

# Timely insights from portfolio managers and industry experts on key financial, economic and political issues.

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## Emerging Markets Debt

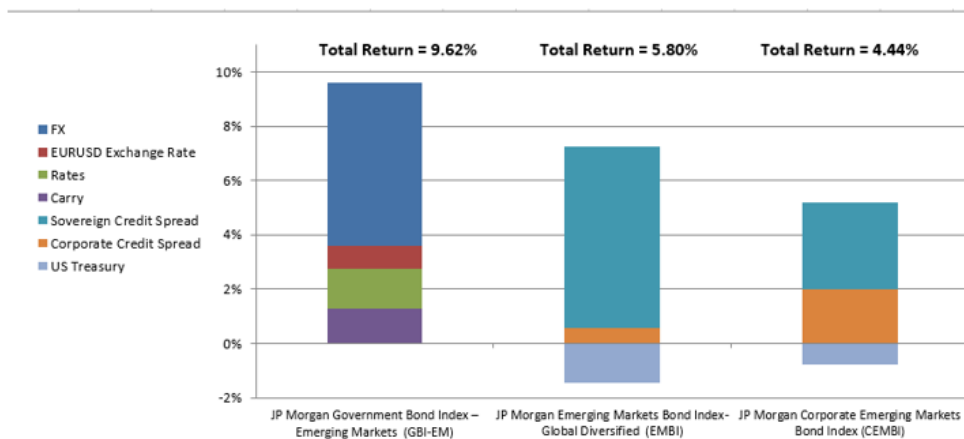
### Macro forces align in broad tailwind for EM debt

**Boston** - In the fourth quarter, emerging markets debt (EM debt) capped a remarkable recovery from the March pandemic sell-off with one of the strongest quarters in recent memory. In November, the macro backdrop turned sharply positive with news of the COVID-19 vaccine and the U.S. presidential election, which was fairly quickly determined to be a clear victory for Joe Biden, notwithstanding protests by President Trump.

The asset class further benefited from other tail winds. The world's major central bank policies remained extremely easy, core bond yields stayed near historic lows, and the U.S. dollar weakened notably. The quarter also saw EM countries, in aggregate, achieve better growth than predicted, while deficits came in likely a bit smaller than expected. Inflows into EM debt were robust, with approximately \$30 billion providing strong technical support.

In the fourth quarter, every EMD factor helped drive positive performance (see exhibit below). For EM local-currency debt, the foreign exchange (FX) gain of 6% was almost two-thirds of the 9.62% return, as the U.S. dollar weakened. For sovereign, dollar-denominated debt, the big story was sovereign spread compression, which contributed almost 7% — total return was 5.80% due to partially offsetting losses from U.S. Treasury returns. The 4.44% gain in EM corporate debt was driven by the strength of both sovereign and corporate spread compression.

#### The last quarter of 2020 was one of the strongest on record for EM debt



Sources: JP Morgan, Eaton Vance as of 12/31/20. 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. **US 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.



**Emerging Markets Debt Team**  
Eaton Vance Management

"We entered the quarter neutral on the space, but the macro environment turned notably positive and we are now broadly quite bullish. With proper due diligence and attention to country-specific risk, we believe EM debt deserves careful consideration from investors."

## Looking ahead

We are broadly quite constructive on EM debt, as we expect the notably positive turn in the macro environment to continue:

- EM economic growth is leading the global economic recovery, yet EM returns in 2020 lagged the asset gains in developed markets. EM economies did not shut down to the same degree, and they are not shutting down as aggressively now either.
- Developed-market monetary policies will continue to anchor core interest rates at extremely low levels, including \$17 trillion of negative-yielding debt. Combined with ballooning deficits in the U.S., the dollar is likely to remain weak. We are especially bullish on EM FX.
- The big rally in oil prices and commodities more broadly have improved the economic dynamics in many countries and represents another tail wind for the asset class as a whole.
- Crossover buyers into EMD, along with widespread interest in the higher yields available in the asset class, will likely continue to provide support.

COVID-19 remains the largest factor at the individual country level and continues to wreak havoc on lives and livelihoods. But many EM countries have learned to live with the virus, and we expect more well-run countries to navigate its challenges best. Of course, trouble spots will remain—several more countries were added to the default list during the quarter, including Zambia and Suriname.

**Bottom line:** We entered the quarter neutral on the space, but the macro environment turned notably positive and we are now broadly quite bullish. With proper due diligence and attention to country-specific risk, we believe EM debt deserves careful consideration from investors.

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**J.P. Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified** is an unmanaged index of local-currency bonds with maturities of more than one year issued by emerging markets governments.

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