RBC BlueBay
Asset Management

# The powerful combination of high yields and very low defaults

For professional investors only | Marketing communication

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**In Emerging Market Debt investing, volatility can offer opportunities to generate compelling returns. Anthony Kettle looks at the macro environment and discusses where the opportunities lay.**

**Key points:**

- **The macro-outlook remains uncertain.**
- **EM credit fundamentals remain strong.**
- **In Emerging Markets, a disinflation trend is coming through.**

> **"We see a strong fundamental case for emerging market (EM) credit to deliver solid total returns over the medium term."**

As 2024 progresses, the choppy macroeconomic backdrop continues to create uncertainty in global markets. However, we see a strong fundamental case for emerging market (EM) credit to deliver solid total returns over the medium term. The composition of those returns, be it carry or duration, is up for debate, but the attractive carry, with yields at 8-9%, and improving fundamental outlook in the sovereign and corporate sectors put us in a much better place than we were a few years ago.

Typically, with carry at such elevated levels, concern over default risk abounds. Consequently, investors demand higher yields to compensate for higher potential risk. However, EM sovereigns are, in fact, likely to have a 0% default rate this year and we believe corporate default rates to decline materially, closer to historical averages by the end of the year. Indeed, it is global inflationary pressures that have driven much of the push for higher yields. Yet, emerging market central banks have been ahead of the curve in terms of monetary policy and we currently see the indications of the disinflation trend coming through.

In terms of geopolitics, the Russia-Ukraine situation is ongoing, as is the conflict in the Middle East. Plus, the future of China's relationship with its neighbours and the US remains a concern for investors. Moreover, with over half of the world's population going to the polls this year, the impact on the outlook of EM economies creates another source of uncertainty, with the outcome of the US election being of particular interest.

Given there are over 80 countries in the EM universe, the volatility created by these elections can create opportunities to take advantage of market over reaction in certain areas, resulting in mispricing of assets. We believe that some economies, such as India and the GCC are generally more insulated from the US election, while some countries in such Mexico and China will likely be more impacted.

**"In terms of specific investment opportunities, we follow the reform stories very closely across the EM universe."**

In terms of specific investment opportunities, we follow the reform stories very closely across the EM universe. As an example, Argentina has a new president, Javier Milei, who is intent on making bold changes. There are concerns, of course, because the population may push back against these reforms and Argentina has a history of repeated defaults. However, in the recent election the people voted for this path and President Milei's popularity appears to be holding up, which is crucial for his ability to enact his reform plan. Therefore, our preferred approach has been to buy long-dated bonds, which should benefit investors significantly if the reform story plays out, and implement hedges, by buying short-dated credit default swaps (CDS), should the reform agenda become derailed.

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