

AMUNDI FUNDS EMERGING MARKETS BLENDED BOND

Monthly
Portfolio
Update

28/02/2025

Meet the Team



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Market Comments

EM debt assets delivered positive returns in February, though there were a few macro headlines related to policy and geopolitics. The month began with the threat of imminent US tariffs on Canada, Mexico and China, to be implemented from February 4th. A last-minute extension for Canada and Mexico led to a relief rally, with the S&P 500 index reaching an all-time high on February 19th. Towards the end of the month, a risk-off tone developed as tariffs came back on the agenda, alongside weaker data out of the US and declines in tech stocks, as smaller revenue beats underwhelmed investors' expectations of bigger surprises.

President Trump announced reciprocal tariffs would be imposed beginning early April, where the US would charge other countries what they had to pay. There was also a proposal for 25% tariffs on all steel and aluminium entering the US. Towards the end of the month, he confirmed that all tariffs on Canada and Mexico would still go ahead on March 4th, leading to a fresh sell-off. The 10% tariffs on China came into force in February, but were topped up with an additional 10% tariff on the same date.

The US treasury curve flattened over the month, with the 10-year yield falling by 33bps over the month to 4.21%, marking the biggest decline in yields since July 2024. In response to weakening signals in the economy, the market adjusted its expectations to price in a more dovish Fed compared to one month ago, now pricing in nearly 75bps worth of cuts for the year. While the US dollar remained relatively strong, it experienced a slight depreciation over the past month. Soft data such as consumer confidence fell to an 8-month low dampening risk appetite, while the US CPI release for January showed the strongest monthly CPI print since August 2023, running at +0.47% on the month.

In Europe, focus was on the possibility of higher defence spending. Yields across eurozone countries rose as markets digested the prospect of increased issuance: NATO head Mark Rutte recently suggested that countries should boost spending to "considerably more than 3%" of GDP (around EUR500bn). In political developments, the German election took place on February 23rd, with the result broadly in line with opinion polls beforehand, and the conservative CDU/CSU block opened exploratory talks with the centre-left SPD to form a new government.

Turning to geopolitics, with many unanswered questions and ongoing uncertainties, the Munich Security Conference and the meeting between Ukrainian President Zelensky, President Trump and Vice President JD Vance, served as reminder that a ceasefire has so far not been easy, pointing to more participation from European leaders, who are set to meet again to discuss new defence initiatives with increasing pressure on them to agree on something meaningful. After numerous headlines on a minerals deal between the US & Ukraine failed, the US has emphasised its stance for diplomacy and an economic deal, President Zelensky reiterated demands for security guarantees as a precondition for a deal and ceasefire. The situation continues to unfold by the minute, with the most recent development coming from President Zelensky on X stating, "...We are working together with America and our European partners and very much hope on US support on the path to peace. Peace is needed as soon as possible."

Meanwhile, EM central banks have continued to unwind their restrictive monetary policy stance.

In Asia, the Reserve Bank of India cut policy rates by 25bps to 6.25%, the Bank of Korea cut policy rates by 25bps to 2.75%, while the Bank of Thailand also cut its policy rate by 25bps to 2%, though contrary to consensus expectations. The People's Bank of China continued to refrain from loosening monetary policy in order to discourage one-way bets in the bond market. In Latin America, most central banks proceeded cautiously in light of heightened external uncertainty and domestic challenges. The exception was the Central bank of Mexico which cut policy rates by 50bps to 9.5%. In CEEMEA, most central banks have remained on hold, with the exception of the Czech National Bank, which cut policy rates by 25bps to 3.75%.

EM hard currency sovereign debt delivered positive returns in February. The JP Morgan EMBI Global Diversified Index returned 1.57% over the month, leading to a cumulative YTD return of 3.03% and a 12m return of 9.82%. The Investment Grade (IG) sub-component outperformed returning 2.27% and 2.98% YTD. The High Yield (HY) sub-component returned 0.91% in February and 3.06% YTD. EM hard currency corporate debt also delivered positive returns in February. The JP Morgan CEMBI Broad Diversified Index returned 1.55% over the month, leading to a cumulative YTD return of 2.36% and a 12m return of 8.75%. The IG sub-component outperformed returning 1.65% in February vs. 1.41% for HY. In local markets, the GBI-EM Global Diversified Index returned 0.66% in February, 2.72% YTD and 2.41% over 12m. Latin America continues to dominate the returns in EM for a second consecutive month, and across both duration and FX; while Asia is a region lagging on both fronts. Per data from JP Morgan, YTD flows to EM bonds and equities stand at -\$2.72bn for EM bonds and -\$7.2bn for EM equities.

Performance Analysis

The fund (I EUR Share class) returned 1.05% net of fees during the period relative to the benchmark return of 0.86%. Duration, currency management and external debt exposure were positive for excess returns. Off-benchmark local debt positions were not a meaningful contributor.

Duration views contributed to returns as we had a bias to be long USD duration and yields fell during the month.

Emerging market debt strategy was helpful due to a positive contribution from EM country selection, while our overall exposure was a drag. We maintained an overweight beta exposure relative to the benchmark.

