FIM GEM DEBT

INVESTOR LETTER – OCTOBER 2022

The fund mainly invests in global EM and frontier debt markets. The strategy uses an unconstrained, high conviction approach to investing, with a framework that ensures high diversification while protecting against downside risk. Alpha generation is based on a bottom-up fundamental analysis of the EM issuers, enhanced with exposure to frontier opportunities. The portfolio manager has a long track record, having managed similar products for some of the largest global asset managers over the years. The sub-fund is dedicated to investors who intend to pursue capital growth in the medium to long term with medium to high volatility.

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In accordance with article 8 of EU regulation 2019/2088, the fund promotes environmental, social and governance characteristics in accordance with European regulation. Notably, the fund's investment process excludes companies having low practice or standards in these sectors, or those with a high long term sustainability risk.

The fund generated -8bps of alpha in October, taking YTD alpha to 329bps in gross terms.

Driving the performance for the month was Egypt in hard currency, which performed strongly ahead of the IMF's announcement of a Staff Level Agreement with the government. Our short FX positions in frontier markets, mostly in Ghana, were also important contributors.

Against this, our bearish position in Turkey credit continues to be a major drag to the strategy, but our conviction remains unwavering. We still assign a high probability of a balance of payments crisis in the future.

Risk assets were buoyed by a global bout in sentiment, with the market pinning its hopes (yet again) on a FED pivot, which failed to materialize (more below).

EM benefited from that backdrop but its beta to global risk was unusually low, with EM hard currency total returns rising a mere 0.5% (or 1.5% in spread returns terms) vs. a 10% surge in the S&P 500 -- as was the case in September, though in the opposite sign.

Whether the breakdown in global risk/EM correlation is a sign of the latter's exhaustion. i.e., sufficiently beaten up to stop falling meaningfully, but lacking the catalyst for a rally, remains to be seen and it would be a good backdrop to be able to collect the 10% carry currently provided by the asset class.

The reality, though, is that all credit asset classes, including US IG, US high-yield as well as EM, had a lacklustre performance in October, seemingly taking their cues from the Treasury market rather than from the S&Ps.

Either way, the pivot hopes were dashed in the November FOMC, with Chairman Powell making it clear that any hope for pausing would be "premature" and that the Fed still has "some ways to go" on rates.

The Fed's hawkishness contrasted with the BOE's more dovish stance, arguing against the rate path set up by the market, and with the ECB's, which felt ostensibly satisfied with the level of tightening thus far.

A terminal Fed Funds rate of 5% as priced in by the OIS curve seems a more symmetric risk on duration, but we still take issue with the markets' interpretation on the disinflation path – 1-year breakevens at 2.7% strike us as too low – and with the market timing of cuts, still pricing-in them, albeit increasingly marginally, by the end of 2023, which seems unrealistically too early.

Our base case is that of stickier inflation, a US economy remaining more resilient to tighter financial conditions, and a Fed hesitant to plough ahead in a more adverse economic environment.

In short, we do not think the terminal rate priced by the market is not yet restrictive enough to bring down inflation to the extent priced in by the market. Therefore, we remain 2 years underweight duration to the benchmark. However, as we have moved higher in rates, we have moderated the underweight by a year over the past weeks.

We also remain UW EMFX, but we have changed the composition of the portfolio, running now a longer position in high beta currencies which we fund (in excess) via Asia and Europe.

Our latest addition to the high beta portfolio, which includes longs in MXN and IDR, has been BRL. We, along with the market, were waiting for the risk-event of the presidential election to pass to add to the currency exposure. In line with our "best expression of risk" approach to investing, we see BRL as the best risk-reward in the Brazil opportunity set.

The currency remains cheap, and real rates are high after a very aggressive tightening campaign by the central bank. In addition, portfolio flows are just coming back, and the balance of payments position remains healthy as per "basic balance".

A China re-opening might remain in fits and starts, but news after CCP Party Congress is encouraging and any growth stabilization or recovery in China would also provide some support for the Brazilian terms of trade. With respect to this and some view on pairing EMFX underweights in general, we have also reduced our long-standing CNH short, which was a great alpha producer over the year.

Elsewhere we didn't make any material changes to the portfolio, though occasionally collecting the new issue premium coming out of the IG market while the HY market remains closed. The debut PIF green deal bond came in at very attractive levels, giving us the opportunity to add to our exposure of "green bonds" from a region we know well and is performing strongly. We trimmed some high-yield exposure, namely trimming our Egyptian exposure on the "IMF rally", and added some FX longs as per above.

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