J.P.Morgan
Asset Management

THE FUTURE OF FIXED INCOME

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Searching for value in emerging markets

A relatively benign G20 summit and expectations for easier financial conditions ahead have boosted demand for emerging market debt. However, areas of value can still be found.

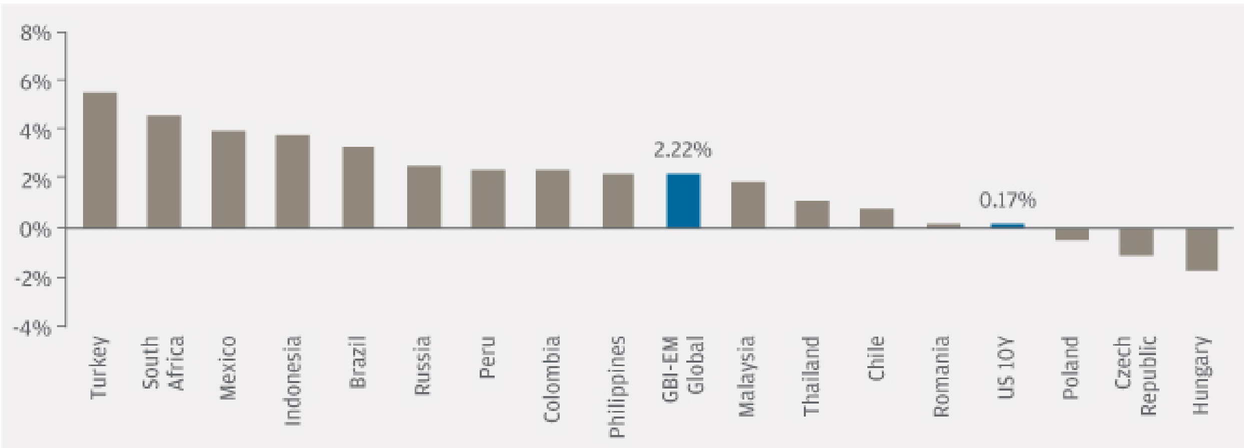
Fundamentals:

The growth trajectory of emerging markets remains intact following the recent G20 summit, which ended without a further escalation in trade tensions. Although uncertainty around global trade will no doubt continue, Chinese growth is so far holding up as policymakers add heavy stimulus and increase infrastructure spending to counterbalance some of the negative effects of trade tariffs. Economic stability in China should help sustain emerging market growth and the ability of emerging market countries to service their debt, at least in the near term. Additionally, cyclical indicators are showing signs of rebounding, both in China and across emerging markets more broadly, while many emerging market central banks are also in a strong position to follow the Federal Reserve and cut interest rates into any slowdown, having sustained higher real rates than developed markets in the recent cycle.

Quantitative valuations:

The search for yield and for asset classes that offer attractive carry has boosted demand for emerging market debt this year—leading to a significant tightening of valuations. The headline yield of 5.61% on the J.P. Morgan GBI-EM Global Diversified index now lies at the lowest level since 2013. However, with yields varying significantly across emerging market countries and idiosyncratic risks expected to continue in higher yielding markets, we believe that investors may be well served by an active approach. For instance, excluding Turkey on the basis of a worsening outlook, countries such as South Africa, Mexico and Indonesia appear attractive in our view (all data as of 9 July 2019).

GBI emerging market real yields



Source: Global Bond Index (GBI) Emerging Market Global Diversified sub-indices. Real yield uses third-quarter 2019 expected CPI inflation. Data as of 9 July 2019.

Technicals:

Emerging market debt fund inflows have surpassed USD 18 billion year to date (to 9 July), while only witnessing two months of net outflows. Meanwhile, net supply is expected to remain light, which provides further support for the asset class. Fund positioning as a whole among emerging market managers has been biased towards a risk-off tilt, suggesting that some countries have benefited more from fund inflows than others.

What does this mean for fixed income investors?

Although there were no negative surprises from the G20 summit, trade tensions between the US and China still have the potential to further impact global growth expectations. For the time being though, the growth outlook for emerging markets remains favourable to that of developed markets. Furthermore, emerging markets that have managed to maintain relatively high real yields have given themselves a higher degree of flexibility in their monetary policies. With the search for yield also set to continue, the backdrop for emerging market debt therefore appears positive. But with idiosyncratic risks abound, investors may benefit from careful country selection.

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

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