

Advisory Blog

Timely insights on the issues that matter most to advisors and their clients

Disclosure



The views expressed in these posts are those of the authors and are current only through the date stated. These views are subject to change at any time based upon market or other conditions, and Eaton Vance disclaims any responsibility to update such views. These views may not be relied upon as investment advice and, because investment decisions for Eaton Vance are based on many factors, may not be relied upon as an indication of trading intent on behalf of any Eaton Vance fund. The discussion herein is general in nature and is provided for informational purposes only. There is no guarantee as to its accuracy or completeness. Past performance is no guarantee of future results.

[Emerging Markets Debt](#) | [Global Investing](#) | [Inflation](#)

Inflation, Rising Rates, Ukraine Conflict Take Their Toll on EM Debt in 2Q

By: [Emerging Markets Debt](#) | July 15, 2022

Boston - The sell-off in emerging markets debt (EMD) continued through the second quarter along with the majority of global capital markets. Stocks and bonds generally moved in tandem, as markets continued to price in the potential for the end of the "easy money" era of the past decade.

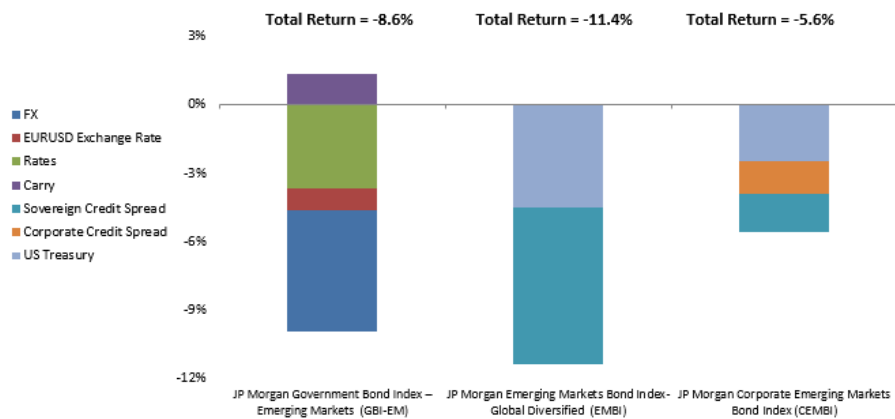
Inflation remained a key issue in just about every country, and central banks have largely been forced to react with increasingly hawkish policy stances. Higher food and energy prices, a second-order effect of the devastating war in Ukraine, continued to divert more consumption toward necessities and away from global discretionary spending and investment.

While we observed some easing of China's zero-COVID policy, it continues to create challenges for global supply chains and remains a drag on the world's second-largest economy. This combination has led investors to more seriously consider the likelihood of recession in the near term — a slowdown in which EMD markets will likely not be spared.

Outflows year to date are at all-time highs for both local- and hard-currency funds, which is reflective of the problems in the market and macro environment.

- Corporate EM debt, while losing 5.6%, was the best-performing EMD sector. Its relative outperformance reflected its country makeup — being more heavily tilted toward Latin America — as well as its higher-quality profile and the underlying relative strength of the issuers.
- EM local-currency debt lost 8.6%, weighed on by the broad rally in the U.S. dollar, while local interest rates generally also moved higher, in keeping with the global trend.
- Dollar-denominated, hard-currency debt was the worst-performing segment, with a loss of 11.4%. Spreads broadly continued to widen, and more countries saw their bond prices move toward distressed levels. Rising U.S. Treasury yields also hurt the sector, given the relatively long U.S. duration profile of most issues.

War and rising rates continue their double whammy for EMD



Sources: JP Morgan, Morgan Stanley Investment Management as of 6/30/22. The vertical axis reflects the amount contributed by each factor to total return-adding the bars above 0% and below 0% (negative numbers) results in the total return in the headline. FX is the gain or loss in the GBI-EM from currency changes relative to the U.S. dollar. EURUSD reflects the portion of currency movement in the GBI-EM that is explained by the change of the euro versus the U.S. dollar. Rates refers to the contribution of change in local-currency interest rates in the GBI-EM. Carry refers to the risk-free returns in each GBI-EM country that cannot be attributed to FX, EURUSD or rates. Sovereign Credit Spread refers to the spread above U.S. Treasuries in the EMBI paid by a country. Corporate Credit Spread is the spread above the sovereign spread paid by an EM corporate issuer. U.S. Treasury refers to the contribution to return in the EMBI and CEMBI (both dollar-denominated indexes) due to interest-rate changes on the U.S. Treasury.

