PICTET
1805
Asset Management

Pictet - Emerging Local Currency Debt - P dm USD

Risk and reward profile

Don't take unnecessary risks. Read the Key Investor Information Document.

Lower Risk						Higher Risk
1	2	3	4	**5**	6	7
Typically lower rewards						Typically higher rewards

Market review

The index returned -5.00% over the month, with Russia being the primary driver of negative performance. The material escalation we have seen in the Russia-Ukraine conflict has dominated the volatility in markets over the past month. The situation has been extremely fluid throughout February, and we ended the month with the tragic development of a full scale invasion by Russia. Following the drastic deterioration, the prices of safe haven assets, such as gold and US treasuries, rallied whilst equities sold off. Oil soared to above $100 for the first time since 2014, with prices settling following the announcement that sanctions on Russia will not target oil and gas flows. US and European leaders have issued a number of sanctions against Russia (and Belarus for its involvement in the invasion of Ukraine), including sanctions on the Russian Central Bank freezing a large share of Russia’s reserves. This led to a plunge in the ruble, and saw the Bank of Russia more than doubling its interest rate from 9.5% to 20%. Such a backdrop of geopolitical tensions brings fresh challenges for a global recovery that was already struggling with elevated price pressures and tightening monetary policy.

Performance analysis

The fund underperformed the benchmark during February owing to a difference of valuation methodologies between Pictet and index provider JP Morgan. This arose from heightened uncertainty around the proper handling of mark to market pricing of Russian assets in light of the inability to find an accurate clearing price in the market and lack of clarity about Russia's ability or willingness to pay accrued interest going forward. Pictet's pricing committee took conservative approach to mark all Russian holdings at zero while the index pursed a different approach with positive prices being used. This resulted in the appearance of a large underperformance on the fund. This will be unwound in the month of March, and will reflect a more accurate reality of relative performance. Away from this, performance was positive, with the underweight to Polish local rates and FX contributing. Hungary, Turkey and Thailand underweights added positive P&L. In LatAm, Chilean, Colombian and Mexican risk also added to performance. Detractors were the long in the Israeli shekel, a relative value position in South African local debt. The largest individual contributor was the underweight position in US treasury futures.

Portfolio activity - overweightings & underweightings

We started February with portfolio construction consistent with January - with core themes of globally elevated inflation and resultant monetary policy normalisation creating a challenging backdrop to EM local and core market bond markets. This continued to be represented with the sizeable net duration underweight on the portfolio. Within Central and Eastern Europe, relative short positions remained in place in Turkey, Poland and Czech Republic - all markets where inflationary pressures and rich valuations relative to fundamentals continue to warrant higher yields. In Asia, Taiwanese and Malaysian monetary policy continues to lag respective domestic financial conditions and so also justifies underweights on the anticipation of higher bond yields. Underpinning this core view continues to be the short positions in both US and German government bond futures, protecting the overall portfolio from the backdrop of heightened interest rate volatility amidst rising rates. This position was reduced in the latter part of February as risk aversion pertaining to the Russian invasion of Ukraine drove a bid for high-quality duration in a divergence from underlying inflationary dynamics. We cut the overweight to Chinese local rates but kept positions in Indonesia and Brazil, where valuations remain attractive in light of high real yields and aggressive monetary policy action, respectively.

Market outlook

Russia's invasion of Ukraine poses significant risks to a global economy already suffering from heightened inflationary pressures. As the military assault continues, we will look to monitor the impacts from a wide range of possible outcomes. Manufacturing PMI data from both the US and the EU have indicated stronger growth; however, due to ongoing conflict, there is an expectation that growth could slow. The effect on EM economies is likely to vary depending on how the situation evolves, with alternate commodity exporters, such as Ecuador and Columbia, naturally expected to benefit from the move away from Russian assets. The expected food price increase due to supply disruptions from the conflict may result in some EM countries facing increasing inflationary pressures, particularly those that rely on Ukraine for grain imports. With monetary policy unlikely to be effective in combating inflation shocks, central banks that have been increasingly hawkish since the year began, may begin to scale back their monetary tightening plans. This delay could be a potential relief for EM economies that have battled with rising rates and increased inflation. As the conflict continues, economies are also increasingly facing the risk of stagflation as prices of goods surge and growth expectations contract. We continue to monitor the fast-evolving situation and look to position the portfolio accordingly.

Portfolio strategy

Naturally, the bulk of portfolio managers' attention has been directed toward the rapidly evolving situation in Ukraine, with a view to understanding the ramifications for asset markets and the global economy. The complexity of the situation is such that uncertainty remains abundant. Our approach, however, has been to take a step back and identify areas where existing themes are likely to persist or even grow in relevance in light of recent developments. One such area is that of inflation, where the supply shock linked to Russian exclusion from global payment systems will feed into further price increases in key commodity markets going forward. This lead us to maintain and even increase the net duration underweight on the portfolio, with commodity importers with CPI and consumption baskets skewed towards fuel and food prices being the obvious losers in terms of trade shock. Turkey remains a negative recipient of this trend, exacerbating an already dire situation. We continue to hold the other core underweights in Poland, Czech Republic, Malaysia and Taiwan. Indian duration also continues to look vulnerable to us, warranting a short in local rates. In currencies exposure, we remain fairly neutral on a net basis, with long exposure to commodity exporters as beneficiaries of tighter markets for raw materials. This includes the Chilean and Colombian peso and Canadian dollar.

General information

Legal form	Sub-fund of a SICAV
Regulatory status	UCITS
Domicile	Luxembourg
Inception date	23.02.2010
Launch date	23.02.2010
Share class currency	USD
Compartment currency	USD
ISIN	LU0476845101
Reference index	JP Morgan GBI-EM Global Diversified (USD)
Min. investment horizon (year(s))	3

Fees

Ongoing charges (OCR)	1.54%
Performance fee (excluded from OCR)	-
Management fee (included in OCR)	1.20%
Max. conversion fee	2.00%
Max. subscription fee	5.00%
Max. redemption fee	3.00%

Management team

Mary-Therese Barton
Alper Gocer

Source: Pictet Asset Management

Further information can be found in the prospectus.

Pictet Asset Management

For further information, please visit our website assetmanagement.pictet

Important Information

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