RBC Global Asset Management

EMD solutions in client portfolios: Navigating emerging markets in 2024

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Amid concerns of short-term volatility following a period of robust rally, investors should consider long-term opportunities within the emerging market (EM) landscape. From hard currency sovereigns to high-yield corporate assets, to capitalise on the long-term yields offered by EMs.

The future landscape for EM debt presents both challenges and opportunities for investment intermediaries. Many investors, wary of a resurgence in volatility driven in part by geopolitical events, remain cautious about their allocations within EM asset classes. Thus, the question looms large: what lies ahead, and how should investors position themselves?

For investors looking to avoid foreign exchange volatility and enhance the stability of their portfolios, EM hard currency sovereign debt is a worthwhile consideration. This asset class allows investors to sidestep the volatility of local currencies, while continuing to capitalise on the enticing carry it offers. Additionally, we believe that EM sovereigns have passed the peak of defaults. If this proves correct, we expect significant spread compression, particularly within the distressed segment. For investors with the flexibility to pursue total return and un-benchmarked strategies, we strongly advocate for the benefits of taking an unconstrained approach. This approach tactically allocates across various EM sub-asset classes, strategically seeking out pockets of attractive value without the constraints of a benchmark. This flexible approach also permits managers to construct portfolios that can capture the upside of the potential returns while also protecting on the downside during market downturns.

Another asset class warranting attention is the EM high yield corporate segment. Our analysis indicates that default rates amongst EM corporates in 2024 are expected to align more closely with historical averages and significantly below the peaks that were seen in 2022. Should this prove correct, the pairing of relatively lower duration and near 8.5% yield[1] of the asset class will be a highly compelling opportunity. Moreover, the diversification benefits offered by this strategy can empower investors to harness beta exposure in a manner less correlated to US Treasury volatility.

Navigating EM corporate solutions requires a nuanced understanding of prevailing dynamics in EM countries and an active approach that doesn't tie investors to an index, which may be exposed to securities with a higher likelihood of default or more vulnerable to potential market downturns. Whether investors pursue benchmarked or un-benchmarked approaches, we believe investors should remain agile in their allocations within the EM landscape leaving them well positioned during a year that is expected to be volatile.

[1] RBC BlueBay Asset Management

Portfolio Manager Perspectives

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