TCW

INSIGHT

MONTHLY COMMENTARY

June Emerging Markets Debt Update

ANISHA GOODLY | SPENCER RODRIGUEZ

JULY 13, 2017

Anisha A. Goodly
Managing Director
Emerging Markets Portfolio Specialist

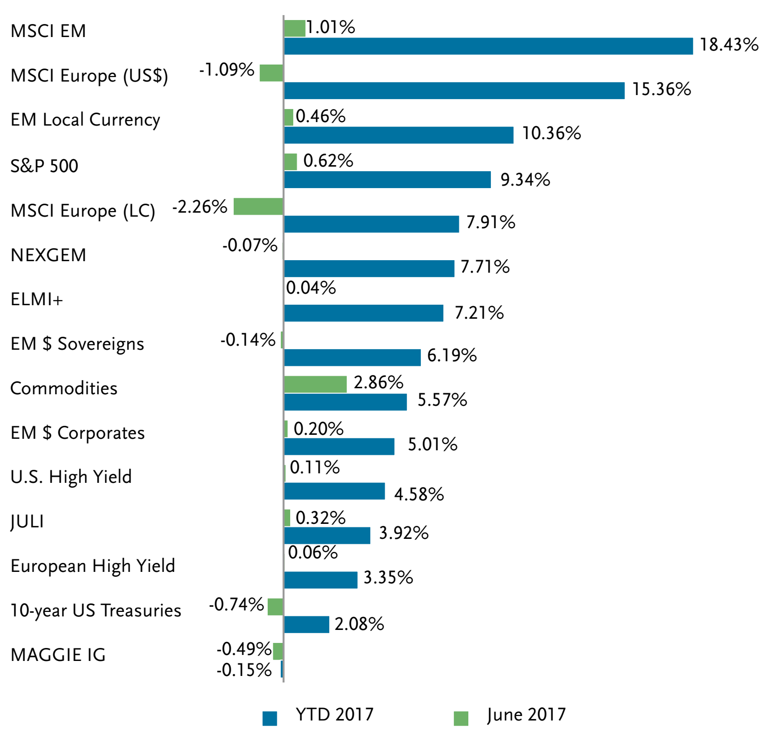
Ms. Goodly is the Portfolio Specialist for the TCW Emerging Markets group, which includes the Emerging Markets Fixed Income, Emerging Markets Local Currency Income, and Worldwide Opportunities strategies. In this role, she serves as the primary liaison between TCW's Emerging Markets investment team and TCW's client relations and marketing professionals. Prior to joining TCW in 2013, Ms. Goodly spent eleven years at Morgan Stanley, most recently as one of the firm's top-producing EM Fixed Income salespersons. At Morgan Stanley, she also served as the Asia Credit Product Manager, marketing Asian credit products globally to the firm's largest institutional clients. In addition, she spent several years working as part of Morgan Stanley's Institutional Investor-ranked U.S. Credit Strategy research team. Ms. Goodly currently serves on the board of Consano. Ms. Goodly graduated with a BA in Economics from Stanford University.

Spencer Rodriguez
Emerging Markets Research Analyst

Mr. Rodriguez joined TCW's Emerging Markets Group in 2015,conducting research on sovereign and corporate fixed income securities. He works closely with the analyst and trading teams as well as the portfolio managers. Mr. Rodriguez holds an AB in History with a certificate in Finance from Princeton University. As a student he worked as a summer analyst for the Financial Institutions Group at Barclays Capital in New York. He also worked as a summer analyst for the Zurich Insurance Group in Tokyo, Japan.

June was characterized by dollar weakness, a surge in metals prices, a decline in oil prices, an expected 25 bps Fed hike, and a flatter U.S. Treasury curve. Select idiosyncratic risk also impacted the performance for dollar-denominated sovereign debt. As a result, performance for emerging markets (EM) dollar-denominated sovereign and local currency debt diverged in June, with the former returning -0.14% and the latter, 0.46% for the month. This brings year-to-date returns to 6.19% and 10.36%, respectively. Corporates returned 0.20% in June, resulting in a return of 5.01% year-to-date. Inflows continued across hard, local and blended currency funds, totaling $6.94 billion for the month and $41.63 billion this year—the strongest start to a year on record. New issuance in June totaled $54.44 billion with the majority by corporates.

