

## Market Commentary

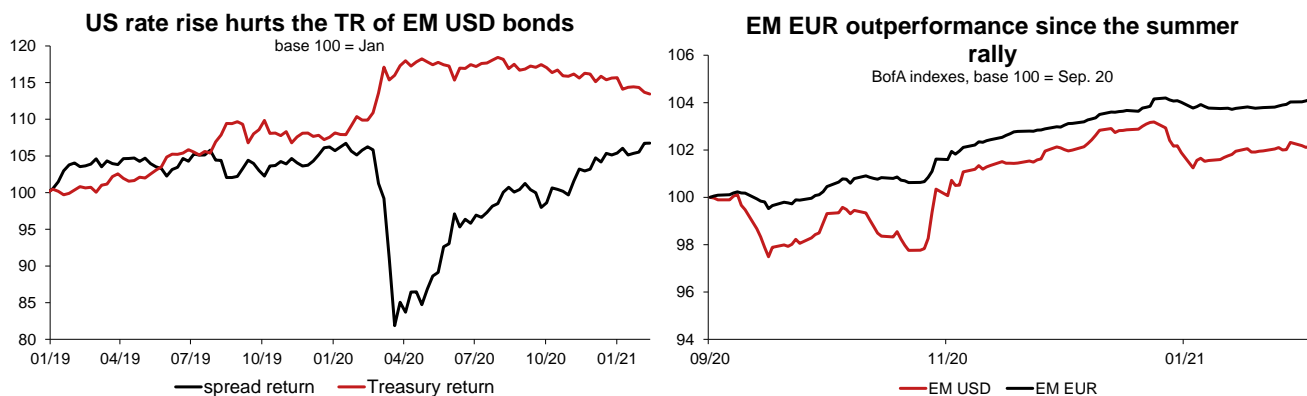
February 17, 2020

Macro & Market Research, Generali Insurance Asset Management S.p.A. SGR

### EM EUR bonds offering an attractive pickup

- **Despite the recent rise of US rates, we remain positive EM USD bonds in the long term.**
- **That said, for European investors, EM EUR bonds are more attractive. We screened 375 USD/EUR bond pairs across the EM sovereign universe and we found that EM EUR bonds are currently offering one of the largest pickup over EM USD bonds since January 2020**
- **In the IG space, we see value to switch from Romania USD bonds into Romania EUR bonds. Likewise, Kazakhstan, Mexico, and Chile EUR bonds are offering a significant pickup over USD bonds. On the other hand, Saudi Arabia USD bonds are more attractive.**
- **In the HY space, valuations are more dispersed and erratic, but we see value to switch into Egypt and Ukraine USD bonds from EUR bonds.**

EM USD bonds total return has been hit by the increase of long-term US rates while EM EUR bonds have proved to be more resilient since the last summer rally. The recent rapid rise of the long-term US rates is raising the question of the EM USD bonds' attractiveness.



On a global basis, we remain positive EM USD bonds in the long term. In our view, EM USD bonds will likely post a positive total return over one year despite the expected rise of long-term US rates. The large carry will be more than enough to offset the rise to 1.40% we expect from the 10Y US rate by year-end. Looking at the total return decomposition, a negative total return in 2021 would need a c.40-50bp US rate rise coupled with a c. 50bp spreads widening. It would mean that EM USD spreads would be back to pre-October levels despite the cyclical recovery and the vaccine rollout while US rates would not decline.

**EM USD: Carry provides a buffer and boost to the TR**

1Y TR for different scenarios, BofA index

OAS	US 8Y							
spread	0.65%	0.75%	0.85%	0.95%	1.05%	1.15%	1.25%	1.35%
226	8.41%	8.32%	8.23%	8.15%	8.06%	7.97%	7.88%	7.79%
236	7.53%	7.44%	7.35%	7.27%	7.18%	7.09%	7.00%	6.91%
246	6.65%	6.56%	6.47%	6.39%	6.30%	6.21%	6.12%	6.04%
256	5.77%	5.68%	5.60%	5.51%	5.42%	5.33%	5.24%	5.16%
266	4.89%	4.80%	4.72%	4.63%	4.54%	4.45%	4.37%	4.28%
276	4.01%	3.93%	3.84%	3.75%	3.66%	3.57%	3.49%	3.40%
286	3.13%	3.05%	2.96%	2.87%	2.78%	2.70%	2.61%	2.52%
296	2.26%	2.17%	2.08%	1.99%	1.90%	1.82%	1.73%	1.64%
306	1.38%	1.29%	1.20%	1.11%	1.03%	0.94%	0.85%	0.76%
316	0.50%	0.41%	0.32%	0.23%	0.15%	0.06%	-0.03%	-0.12%
326	-0.38%	-0.47%	-0.56%	-0.65%	-0.73%	-0.82%	-0.91%	-1.00%

