Global Asset Management

Capturing emerging market potential

For professional investors only | Marketing communication

Polina Kurdyavko
Head of Emerging Markets

RBC BlueBay
Asset Management

Published May 2023

"Emerging markets have had a strong start to the year as significant tailwinds could continue to drive momentum in the asset class."

Despite the uncertainty in the global economy, emerging markets are continuing to generate opportunities for investors.

Emerging markets have had a strong start to the year as significant tailwinds could continue to drive momentum in the asset class.

Even as uncertain and riskier markets and economic dynamics continue, there are enduring and compelling opportunities in EM. Indeed, local and hard currency, loans and absolute return funds are all well positioned to capture EM potential.

Central banks have been preemptively hiking interest rates for around 18 months earlier than developed market central banks and this helped manage and rein in inflation. Inflation has already peaked in most EM countries and in some it is already on a downward trajectory.

"Rate hikes have given confidence to domestic investors in those EM countries that rely mostly on the domestic markets for funding. Investors would think twice before taking a short view on the currency with double-digit interest rates," says Polina Kurdyavko, Head of Emerging Markets and Senior Portfolio Manager at RBC BlueBay.

On the hard currency side, while expected returns are related to the expected default rate, Kurdyavko says that the default rate is likely to remain in mid-to-low single digits and she believes that investors are well compensated for the opportunity in EM debt. Sovereign debt today is paying just shy of 9%.

"If you put the tailwinds of interest rate hikes and high commodity prices together and with close to double-digit yields on their hard currency, investors are seeing some interesting investment propositions," she says.

In the current market environment, she explains that barbell structure is a useful strategy to strike a balance in this riskier asset class.

"We want to overweight everything that makes up the 'sleep well at night' part of the portfolio, like the Middle East and high-quality sovereigns in Latin America that give you the carry," she says.

Unsurprisingly, another supportive tailwind for EM have been high commodity prices. This matters because historically, most EM crises have been triggered by a balance of payments crisis.

If anything, EM countries have seen an improvement of current account dynamics. While oil-rich regions like the Middle East have benefited the most, countries in Latin America are also seeing a positive trend in current account surpluses due to rising commodity prices.

“Then there is the other part of the barbell which involves recently defaulted credits. If a country has defaulted on its sovereign debt in the last two years and has no debt to pay in the next two years, the yield on the debt can be attractive, while the near-term chances of defaulting again are low,” she explains.

Additionally, Kurdyavko explains that funds that take advantage of EM loans are also going to be in an advantageous position. Loans are linked to floating rates, which protects investors on the duration side.

“In buying emerging market loans, you are being paid close to double digits for illiquidity premium and not credit risk,” she says.

Is now the time for unconstrained investing in emerging markets?

The more uncertainty investors have in the world, the more options they want. They want maximum flexibility in duration, choice across the high yield to investment grade credit spectrum, and options of looking at different asset classes.

“The more uncertainty investors have in the world, the more options they want.”

“For us, the Emerging Markets Unconstrained fund gives investors the maximum amount of optionality that you can take because you look at 40 best ideas in emerging markets across corporates, sovereign, local currency, hard currency,” says Kurdyavko.

“You’re not constrained by the benchmark, you’re not constrained by universe segment, you’re not constrained by duration.”

Published May 2023

RBC Global Asset Management