Total Returns Across Asset Classes



Source: Bloomberg; JP Morgan; Data as of June 30, 2017

Looking at the Individual Asset Classes:

Sovereign Dollar Debt

EM dollar sovereign debt performed largely in line with U.S. treasuries in June, with spreads widening only 4 bps to end the month at 310 bps. Since the beginning of the year, sovereign dollar spreads have tightened 32 bps. Despite weakness in June, sovereign dollar debt returned 2.24% in the second quarter and 6.19% year to date through June 30.

The Fed was the main story of the month and, as expected, delivered a 0.25% rise in the federal funds rate but followed it with dovish forward guidance. Long duration benefitted from the dovish tone, and investment grade credit outperformed high yield given the longer duration profile of the former. The divergence in investment grade and high yield sovereigns also reflected a slight pullback in risk appetite heading into the end of June. Geopolitics dominated the headlines during the month as a result of the dispute between Qatar and the other Gulf countries, a deterioration in U.S.-Russia coordination in Syria, and the threat of North Korea's expanding military capabilities.

From a country perspective, Uruguay and El Salvador were the best performers in the index during the month, returning 1.53% and 1.28%, respectively. The growth outlook for Uruguay has started to improve, and the government recently doubled its GDP forecast for 2017. In El Salvador, the government made progress on budget adjustments and pension reform negotiations.

Venezuela was the worst performing credit in June, returning -5.5% for the month. The confluence of falling oil prices and heightened political unrest, the latter of which culminated in a helicopter attack on the Supreme Court, added to investor unease and weighed on Venezuelan bonds during the month. Venezuelan assets have decoupled from the broader market in recent months as a restructuring event has begun to appear increasingly likely.

Corporates

EM dollar corporate spreads tightened by 6 basis points in June after widening out by an equal amount the prior month. Spreads were essentially flat in the second quarter, ending the period 3 bps tighter. Although corporate debt has lagged both dollar sovereign and local currency debt in the first half of 2017, it has outperformed U.S. credit across all ratings segments.

As with sovereign debt, the move in U.S. Treasuries was the biggest driver of performance in June. The consumer sector was the best performer in the index, returning 0.66%. Sector performance was mostly attributable to Teva Pharmaceuticals, which represents close to 30% of the consumer sector's index weight. The weakness in oil prices during the month may also have played a role as higher quality sectors outperformed. Oil & Gas was indeed the worst performing sector and the only sector to post negative returns in June (-0.04%). The sector fared much better than would be expected, however, given the ~5% decline of Brent.

Local Currency Debt

Dovish forward guidance from the Fed contributed to dollar weakness relative to EMFX in June. Emerging markets local currency debt also benefitted from continued strong inflows, reflecting renewed interest in carry trades. Mexico was the index's best performer after a PRI victory in the State of Mexico elections eased investors' concerns about the political outlook. On the other hand, energy exporters Colombia and Russia were the worst performers in the index on the back of the sharp decline in oil prices.