Within EM country allocation, one of the largest positive contributors was a long position in Venezuela. Bonds performed well as investors continue to search for yield. Other positions that worked well included long positions in Romania and Colombia, respectively. Romanian bonds remain attractively valued despite the wider fiscal deficit driven by higher wage spending and lower than expected revenues. An underweight in Ecuador was also helpful.

In terms of negative contributors, a long position in Argentina was the biggest negative during the period. Political uncertainty increased due to Milei's potential involvement and endorsement of a meme coin. Other positions that were a drag included a long position in Senegal. Bonds underperformed as a recent audit report indicated a higher fiscal deficit and debt levels over the last 5 years.

FX positions were positive for relative returns, helped by overweight position in TRY and CLP, respectively as well as underweight positions in THB and TWD. A long INR position, however, was a modest drag.

Within our off-benchmark local currency rate positions, longs in Mexico and Nigeria were helpful, but these were offset by positions in Turkey and Brazilian local rates, respectively.

Positioning Changes

Duration: As at the end of February, the Fund has an overweight duration position of about 1.25 yr relative to the benchmark. Our overweight reflects longs in both EUR and USD duration as well as our off-benchmark exposure to EM local currency debt.

We remain constructive on the medium-term outlook for EM debt but more cautious near-term. The reasons for this include the following: (a) the market has delivered two years of solid returns and (b) there remains significant policy uncertainty related to the Trump administration. We await to get further clarity on Trump's approach to tariffs, immigration and the wars. As such, we are keeping some 'dry' powder should we see a repricing in markets. That said the overall macroeconomic environment for EM debt remains supportive; a Fed easing cycle, albeit gradual, in the context of a resilient US and global economy and light investor positioning could support the next leg of the rally in the asset class. US growth is expected to remain at trend in 2025 with inflation under control and monetary policy still quite restrictive.

Although valuations are somewhat less compelling given the solid performance of the asset class, the absolute level of yields in EM debt remains high relative to history. A Fed easing cycle, even if gradual, should reduce the attractiveness of US assets and drive the search for higher yielding alternatives. EM countries are also cutting rates but at a measured pace to support their currencies. A cautious pace of EM rate-cuts, however, should support the carry of EM debt and provide a cushion to further rate and/or FX volatility.

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Fundamentals are also improving for many EM countries who have embarked on a structural reform path and secured IMF and/or external financing. These include some of the higher yielding countries like Egypt, Argentina, Ecuador and Ivory Coast, among others. Both Ghana and Zambia have also completed a debt restructuring deal with external creditors and with IMF support. The only countries who have yet to restructure include Venezuela, Lebanon and Ethiopia, respectively.

Rating migration trends are also positive in both the sovereign and corporate market as the level of upgrades outpaces downgrades. The sovereign market had no defaults in 2024 and only one in 2023 (Ethiopia), while the corporate default rate remains very low (below 3%).

As noted, investor positioning in EM debt is light following \$150bn of outflows since 2022. Although EM corporate/sovereign issuance has picked up to start the year, net issuance should remain muted given large amortisations expected. EM corporate net issuance is expected to remain negative this year.

There are meaningful risks to our outlook. Trump's recent tariff announcements could start a global trade war, elevate US inflation pressures and delay and/or even prevent Fed rate cuts. A potentially aggressive deportation policy will also be inflationary given an already tight US labour market. At this point, our base case is that the Fed will have room to cut rates modestly this year, but we continue to monitor the extent to which he pursues his desired policy measures. Tariffs will also pose as a headwind to EM growth and their respective currencies. On balance, we prefer those countries that are less directly exposed to potential tariffs, including commodity exporters, unless valuations already reflect those risks.

In hard currency debt, we maintain our overweight exposure to the asset class. We like idiosyncratic stories in countries that are seeing an improvement in fundamentals and/or those that have good relations with the incoming administration. We maintain our preference for Latin America and select African countries as valuations are relatively compelling compared to other regions. We remain broadly underweight Asia where spreads are generally tight. From a rating perspective, high yield still offers value, whereas investment grade spreads are relatively tight. Although our return expectations are largely driven by the carry the asset class offers, there is room for some spread compression in high yield given relatively elevated spreads.

In Argentina, economic activity is recovering following the government's fiscal austerity program, while macro imbalances are improving as the current account and primary balance are in surplus. In Mexico, quasi-sovereign valuations are attractive, and there is room for spreads to tighten relative to the sovereign. We also like Egypt due to the government's structural reform plans as part of its IMF package, while the UAE investment will support FDI inflows. In CEE, we like Romania as valuations are attractive relative to peers, and there is room for some medium-term fiscal consolidation relative to current expectations.

In off-benchmark EM local currency debt, we are selectively long rates in countries that offer higher nominal and real yields. Within local rates, key positions include Brazil, Mexico, and South Africa, respectively. Brazilian real rates remain the highest in the EM universe as the Central Bank is hiking rates, while in Hungary, the carry is attractive. The rate cutting path for the National Bank of Hungary is likely to be cautious and gradual.

In EM FX, we are selective but like countries that offer high carry, including BRL, TRY, INR, and ZAR, respectively. We also hold a tactical long in MXN.

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