

THE FUTURE OF FIXED INCOME

Weekly Bond Bulletin

21 March 2019

All stars aligned for emerging markets?

Dovish central banks, strong fundamentals and an improved outlook for China suggest that all stars are aligned for emerging markets. How long can the year-to-date rally continue?



Fundamentals:

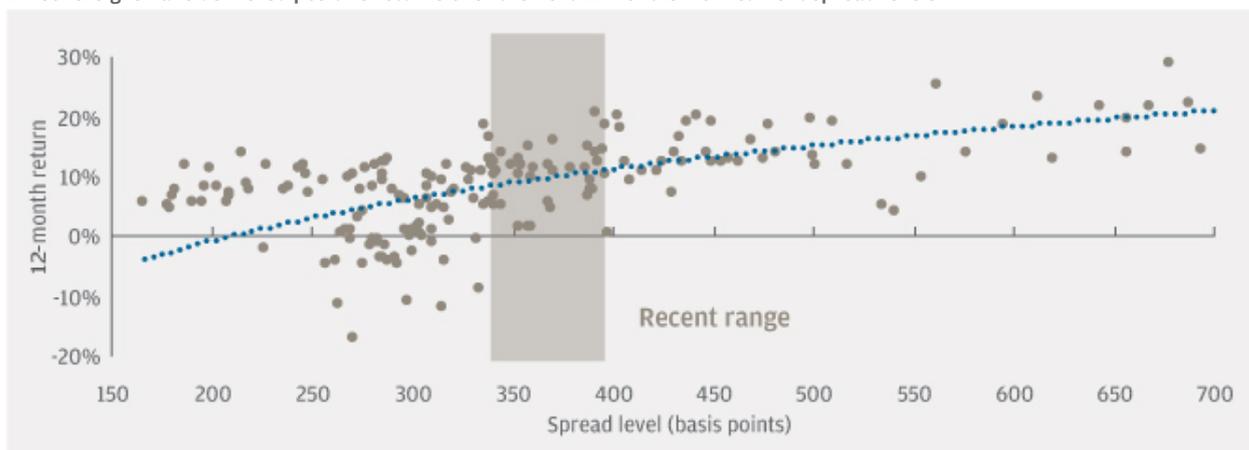
The recent dovish tone from the Federal Reserve (the Fed) and European Central Bank has provided a substantial tailwind for emerging markets so far this year. However, other factors have also helped boost emerging market (EM) performance. China, which contributes around 40% to EM GDP, has benefited from increased policy stimulus and substantial progress in trade talks with the US. As a result, we now expect Chinese GDP growth of approximately 6.3% in 2019. Combined EM growth is still expected to slow from 4.6% in 2018 to 4.4% in 2019, but the growth differential between emerging markets and developed markets should actually widen according to our forecasts. Meanwhile, EM corporate fundamentals continue to improve. Although revenue growth may have peaked, disciplined capital expenditure has helped leverage fall to the lowest levels in the past six years. Nonetheless, some risks continue to lurk in the background. If growth fails to rebound in Europe and China, for example, or if the Fed reverses its dovish stance—or even if the upcoming US election campaign favours less market-friendly candidates—risk sentiment could change quite quickly.



Quantitative valuations:

The positive fundamental backdrop has continued to boost EM debt performance into March. Hard-currency sovereigns and corporates have returned 6.26% and 4.61% respectively since the start of the year (as of 19 March). While some investors may think this rally is overdone, spreads for both sectors have so far only retraced about 55% of the spread widening experienced in 2018. Furthermore, EM sovereigns have historically always delivered positive returns over the next 12 month period when spreads have traded around the current level of 340 - 350 basis points. Local currency EM sovereigns have also delivered a positive return this year (+4.45% in US dollar terms) and are yet to recoup last year's -6.21% return. Also, the factors that helped support US dollar strength in 2018 are fading and should therefore provide a tailwind for EM currencies.

EM sovereigns have delivered positive returns over the next 12 months from current spread levels



Source: J.P. Morgan Asset Management; data as of 28 February 2019.



Technical:

Across most of the risk asset classes, we continue to see ample investor demand this year. According to our in-house fund flow monitor, the combined EM debt fund universe received over \$16 billion of inflows in 2019 (as of 19 March), with almost half of the inflows coming into the hard-currency sovereign space. Although these inflows have already surpassed the \$13 billion that flowed out of EM debt in the second half of last year, we think further inflows are likely given the positive market environment. The current strength of investor demand is illustrated by a recent Eurobond issuance in Ghana, where the total order book was around \$20 billion, although the country's Ministry of Finance was looking to issue only \$3 billion.

What does this mean for fixed income investors?

Although global growth has been slowing, the fundamental backdrop remains broadly supportive for EM debt. Investors will need to keep a close eye on central banks for any signs of a reversal to their current dovish policy stance, and on economic data to ensure that EM growth is picking up as anticipated. In the meantime, investors can take advantage of some attractive carry opportunities while also looking to extract value from selective EM corporates and sovereigns that have lagged behind in the year-to-date rally.

About the Bond Bulletin

Each week J.P. Morgan Asset Management's **Global Fixed Income, Currency and Commodities** group reviews key issues for bond investors through the lens of its common Fundamental, Quantitative Valuation and Technical (FQT) research framework.

Our common research language based on **Fundamental, Quantitative Valuation and Technical** analysis provides a framework for comparing research across fixed income sectors and allows for the global integration of investment ideas.



Fundamental factors include macroeconomic data (such as growth and inflation) as well as corporate health figures (such as default rates, earnings and leverage metrics)



Quantitative valuations is a measure of the extent to which a sector or security is rich or cheap (on both an absolute basis as well as versus history and relative to other sectors)



Technical factors are primarily supply and demand dynamics (issuance and flows), as well as investor positioning and momentum



LET'S SOLVE IT.SM

NOT FOR RETAIL DISTRIBUTION: This communication has been prepared exclusively for institutional, wholesale, professional clients and qualified investors only, as defined by local laws and regulations.

The views contained herein are not to be taken as advice or a recommendation to buy or sell any investment in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit and accounting implications and determine, together with their own professional advisers, if any investment mentioned herein is believed to be suitable to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yield are not a reliable indicator of current and future results.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. This communication is issued by the following entities: in the United Kingdom by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions by JPMorgan Asset Management (Europe) S.à r.l.; in Hong Kong by JF Asset Management Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited; in Singapore by JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), or JPMorgan Asset Management Real Assets (Singapore) Pte Ltd (Co. Reg. No. 201120355E); in Taiwan by JPMorgan Asset Management (Taiwan) Limited; in Japan by JPMorgan Asset Management (Japan) Limited which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Korea by JPMorgan Asset Management (Korea) Company Limited; in Australia to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Cth) by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919); in Brazil by Banco J.P. Morgan S.A.; in Canada for institutional clients' use only by JPMorgan Asset Management (Canada) Inc., and in the United States by JPMorgan Distribution Services Inc. and J.P. Morgan Institutional Investments, Inc., both members of FINRA/SIPC.; and J.P. Morgan Investment Management Inc.

Copyright 2019 JPMorgan Chase & Co. All rights reserved.

0903c02a82546ad0