SEIZING ADVANTAGE IN EMERGING MARKET BONDS

Extreme moves in emerging market bond prices are often coupled with high income for long-term investors. Such opportunities are rare, but our emphasis on sustainability could allow us to take advantage, explains Investment Manager Mindaugas Lepeska

The value of an investment, and any income from it, can fall as well as rise and investors may not get back the amount invested.

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Mindaugas Lepeska: The events of 2022 have shown that turbulence has the potential to create excellent opportunities for returns. There have been significant drawdowns in emerging market bonds this year, and outflows from the asset class are at their highest level for 15 years.

The war in Ukraine has caused many investors to re-evaluate their exposure to this asset class, which now yields more than 8 per cent - a level last seen during the Global Financial Crisis. High inflation, rising interest rates, and a stronger US dollar have been formidable headwinds this year.

As investors in emerging market bonds, we believe this indiscriminate sell-off has created a compelling opportunity for income investors to buy bonds in the most resilient countries at highly attractive yields.

For the Sustainable Emerging Market bond strategy, we assess resilience through an approach centred on sustainability. We look for progress rather than perfection, and we use our team's depth of experience to identify signs of improvement.

Take Angola for example. Under President Eduardo dos Santos, Angola endured extreme income inequality and significant corruption issues. His successor, Joao Lourenco, inherited a poisoned chalice of dwindling oil production, a huge debt burden and an overvalued currency. Today, after five exceptionally difficult years, Lourenco's government has restored debt sustainability, reduced corruption, and won a new five-year term. With growth picking up and debt levels falling fast, Angola is well-positioned to unlock its vast potential and deliver prosperity for its people. Its bonds offer generous yields of over 10 per cent.

In Sri Lanka, on the other hand, the adoption of unsustainable economic policies led to impoverishing of its people and no realistic way of repaying its bonds.

These two examples summarise our approach – our team invests where we see the potential for long term improvements to an issuer's sustainability and avoid countries where we believe a more fundamental deterioration is underway.

We have a similar approach to sustainability when investing in corporate bonds. Costa Rica's state-owned electricity company, ICE, produces the majority of the country's electricity from renewable sources. This has been positive for both the company and the country as international energy prices have risen, and ICE bonds have outperformed in a falling credit market.

Extreme moves in emerging market bond prices are often followed by periods of high income and capital returns for those investors who can take a longer-term view. Opportunities like this are rare. We believe that our emphasis on sustainability provides an innovative solution for clients looking to take advantage of the high income offered by Emerging Market Bonds.

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