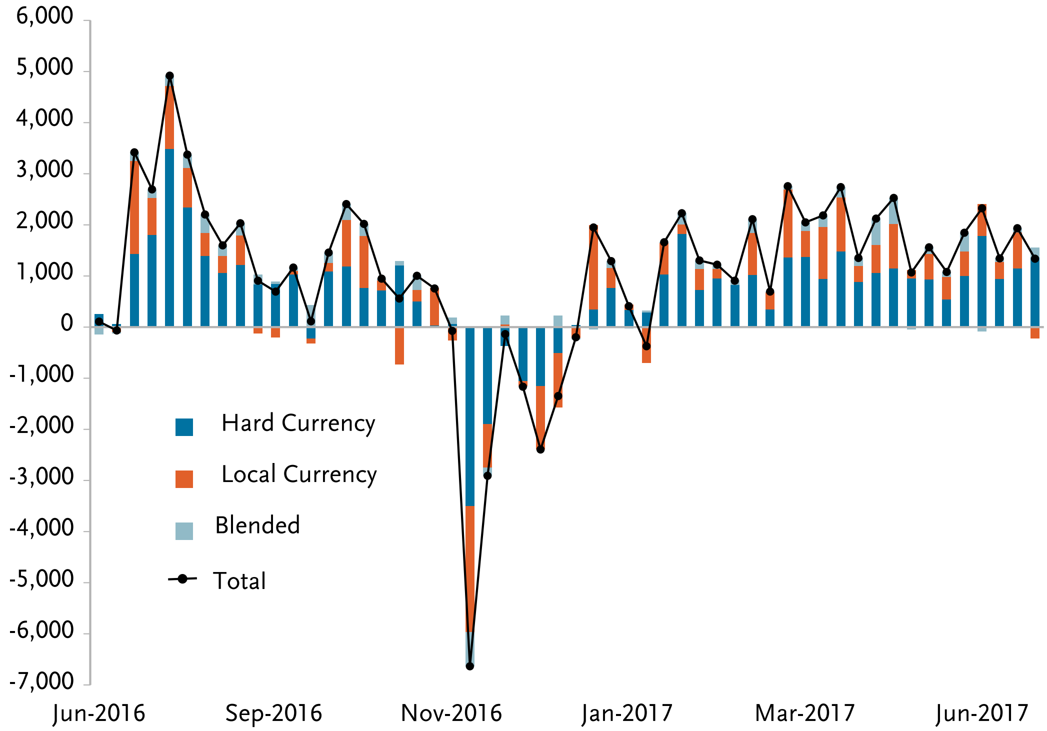
Flows

Inflows continued across hard, local and blended currency funds, totaling $6.94 billion for the month and $41.63 billion this year—the strongest start to a year on record. Inflows have been supportive of the asset class and have helped to absorb the bulk of new supply.

New Issuance

EM sovereigns have issued $108 billion through the first half of the year, eclipsing the full year totals from 2013, 2014 and 2015. EM corporates have issued a record $249 billion through the first six months and are expected to issue an additional $134 billion in the second half of the year. We would note that levels for sovereign net issuance remain manageable, and the bulk of corporate net issuance has been from Asian corporates. In fact, Latin American corporate supply has been net negative so far in 2017. We expect a moderate slowdown in issuance in the second half of the year as supply tends to be disproportionately larger in the first half.

Weekly EM Dedicated Bond Fund Flows (USD Millions)



Source: EPFR Global, CIBC; Data as of June 30, 2017

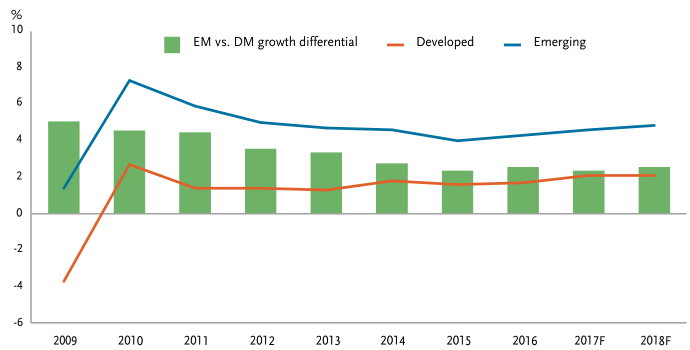
	JUNE 2017 ISSUANCE				2017 YTD ISSUANCE			
	Gross Total	Investment Grade	High Yield	Net* Total	Gross Total	Investment Grade	High Yield	Net* Total
Sovereign	16.7	9.0	7.7	8.7	108.4	60.3	48.2	56.9
Corporate	37.7	16.8	20.9	20.8	249.2	133.2	116.0	118.2
Total	**54.4**	**25.8**	**28.6**	**29.5**	**357.7**	**193.5**	**164.2**	**175.1**

