Monthly Portfolio Update

*Amundi Funds II – Emerging Markets Bond**

31 August 2018

Bond

COMMENTARY

Market Review

Emerging Markets (EM) did not experience a lull over the summer. Although the USD reversed its upward course during the second half of August (thus providing some support to EM), the asset class was weighed down by trade concerns, Turkey, Argentina, Chinese data, and Brazilian politics.

On the macro front, EM GDP continued to trend upwards in August, which was somewhat of a surprise; this continues to be driven by Asia GDP, while CEEMEA and LatAm lack any clear direction. EM CPI Surprise index continued to trend downwards. Inflation remains subdued in most of the Asian Markets; however; it came in higher than expected in Mexico and Brazil.

On the news front, stories from Turkey, Argentina and Venezuela dominated headlines. Beginning with Turkey, rising inflation, combined with an escalation in tensions with the US and a lack of action from the Central Bank, caused yields to rise and the currency to depreciate; over the month the 10Y local debt yield widened by 295 bps with the TRY losing 25.5% of its value versus the USD. A similar story occurred in Argentina with capital outflows on-going, and in Venezuela the government devalued the currency by 95%. In the US, data was strong as job openings reached historic highs. However, there was no clear breakthrough in trade negotiations between the US and China, raising the possibility that the US could place tariffs on over $200bn worth of Chinese imports. Additionally, a major story broke through later in the month, raising concerns around the possibility of impeachment proceedings.

Across the ocean, in the UK, higher chances of a no deal Brexit following comments from Trade Secretary Liam Fox drove the GBP down, although growth figures came in strong.

Market reaction to this multitude of geopolitical stories throughout the month saw developed market yields fall, with US and German 10 year yields down about 10 and 12 bps respectively. Corporate bond markets followed a similar pattern with the US outperforming Europe. The broad Bloomberg Barclays Euro Aggregate Corporate index was flat at 0.0%, whilst the Bloomberg Barclays U.S. Corporate index was positive to the tune of +0.5%. In High Yield (HY) markets, Euro HY lost -0.2% while US HY gained +0.7%.

In the EM space, EMBI GD returned -1.73%, CEMBI BD was down -1.08%, while GBI – EM lost -6.09%.

Within currency markets, the US Dollar Index (a trade-weighted basket of currencies against the US Dollar) rose +0.6% with notable gains versus the British Pound (+1.3%) and Euro (+0.8%). The Japanese Yen was one of the few currencies to rally versus the USD as investors continued to buy Yen, given its safe haven status. EM currencies experienced a significant rout in August with the JP Morgan Emerging Markets Currency Index ending down -6.2% due to exceptional depreciations in Argentinian Peso (-34.5%), Turkish Lira (-25.0%), South African Rand (-10.6%) and Russian Rouble (-7.1%) among others.

In commodity markets, the S&P GSCI Total Return Index returned positively, adding +1.0% in August primarily due to the modest pull-back in energy markets amidst Iranian sanctions. West Texas Intermediate regained strength (+1.1%) but remained volatile given demand uncertainty owing to trade wars. Most industrial metals also suffered as a result; Nickel and Copper fell -8.8% and -5.0%. Despite their safe haven status, Gold (-1.9%) and Silver (-6.3%) prices also slipped amidst a stronger USD.

* Prior to 16 February 2018, Pioneer Funds - Emerging Markets Bond

Portfolio Review

The Portfolio and the benchmark[1] both registered negative returns in August.

This performance comes in times when benchmark experienced the second worst performing month of the year, following February's -2.0%. At the benchmark level, a strong, negative contribution came primarily from Zambia (-17.8%), Argentina (-11.9%), and Venezuela (-10.5%).

At the portfolio level, key performance drivers were the shift from short duration exposure to neutral, selection both in sovereign and credit space (our off-benchmark positions suffered from lower August trading liquidity) and small allocation to local currencies bonds. (JPM GBI EM returned -6.09% in August.)

Our strategic allocation to CEMBI IG and relative value credit index arbitrage strategy performed ahead of the benchmark.

Our main positing remains similar to July, thus we continue holding ~36% in credit at expense of sovereign, are now only 30bps short duration vs benchmark's 6.2Y and are obtaining yield of 8.28% vs benchmark's 5.94%. Our main overweights, at the country level, are Brazil, Qatar, Ukraine and South Africa which we bias over Philippines, Hungary Panama and Malaysia. Within sectors, we are positive on Financials, Basic Material and Telco and underweight in Health Care, Consumer Staples and Consumer Discretionary.

Key changes for the month of August were adding exposure to South Africa, Indonesia and China, followed by simultaneous reduction of risk in Brazil, Egypt and Turkey. Sector wise, we added to our Real Estate exposure; primarily in China, and have opened tactical trade in Basic Materials (after the last commodity let down) as we expect sector to benefit from lower input prices.

Heightened volatility and perceived negative sentiment also saw us pre-emptively bringing our overweight in Financials and Energy to neutral; as sovereigns come into the spotlight we are of a view that investors will likely first look to reduce risk in more liquid credits.

[1]JPM EMBI Global Diversified 95%, JPM Cash 1 Mnth Euro 5%

Outlook

The noise level in EM has risen, and pressure on Turkey is creating fear of contagion; nonetheless, we think this is creating buying opportunities elsewhere.

We have previously suggested that in the second half of 2018, investors would be likely to worry more about protectionism than US monetary tightening; we continue to think this transfer of risk perception is likely to occur. We do acknowledge that series of negative headlines starting with trade, Italy, etc. might stay with us for a while, but a lot is priced in and some disappointment on the USD could be something markets are not prepared for.

Although being a bit more conservative than few months ago, in the near-term, amid the worsening geopolitical outlook we expect the global expansion to remain broad based and robust. Furthermore we continue to believe corporate fundamentals are in good shape, favour a short duration stance and will look to actively manage our beta exposure. We aim to take advantage of attractive yield opportunities as they arise in favour of off-benchmark positions.

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