

Em Debt – The Journey Is As Important As The Destination



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EM debt is in a sweet spot. The global economy is on the mend and the FED and other core central banks are fully engaged in supporting the recovery. EM economies are a high beta expression of global growth and inflation, and traditional recipients of flows during global upswings.

Despite being largely an investment-grade asset class, EM debt denominated in dollars offers today higher yields than US and global high-yield credit, even when adjusted by duration. Meanwhile valuations in emerging market currencies are cheap, and currencies are set to benefit from any bout of US dollar weakness.

Too good to be true?

There are challenges, of course: for one, with such a dovish FED, a steepening of the US Treasury curve and a move higher in Treasury yields can be a problem for emerging markets, as was the case in Q1 this year. Even though EM debt spreads vs. Treasuries were remarkably stable throughout the period, total returns on EM debt suffered on the back of the Treasury yield move (just like was the case for any other fixed income investment). We think the Treasury risk going forward is more balanced but has not yet disappeared.

Likewise, in a liquidity-abundant environment where risk sentiment is high, the market tends to underestimate risks. Financing and political risks are very important in EM and as the world emerges from Covid, some economies will be in better shape than others. We think the political and economic fallout from the Covid shock has yet to manifest in a number of countries, and as such we expect a wide range of return-differentiation between credits and instruments.

Therefore, as promising as returns in EM bonds are (the destination), we need to be cognizant of the risks along the way (the journey). Our mission at FIM-Aristea is to have a strategy and build a portfolio that harvests the exceptional returns of emerging market debt while protecting our investors from the downside risks.

The Strategy

The FIM-Aristea EM debt strategy looks at EM on a multidimensional basis. Our goal is to exploit the rich menu of opportunities offered today to EM fixed income investors rather than narrowing ourselves to a particular asset class or a particular set of risk factors.

Thus, we use what we call a “best expression of risk” approach to investing, anchoring our positions to a fundamental view of a country to then choose the instrument that gives us the highest ex-ante risk-adjusted return to express that fundamental view, be it hard-currency debt, local-currency

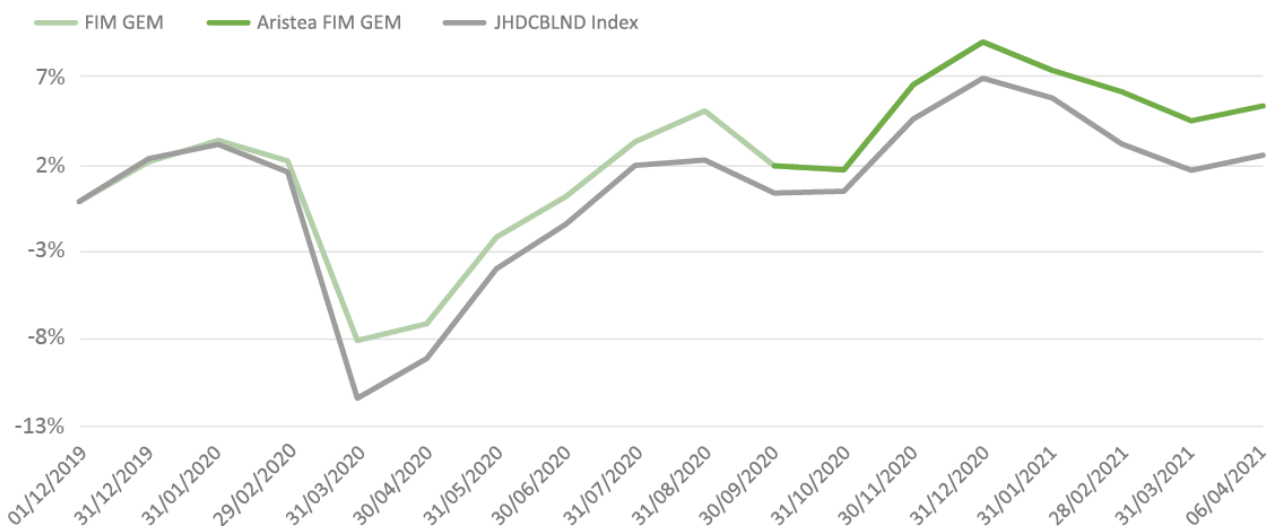
denominated debt or just currencies. Only by doing it this way we maximize the opportunity set in EM fixed income while capturing what we think are the three key pillars of EM investing: fundamentals, *technicals* and valuations.

In essence, the strategy is designed to extract best value given a fundamental country view while protecting downside risk by paying extra attention to *technicals* and valuations.

Indeed, fundamentals do matter a lot, and capital preservation is paramount to the strategy. The FIM-Aristea team has 20yrs+ average individual experience, with the senior members of the team coming from top investment houses, and years of experience in international institutions such as the IMF and the World Bank.

The fund is global in scope, taking positions from Mexico to South Africa to Uganda, and across different fixed income and currency instruments. We actively look for opportunities that give us income (e.g. carry) and which are uncorrelated to global risk as much as possible. From that perspective the fund has a slight bias towards the “frontier” space, which are markets yet to become EM mainstream economies.

The strategy has consistently beat its reference benchmark while providing a steady stream of returns without taking excessive risks (see chart). At the end of the day, there is no destination at hand without a proper focus on the journey.



Performance shown up to 09/10/2020 is that of FIM GEM Debt Fund (Cayman). Thereafter, the performance is of Aristea FIM GEM Debt I1 USD Acc. T

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