Source: Bank of America Merrill Lynch, JP Morgan, TCW Emerging Markets; Data as of June 30, 2017

*Net financing requirement assumes cashflows from amortizations, coupon payments, tenders and buybacks will be re-invested

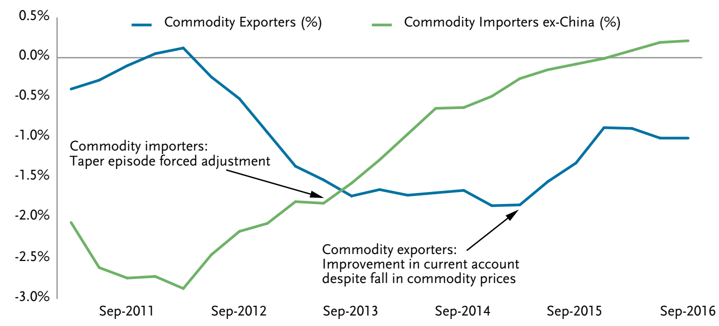
ADDITIONAL FUNDAMENTAL AND VALUATION CHARTS

Signs of an EM Growth Pickup with the EM/DM Growth Differential Widening



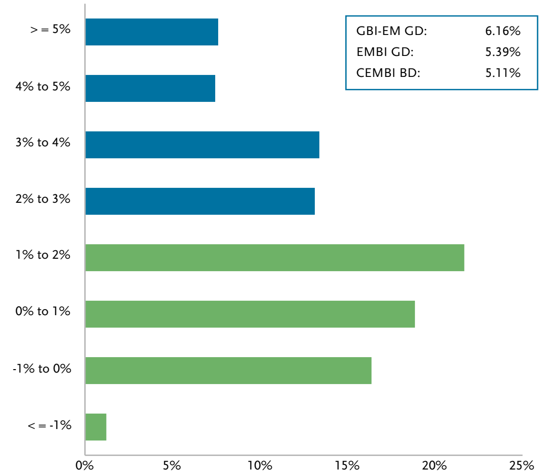
Source: TCW Emerging Markets Research; Data as of July 13, 2017

Current Account Balances Have Improved



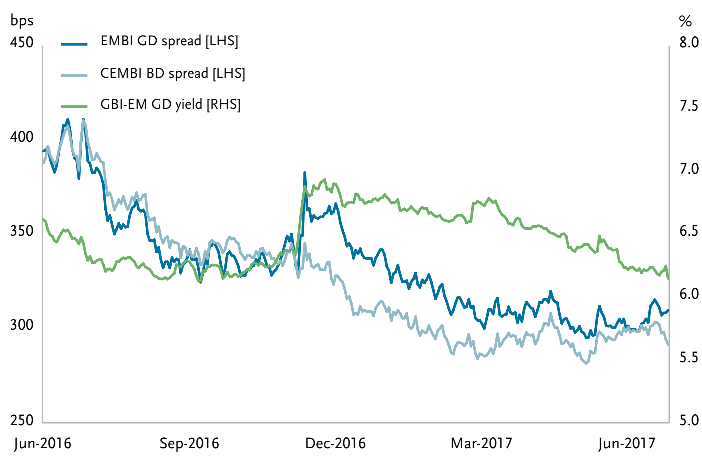
Source: Morgan Stanley; Data as of December 31, 2016

Nearly 60% of Global Fixed Income Yields 2% or Lower



Source: Standard Chartered; Data as of July 3, 2017

Emerging Markets Index Valuations



Source: Bloomberg, JP Morgan; Date as of June 30, 2017

865 South Figueroa Street | Los Angeles, California 90017 | 213 244 0000 | @TCWGroup