Looking ahead

Through the remainder of 2022, we are optimistic on EMD, as valuations appear to be well compensating investors for the risk.

- The macroeconomic environment is challenging for all areas of capital markets, but it appears EM investors have already priced this in better than most.
- Inflationary pressures, and corresponding central bank reactions, remain the most important factor for the asset class. Commodity prices are likely to be the largest driver here and something we are watching closely.
- No end appears in sight for the devastation in Ukraine, or the impact on food and energy prices.
- China appears to be easing policy on the margin and moving slightly off its strict, zero-COVID policy. Reformers may make gains during the Party Congress in a few months, but President Xi's power remains unquestioned.
- While COVID continues to wreak havoc on lives and livelihoods, many countries have learned to live with the virus, and it appears to no longer be the most important factor in most countries.

Bottom line: We expect markets to continue emphasizing differences among countries and credits. That creates investment opportunities for those with research capabilities and due diligence that are up to the task. That is why we focus on country-level macroeconomic and political research, and stand-alone analysis of specific risk factors such as currency, credit spreads and interest rates — an approach we have followed for more than two decades.

Investing entails risks and there can be no assurance that any strategy will achieve profits or avoid incurring losses. It is not possible to directly invest in an index. Past performance does not predict future results.

The value of investments may increase or decrease in response to economic and financial events (whether real, expected or perceived) in the U.S. and global markets. 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. Investments in debt instruments may be affected by changes in the creditworthiness of the issuer and are subject to the risk of nonpayment 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. As interest rates rise, the value of certain income investments is likely to decline.



"Second-order effects from the devastating war in Ukraine along with strict COVID policies in China contributed to inflation levels and negatively affected global growth and EMD performance. Outflows year to date are at all-time highs for both local- and hard-currency funds, which is reflective of the problems in the market and macro environment."

To report a website vulnerability, please go to [Responsible Disclosure](#).

Eaton Vance is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley.

For USA PATRIOT Act Disclosure Notice please click [here](#).

 This image indicates content designed specifically for Financial Advisors / Investment Professionals. This material is not to be used with the public.

Before investing in any Eaton Vance, Calvert or Morgan Stanley Investment Management Inc.-advised fund, prospective investors should consider carefully the investment objective(s), risks, and charges and expenses. Read the prospectus carefully before you invest or send money. For **open-end mutual funds**, the current prospectus contains this and other information. To obtain an **open-end mutual fund** prospectus or summary prospectus and the most recent annual and semiannual shareholder reports, contact your financial advisor or [download a copy here](#). For **closed-end funds**, you should contact your financial advisor. To obtain the most recent annual and semi-annual shareholder report for a closed-end fund contact your financial advisor or [download a copy here](#). To obtain an **exchange-traded fund**, ("ETF") prospectus or summary prospectus, contact your financial advisor or [download a copy here](#).

Before purchasing any **variable product**, consider the objectives, risks, charges, and expenses associated with the underlying investment option(s) and those of the product itself. For a prospectus containing this and other information, contact your investment or insurance professional. Read the prospectus carefully before investing.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT

Eaton Vance does not provide tax or legal advice. Prospective investors should consult with a tax or legal advisor before making any investment decision. The information on this Web page is for U.S. residents only and does not constitute an offer to sell, or a solicitation of an offer to purchase, securities in any jurisdiction to any person to whom it is not lawful to make such an offer.

© Eaton Vance Management. All rights reserved.

Eaton Vance open-end mutual funds are offered through Eaton Vance Distributors, Inc. Two International Place, Boston, MA 02110. Member [FINRA](#) / [SIPC](#). Calvert exchange-traded funds are distributed by Foreside Fund Services, LLC.