Fund report, September 2021
Emerging Markets Bonds EUR R
Fixed Income

Sparinvest

CHINESE REGULATION IN FOCUS

Utility and real estate crisis in China

Markets. September ended with a negative return for Emerging Markets (EM) government bonds of 2.1%. The return was driven by increasing credit spreads and interest rates. 10Y American interest rates increased by 18 bps and the credit spread increased by 12 bps, and ended the month at 357 bps.

In China, the increased sector regulation performed by the authorities are starting to make an impact on the utility and property sector. The authorities regulated the use of coal fired electricity production to curb air pollution, especially in the larger cities. This resulted in a transition away from coal into natural gas. This has increased the gas demand beyond the growth in secured supply – a similar effect, as we are seeing in Europe. As a result, several cities have therefore experienced blackouts prompting the authorities to take actions. Actions including selectively shutting down energy intensive corporations within the steel, chemical and cement industries. These shutdowns affect both the national and emerging market growth expectations. Further, to mitigate these impacts, the authorities have called on local utilities to secure adequate supply of coal for the winter 'at any cost'. Therefore, Chinese coal prices have increased 65% since mid-August.

In the property sector, the increased regulation have brought the biggest actor, Evergrande, to its knees – a company who owes USD 300 bn. The company is now working with the government to determine the future of the company. These restructuring talks have led to increased speculation about this being a Chinese 'Lehman moment'. These uncertainties have spread to the rest of the sector and financial markets and caused large losses to investor portfolios causing risk premiums to increase among risky assets emerging market debt included.

Negative return in September

The Portfolio had a negative return of 2.3% in June, which was 0.1% below the benchmark before costs.

In September, there was no abundance of positive stories. One bright spot was Lebanon, who managed to form a government for the first time in more than a year. Bond markets received this information well and bond prices increased by 30%. In general, the High Yield (HY) segment delivered the poorest returns in September. The fund has an overweight in HY, which is the main reason for the weak relative return.
The biggest contributors to the absolute return in September came from Mexico, the United Arab Emirates and Lebanon. Opposite, HY countries of El Salvador, Ecuador and Bahamas had the biggest negative contribution to the fund return.

The relative return was supportive of overweight in Mexico and Nigeria, but also an underweight in Turkey. Overweight in El Salvador, Bahamas and Romania had a negative contribution to the relative return.

During September, we have participated in new issues of Nigeria and Egypt and increased our Colombia allocation. This has been financed by reducing exposures in Paraguay and Guatemala. However, on an overall level the portfolio composition is unchanged.

See performance and fund data Click here >

Strategy

Value Bonds - Emerging Market Corporates primarily invests in Emerging Markets corporate bonds, cf. the fund's prospectus. Bond selection is based on the value approach, meaning that the team focuses on bonds issued by companies with healthy long-term earnings power and strong balance sheets as well as an expected ability to service outstanding debt. The portfolio is diversified across sectors, regions and credit ratings. The investment universe includes Investment Grade bonds, High Yield bonds and to a limited extend non-rated corporate bonds.