EMERGING MARKETS DEBT | INTERNATIONAL/GLOBAL | OUTLOOK

2024 Outlook: Emerging Markets Debt

By: Marshall L. Stocker, Ph.D., CFA | & Kyle Lee, CFA | December 6, 2023

Technicals Tailwind Expected for Emerging Markets Debt in 2024

KEY POINTS

1. Many emerging markets (EM) central banks were early and more aggressive in tightening policy than their developed market peers, which is helping to tame inflation and opening the way for more growth-friendly policy.
2. We expect net inflows to rebound into EM debt in 2024, providing a technicals tailwind for the asset class.
3. The asset class remains susceptible to macro sensitivity, which places an added emphasis on in-depth country and company research to guide judicious credit selection.

What We Are Seeing

We believe there is further upside across the EM debt asset class as we look to 2024, which follows from stabilization in performance for a relatively good result in 2023. We continue to favor local interest rates, currencies and corporate spread exposures, while staying more neutral on sovereign spreads. Of course, these broad-brush views come along with many exceptions.

From our perspective, many emerging markets central banks have run better and more orthodox monetary policy than their developed markets peers. The result of being early and aggressive to tighten policy in the beginning stages of this global inflationary cycle is threefold: High current real yields, falling inflation and either the end of tightening cycles or the beginning of easing cycles. This combination is a strong backdrop for local interest rates.

We foresee a technical tailwind for EM debt in the coming year. As 2023 draws to a close, the year is on track to be another *annus horribilis* for flows with roughly $30 billion in net outflows from EM debt funds globally. While this marks two years of record withdrawals (the nadir came in 2022), we believe that outflows have nearly bottomed out. We are currently seeing significant interest from global institutional investors around the world, which to us signals strong potential for inflows to materialize in 2024 from asset allocators into dedicated EM debt funds.

At the individual country level, there remains broad dispersion from a fundamental perspective. That said, we would be remiss to not highlight some of the surprising, unfolding reformers across emerging markets. Specifically, Turkey and Nigeria have implemented major, positive turns in policy from what we viewed to be concerning levels. Greece continued down its path back to a "developed market" country. And, while too early to make any definitive statements, Argentina's political direction has likely and necessarily changed for the better with its recent election.

What We Are Doing

Based on our constructive views, we have been adding select opportunities across our EM debt portfolios. We remain particularly optimistic about EM local interest rates and this is where our portfolios tend to be overweight. While off their peak, real yields remain substantially elevated relative to the past decade plus.

We have also recently upgraded our view on EM currencies, which, together with local interest rates, speaks to the emerging opportunities in the EM local currency segment.

Within sovereign and corporate hard currency segments, we continue to find mispriced assets - both underpriced and overpriced - relative to our view of the state of policies and economic institutions.

What we are watching

We continue to evaluate all opportunities on a bottom-up, country-by-country and company-by-company basis, as we believe this to be the best way to find attractive EM turnaround stories.

We recognize, however, that the broad asset class remains more sensitive to macro conditions and market sentiment at present. So we continue to monitor developments in key global markets, such as the U.S. and China, and their impact on the asset class.

Risk Considerations: *The value of investments may increase or decrease in response to economic and financial events (whether real or perceived) in the U.S. and global markets. The strategy employs an "absolute return" investment approach, benchmarking itself to an index of cash instruments and seeking to achieve returns that are largely independent of broad movements in stocks and bonds. Investments in foreign instruments or currencies can involve greater risk and volatility than U.S. investments because of adverse market, economic, political, regulatory, geopolitical, currency exchange rates or other conditions. In emerging or frontier countries, these risks may be more significant. Investments in debt instruments may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer's ability to make principal and interest payments. Exposure to derivatives involves risks different from, or possibly greater than, the risks associated with investing directly in securities and other investments. As interest rates rise, the value of certain income investments is likely to decline. The value of commodities investments will generally be affected by overall market movements and factors specific to a particular industry or commodity, including weather, embargoes, tariffs, or health, political, international and regulatory developments.*

Marshall L. Stocker, Ph.D., CFA
Co-Head of Emerging Markets Debt
Portfolio Manager

Kyle Lee, CFA
Co-Head of Emerging Markets Debt
Portfolio Manager

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