**EM EUR: less attractive total return due to the lower carry**

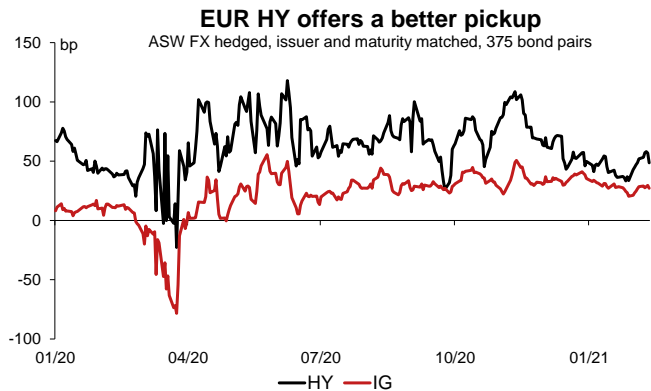
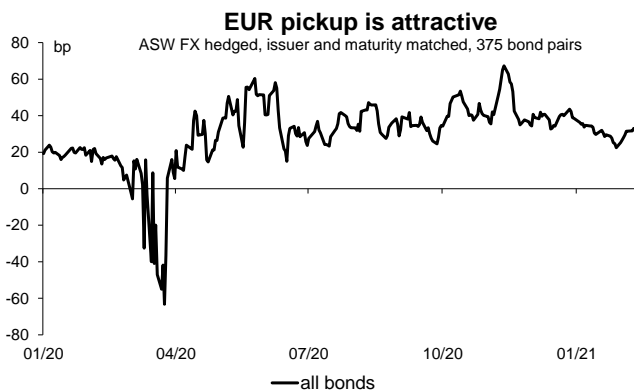
1Y TR for different scenarios, BofA index

OAS	8Y Bund							
spread	-0.63%	-0.58%	-0.53%	-0.48%	-0.43%	-0.38%	-0.33%	-0.28%
119	5.35%	5.31%	5.27%	5.23%	5.19%	5.15%	5.11%	5.07%
129	4.55%	4.51%	4.47%	4.43%	4.39%	4.35%	4.31%	4.27%
139	3.75%	3.71%	3.67%	3.63%	3.59%	3.55%	3.51%	3.47%
149	2.96%	2.92%	2.88%	2.84%	2.80%	2.76%	2.72%	2.68%
159	2.16%	2.12%	2.08%	2.04%	2.00%	1.96%	1.92%	1.88%
169	1.36%	1.32%	1.28%	1.24%	1.20%	1.16%	1.12%	1.08%
179	0.56%	0.52%	0.48%	0.44%	0.40%	0.36%	0.32%	0.28%
189	-0.24%	-0.28%	-0.32%	-0.36%	-0.40%	-0.44%	-0.48%	-0.52%
199	-1.04%	-1.08%	-1.12%	-1.16%	-1.20%	-1.24%	-1.28%	-1.32%
209	-1.84%	-1.88%	-1.92%	-1.96%	-2.00%	-2.04%	-2.08%	-2.12%
219	-2.64%	-2.68%	-2.72%	-2.75%	-2.79%	-2.83%	-2.87%	-2.91%

In addition, the recent market correction has pushed higher the effective yield of the EM USD BofA index by 20bp to 3.84%. FX hedging costs for European investors have only moved slightly and so at the global level EM USD bonds appear to be more attractive than EM EUR bonds since January.

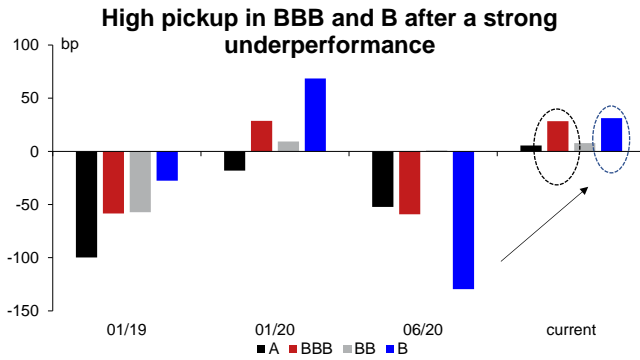
That said, it is EM EUR bonds that are effectively more attractive, offering a better pickup for European investors. For sure, EM EUR bonds are offering a less compelling total return due to a lower carry. However, it is always difficult to compare two bond indexes given their maturity, issuer, credit risk, or duration differences. It is why we screened 375 USD/EUR bond pairs across the EM sovereign universe. We find that for a same issuer and maturity on an FX-hedged basis, EM EUR bonds have been offering one of the largest pickup over EM USD bonds at c.31bp.since January 2020.

At the rating level, the IG segment is offering a less important pickup than the HY segment but it is high on an absolute level, back to its pre-Covid level. We would expect this pickup to tighten as the supply of the largest EM EUR issuers, which are in CEE, will decline significantly on a net basis as they are expecting to benefit from the new European SURE program.



