4, 28020 Madrid and is registered with the Comisión Nacional del Mercado de Valores (CNMV) as an European Economic Area management company with a branch. CNMV:1493