THE FUTURE OF FIXED INCOME

Weekly Bond Bulletin

3 December 2020

Room to run in EM

November's risk-on rally produced strong returns for emerging market (EM) debt, but we think there is still room to run.

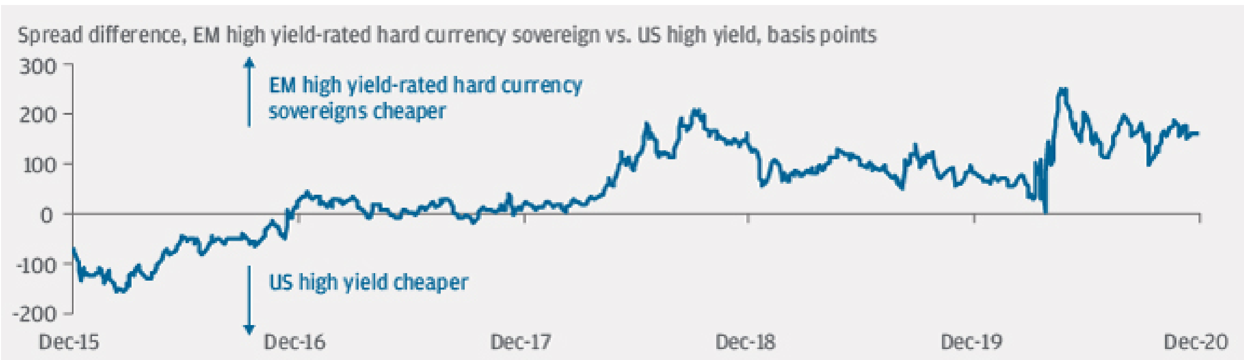
Fundamentals:

The clear path towards a global growth recovery, combined with benign monetary policy, provides a constructive environment for emerging markets. Importantly, though, it's not only these external factors underpinning the EM complex; dynamics within emerging markets are also supportive. Manufacturing has rebounded more sharply in emerging compared to developed markets, as evidenced by both industrial production and export volumes, and signals from survey data are also positive. In particular, China data continues to be robust: recent purchasing managers indices' were better than expected, and strength was broad-based across new orders, output and employment. That said, the consumer picture still bears watching, as consumer confidence in emerging markets (excluding China) lags developed markets and retail sales are highly dependent on lockdown measures.

Quantitative valuations:

Risk markets, including EM debt, posted very strong returns in November, propelled by the month's momentous fundamental developments: positive vaccine news and the removal of US election tail risk. EM hard currency sovereigns returned 3.9% for the month, while the local currency sovereign market was up 5.5%. Even more noteworthy was the performance of high yield-rated hard currency sovereign debt, which posted its fourth-highest monthly return on record, at 6.1%, trailing only May of this year and two months in the wake of the global financial crisis. While these are impressive gains, we believe spreads could still tighten further, especially with a cross-market view, as high yield-rated hard currency sovereign debt trades wide to US high yield.

High yield-rated EM sovereign debt trades wide to US high yield



Source: J.P. Morgan Asset Management, J.P. Morgan, Bloomberg, Bank of America Merrill Lynch; data as of 30 November 2020.

Technicals:

EM debt funds, particularly in the hard currency sovereign and corporate space, are trading with betas above one, suggesting that consensus is to be overweight the market. The potential for crowded positioning certainly warrants monitoring, but we still see scope for further demand from crossover investors. Meanwhile, supply and demand dynamics are largely balanced. The new issue calendar has picked up for both sovereigns and corporates, but flows have improved, with nearly USD 1 billion of inflows across EM debt strategies in the week to 1 December.

What does this mean for fixed income investors?

Emerging markets stand to benefit from both the supportive external backdrop and the rebound in data within the complex. As we move into the growth recovery phase, it is likely that domestic policy across emerging markets will become less synchronised, requiring a more differentiated approach. We currently see value in the higher yielding parts of the market, though rather than adding risk outright we are focused on rotations and participation in the active primary market.

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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