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Investment View

Top 10 insights mark 25 years of investing in Emerging Market Debt

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NN Investment Partners (NN IP) today marks 25 years of investing in Emerging Market Debt (EMD) by publishing 10 insights it has formulated over that time. NN IP draws these insights from the wealth of experience that it has gathered in navigating multiple cycles across the most dynamic and diverse universe of debt markets globally. These insights are incorporated into the investment processes of NN IP's EMD strategies.

Marcelo Assalin, Head of Emerging Market Debt at NN Investment Partners, commented: "In the 25 years since NN IP began to invest in EMD, the opportunity set has evolved considerably and markets themselves started to converge towards their more developed counterparts in terms of investors' perceptions. Collectively, these countries have undergone dramatic economic improvement and today they present a compelling source of differentiated returns for investors of all types.

"However, as with any growth market, the road ahead will not be without its challenges. The investors who are most likely to succeed in EMD will therefore be those with considerable knowledge of both local and regional macroeconomic and political dynamics, enabling them to anticipate when market cycles are likely to change. They will also have close relationships with other key market participants to access liquidity at the best prices and sufficient resources to monitor fast-moving market conditions and risk dynamics that change daily."

Insight No 1 - There's nearly always a silver lining

Countries may default on their credit obligations but unlike companies, they are unlikely to fail completely. Recently, the international community, with the help of multilateral organizations such as the World Bank and International Monetary Fund (IMF), have shown significant political will to support ailing countries in the face of full-scale defaults, making it highly unlikely that creditors will suffer a total capital loss. For the more committed investor, investing in distressed countries can present excellent opportunities to invest in a country's bonds at highly discounted levels.

Insight No 2 - Simple thinking just won't make the cut

Investors often attempt to simplify the world by thinking in terms of large economic blocs. The 'BRICs' identified by Goldman Sachs in 2001 is a good example. At that time, these countries boasted enormous growth potential on lower production costs, comparatively young workforces and considerable reserves of natural resources. However, two decades later these beliefs proved to be unfounded as falling commodity prices, declining global trade and mounting debts took their toll, particularly on Russia. The emerging market universe is extremely diverse and investors must not lose sight of the idiosyncrasies within countries.

Insight No 3 - Never lose faith, the cavalry will come in the end

Since the Global Financial Crisis, there have been several notable examples of cooperation between central banks, multilateral entities such as the IMF and private investors to rescue overindebted nations. No investment is entirely risk-free but the political will demonstrated recently to rescue overindebted nations can be a seen as a positive factor for emerging market debt investors.

Insight No 4 - Sleeping dragons become crouching tigers

For over two decades, China's emergence as an economic superpower has had an immensely positive impact on other emerging economies and the global economy. However, China has recently begun to increase its influence on emerging economies more directly by funding infrastructure projects across Asia, Europe and Africa. However, China's growth rate will likely decelerate in the medium term on the back of structural reforms that it must make as its economy matures and, given the extent of its influence, this could have far reaching negative implications. Investors will therefore need to closely monitor China's economic progress over the longer term.

Insight No 5 - The IMF's got competition!

The IMF has played a vital role in the development of emerging markets since the 1990s. However, there is a risk that China may supersede the IMF as the go-to provider of economic support. Unlike the IMF, China's support does not come with the same demands for structural reform and emerging countries may therefore be less incentivised to implement the kinds of changes that the IMF is prescribing. But the IMF and China can both make important contributions to growth and countries should leverage support from both.

Insight No 6 -You can't move forward with the brakes on

Protectionist rhetoric will often appear when a country is concerned about the possibility of economic decline. However, high import tariffs and other protectionist policies used to insulate domestic workforces from international competition may only work in the short term. The highest performing countries are those that open up their economies, join the global market and reap the benefits of a more dynamic business climate and foreign direct investment.

Insight No 7 - Big ships don't turn easily

After decades of structural and institutional reform across the emerging world, larger, non-specialist funds and ETFs that tend to invest opportunistically are beginning to make significant allocations to Emerging Market Debt. This means growing investor demand will gradually reduce risk premia. Also, very large benchmarked vehicles such as ETFs often need to adjust their investment positions regardless of price or liquidity, which can distort market prices. However, these distortions often create excellent opportunities for investors with the expertise and dynamism to exploit them**.**

Insight No 8 - You can't hide the scars of corrosive corruption

Corruption acts like a stealth tax on an economy, hampering growth and dampening investor sentiment. With less foreign investment, external revenues fall and corruption is highly correlated with fiscal deterioration. While the battle against corruption is a long and strenuous process, it is gaining strong momentum globally, as evidenced by anti-corruption measures taken recently in Brazil, Peru and South Africa and by uprisings across the Arab world. Environmental, Social and Governance (ESG) considerations are core to NN IP's investment process, ensuring our managers unlock the value of improved governance and stronger institutional quality.

Insight No 9 - Do what I do, don't do what I say

There is often significant disparity between political campaign rhetoric and policies that are subsequently implemented. However, markets remain easily spooked by potentially radical changes of political direction and this is particularly true at election time. Government policies are often much more moderate and pragmatic in tone than election rhetoric would suggest.

Insight No 10 - Nimble are those who are focused

Emerging markets require a constant and disciplined focus on fair value in up and down markets. Investors are highly sensitive to negative market news and sell-offs/corrections can often overshoot, creating excellent opportunities to increase positions in high conviction names. Equally, investors need to reserve a healthy level of caution in upward trending markets. It is crucial that investors are aware of all the risks that their portfolios are carrying and that they de-risk their portfolios in anticipation of a correction.

In the last 25 years since NN IP invests in EMD, the opportunity set has evolved considerably. As with any growth market, the future will not be without its challenges. Still we expect EMD to improve further in the coming years.

ENDS

Disclaimer

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About NN Investment Partners

NN Investment Partners is the asset manager of NN Group N.V., a publicly traded company listed on Euronext Amsterdam. NN Investment Partners is head-quartered in The Hague, The Netherlands. NN Investment Partners in aggregate manages approximately EUR 244 bln* (USD 288 bln*) in assets for institutions and individual investors worldwide. NN Investment Partners employs over 1,200 staff and is active in 15 countries across Europe, U.S., Latin America, Asia and Middle East.

NN Investment Partners is part of NN Group N.V., a publicly traded corporation.

* Figures as of 30 September 2017, EUR 50 bln relates to the AuM of Delta Lloyd Asset Management