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## Interest rates and currencies to provide boost to emerging market local currency debt

### - Pictet Asset Management

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#### Kontakt

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“Local currency emerging market debt is becoming increasingly attractive”, says Luca Paolini, chief strategist at Pictet Asset Management.

“Valuations for both bonds and currencies and a likely continuation of a benign interest rate environment are supporting high-yielding asset classes.

“As emerging growth is slowing, especially in Latin America, the differential between developing and advanced economies has narrowed, although it is still positive in favour of emerging markets.

“More importantly given the sharp fall in energy prices, there seems to be a growing divergence in the financial fortunes of many emerging economies. Manufacturing exporters and energy importers such as Turkey, Korea and India are benefiting from the decline in energy costs, while commodity exporters especially those in Latin America are struggling.

“Manufacturers are also better positioned to benefit from good momentum in the US economy, which is the sole engine of global growth at the moment.

“After losing nearly a fifth of their value in the past three years, emerging market currencies are further away from ‘fair value’ than they have ever been before, suggesting some scope for a rebound in the medium term. This, together with high carry and attractive valuation, makes local debt in developing markets attractive.

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“We are long local currency debt in Brazil and Turkey, while we take tactical long positions in currencies in South Africa, Turkey, Korea and India.

“Conversely, the outlook for investment grade debt is not positive. Valuations look stretched and we have reduced European investment grade bonds to a single-digit underweight position.

“We remain neutral on high-yielding debt: volatility has risen as liquidity has deteriorated and investors have become cautious about the credit risk within non-investment grade companies.

“Government bonds remain less attractive - yields are already very low, having moved too far in discounting slow growth and weaker inflation relative to our own expectations.

“Elsewhere, we see improving environment for equities as a drop in oil prices and ongoing monetary support from central banks are likely to boost economic momentum and risk appetite towards the year end.

“Our regional equity allocation remains unchanged and we keep our preference for European equities over US, whilst Japan and emerging markets are maintained at benchmark weights.”

“European equity markets should be boosted by improving liquidity conditions, favourable valuations adjusted over the business cycle and overly pessimistic assumptions about the region’s growth prospects.

“By contrast, US stocks do not look particularly cheap. The region’s economic momentum remains strong and offers a solid backdrop for US firms but this seems to have already been discounted by the markets.

“Japanese equities are attractively valued and supported by favourable liquidity conditions after the Bank of Japan’s latest monetary easing, although this is offset by mixed macroeconomic data, particularly in manufacturing.

“Improving global growth will support the most cyclically-exposed sectors: industrials and energy. We have brought our long exposure to materials back to neutral to reflect an economic slowdown in China.

“Cyclical stocks also look attractive relative to defensive sectors whilst we are cautious about utilities and healthcare.”

-Ends-



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Each month, the PSU sets a broad policy stance based on its analysis of:

- business cycle: proprietary leading indicators, inflation
- liquidity: monetary policy, credit/money variables
- valuation: equity risk premium, yield gap, multiples vs. history
- sentiment: Pictet sentiment index (investors’ surveys, tactical indicators)

