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Australian investors missing out on emerging market debt opportunities

Sydney, 15 June 2016 – Australian investors have not achieved optimal exposure to emerging market debt over the past decade because they have depended on a global bond strategy that has had far less emerging market debt than it should have based on returns and volatility, according to Eric Fine, Managing Director of Emerging Market Debt at VanEck.

Visiting Australian institutions this week, Mr Fine said emerging market debt has higher premiums and better fundamentals than developed market sovereign and corporate bonds and should be considered as a standalone asset class using an unconstrained approach.

"Based on fundamentals, emerging market debt is delivering better returns and lower risks than developed markets. Since a large portion of the world's government bonds have low or negative interest rates, emerging market bonds have merited more attention. Investors should be considering emerging market debt as a separate asset class for its uncorrelated benefits to portfolio construction including higher liquidity and less volatility than developed market debt," he said.

According to Fine, an unconstrained and nimble approach is the ideal way of investing in emerging market debt in the current market environment because such an approach can more easily respond to adverse risks.

"The world is potentially over-leveraged with the developed market and China the main culprits. China's debt keeps increasing, while its growth keeps declining. This cannot continue forever, especially when the debt may not be increasing economic productivity.

"From a US perspective, the US Federal Reserve is in a quandary. If it raises interest rates, it risks global leverage which will come back to hit the US economy, forcing the Fed to reverse course. If it maintains or magnifies monetary forbearance, savings rates look set to rise impacting. Harder structural reforms are the answer, but Fed forbearance has prevented any sense of urgency from authorities.

"Europe has not addressed its central problem. The single currency and many fiscals and financials are inconsistent. They tried, as a result of their crisis, but fiscal and financial policy is still nationally driven rather than at the level of the European Union. When the next inevitable challenge arrives it is hard to see how 'Europe' can credibly promise that its next effort to federalise fiscal and financial policy will calm markets," he said.

"A nimble and unconstrained approach can help avoid some of the current global risks for several reasons. First, it can more easily avoid local-currencies which are the most vulnerable to global risks and instead be invested in USD-denominated emerging market debt. Second, many emerging markets' sovereign and corporate bonds are both high-yielding and idiosyncratic, so should generate high returns without reference to the key risks. Finally, while many emerging market sovereign and corporate bonds are lower-yielding they are also very defensive, so should generate safer returns.

"An unconstrained approach can also take advantage of the shorter-term opportunities that arise in emerging markets' currencies as the Fed keeps applying the same medicine of monetary forbearance, which can generate short-term boosts to asset prices," Mr Fine said.

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