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| **ENGLISH** | **TRANSLATION** |
| HEADLINE: Fear factor |  |
| AUTHOR Simon Fasdal |  |
| INTRO As predicted, fear infected the markets during Q3 and remains a force to be reckoned with as we stand on the cusp of Q4. But make no mistake, this is also the flux point where opportunity begins to knock. |  |
| PULL QUOTE “The focus is back on governments, and promises versus reality.” |  |
| **Clearer picture** |  |
| Our view at the cusp of Q3 was that we could see a buildup of excessive fear, geopolitical risk factors and less risk appetite, especially for emerging market bonds. We highlighted that investors could exploit this excessive fear at a given point – probably after the first US rate hike. |  |
| Indeed, markets have entered a mode of fear, igniting a broad based risk-off sentiment for emerging markets over the last three months ­– for stocks, bonds and especially currencies. There is indeed cause for concern; financial imbalances are present, the many years of a low-yield environment has fed the most popular acronyms for EM – BRICS, MINTS or Next 11 – with substantial inbound capital flows, fuelling multi-year growth parties in most of the these countries. |  |
| And then at some point the party is over. The ordinary resumes and for EM one saying is particularly apt: “The dimming of the light makes the picture clearer”. Double-digit growth rates have disappeared and been replaced by the anaemic growth rates mostly seen in the Eurozone for a decade. The focus is back on governments, and promises versus reality. |  |
| **Opportunity knocks** |  |
| Against this backdrop, it is easy to see why EM have been under severe pressure, and also why the media has made such an issue of their predicament. Indeed, this media focus has sent emerging market bond yields into high orbit, way above the general low-yield environment. |  |
| But we have several reasons to believe that this is where we believe the road to opportunity begins. |  |
| First of all, the overall rotation away from emerging- market assets has increased the yield difference between developed markets and emerging markets significantly. In general, we find emerging market bonds (both government and corporates) trading at better risk/rewards than compared to their developed market counterparts. Especially when considering previous higher-yielding segments of US and Europe, which have contracted on the back of substantial quantitative easing to levels where it is questionable if the risk premium expresses the entire risk. |  |
| To view this in a measurable way, a sample of USD-denominated emerging market bonds has a high premium per risk unit compared to peers. This risk is there for a reason, of course. A combination of sluggish growth and bad politics hits not only the government bonds, but a spillover to corporate bonds in such countries is also typical. In many cases this spillover is unjustified and investors can find opportunities when they pinpoint such discrepancies. |  |
| Second, the lack of growth is playing too big a factor. The very high growth rates we have seen in EM are unsustainable and gravity defying in the long run. The whole idea with emerging markets is their “emerging” into more developed economies. When these markets eventually do evolve we will see growth levels more aligned to developed economies. At present, several EM countries are troubled by negative or close to negative growth (Russia and Brazil for instance), but it is not a given that things stay this way. |  |
| Third, the EM fear over lower commodity prices is exaggerated. Besides Russia, Venezuela, and Nigeria, which have government spending hugely dependent on a high oil price, most EM countries are less vulnerable to oil price drops than the present fear expresses. These other EM countries are normally more dependent on other commodity prices (for instance iron ore in the case of Brazil) that often have a less dramatic impact on the overall economy than sudden oil price drops. |  |
| Finally, the EM difficulties are linked to the fear of higher yields ignited by a quite aggressive series of rate hikes by the US Federal Reserve. As you read these lines, I think the market is slowly realising that the Fed would have hiked in September if there were *any* reason to hike, and it did not. In our view, every Fed action from here will be light and shallow, and with a good chance of postponement way into 2016. In that case the overall emerging market risk premium related to Fed action will have to be repriced lower. |  |

Banco de Brasil’s got much going in its favour as we explain here in this #SaxoStrats view.

The iShares J.P. Morgan USD Emerging Markets Bond ETF, which seeks to track the investment results of an index composed of US dollar-denominated, emerging market bonds, is one way to take advantage of the yield advantage in Emerging Markets, with the added benefit of diversification and low costs. Read more in #SaxoStrats. (NO LINK FOR THIS ONE YET…)