In the HY segment, the pickup is even more important at c. 48bp. The difference with the IG segment can be partially explained by the movement of the EUR/USD basis which tends to have a larger impact on the IG names given the absolute lower levels of spreads.

At a more granular level, B and the BBB are the most attractive segments, after a relevant underperformance since the last summer rally. In the B segment, one of the reasons is likely the liquidity difference between the EUR and the USD bonds.



## Country opportunities

In the IG space:

- Romania EUR bonds are offering a decent pickup especially at the backend of the curve. We will switch Romani USD 51 into Romani EUR 50. Romania is trading a bit expensive on the spread-to-rating curve but it is less expensive than its CEE peers. Political risks have been receding and a downgrade looks less likely. There is room for further compression towards other CEE BBB names like Hungary.
- In Mexico, the pickup offers by EUR bonds is not uniform across the curve. We will switch Mexico USD bonds 2025/2029 into their EUR equivalents. Mexico is trading slightly cheap on the curve. A rating downgrade is remote and if any risk, it is more for the end of the year or in 2022.
- In Chile, the front-end of the EUR curve is more attractive. Chile has been trading cheap on the curve due to political risks and a possibly delayed fiscal consolidation with the new Constitution. That said, in the short-term, it has handled better the Covid situation and it is in a good position to benefit from the cyclical recovery.
- Kazakhstan EUR curve is offering a significant pickup in ASW for both the KAZAKS 2026 and 2023. Rating is not under pressure and it could benefit from the commodity recovery.
- Saudi Arabia EUR 2027 is an expensive bond in the IG space vs its USD equivalent. KSA USD 2027 offers better value. More globally, Saudi Arabia is slightly cheap on the curve.

In the HY space:

- Valuations are more dispersed and erratic. Discrepancies can be more driven by liquidity issues. That said we note that SOAF USD 2030 and Ukraine USD 2028 are offering an attractive pickup. They are facing relevant idiosyncratic risks but at least Ukraine is discussing with the IMF.

## Non exhaustive list of USD-EUR bonds pairs

a positive ASW means than EUR ASW is higher

Country	USD bond	EUR bond	YTM_USD	YTM_EUR	Adj. Zspr	Adj. ASW	Composite Rating
ARGENTINA	09/07/2035	09/07/2035	14.71	13.46	85	117	NR
ARGENTINA	09/01/2038	31/12/2038	13.46	13.22	113	-32	NR
CHILE	27/03/2025	30/01/2025	0.75	-0.05	26	23	A
CHILE	21/01/2026	20/01/2026	0.97	0.02	20	17	A
CHILE	06/02/2028	01/02/2029	1.46	0.32	17	15	A
CHILE	31/01/2031	02/07/2031	1.92	0.45	6	6	A
CHILE	30/10/2042	29/01/2040	2.97	1.16	-15	-1	A
CHILE	25/01/2050	22/01/2051	3.16	1.49	-4	16	A
CHINA	21/10/2025	12/11/2026	0.76	0.00	31	27	A+
COLOMBIA	28/01/2026	22/03/2026	1.93	0.96	13	14	BBB-
CROATIA	04/04/2023	30/05/2022	0.54	-0.28	5	0	BB+
CROATIA	26/01/2024	11/03/2025	0.69	0.17	33	30	BB+
EGYPT	10/11/2026	16/04/2026	4.45	3.61	41	37	B
EGYPT	10/11/2030	16/04/2030	6.85	4.99	-34	3	B
HUNGARY	25/03/2024	22/10/2025	0.71	-0.05	8	2	BBB-
INDONESIA	15/04/2023	14/06/2023	0.64	0.02	22	20	BBB
INDONESIA	29/03/2026	18/09/2026	1.46	0.60	27	21	BBB
INDONESIA	28/05/2025	24/04/2025	1.25	0.35	17	12	BBB
INDONESIA	29/03/2027	14/02/2027	1.77	0.64	15	9	BBB
INDONESIA	24/04/2028	14/06/2028	1.89	0.76	25	30	BBB
ISRAEL	30/06/2022	22/07/2022	0.29	-0.28	23	21	A+
ISRAEL	30/06/2023	29/01/2024	0.41	-0.23	20	17	A+
ISRAEL	16/03/2026	18/01/2027	0.90	-0.02	20	17	A+
IVORY COAST	03/03/2028	22/03/2030	4.21	4.17	127	134	B+
IVORY COAST	31/12/2032	30/01/2032	5.41	4.40	267	264	B+
KAZAKHSTAN	14/10/2024	09/11/2023	0.79	0.23	47	43	BBB-
KAZAKHSTAN	21/07/2025	30/09/2026	0.95	0.49	54	47	BBB-
MEXICO	02/10/2023	22/04/2023	0.39	-0.36	15	11	BBB
MEXICO	30/01/2025	15/01/2025	0.69	0.04	37	34	BBB
MEXICO	15/05/2026	08/04/2026	1.68	0.37	-16	-41	BBB
MEXICO	28/03/2027	18/09/2027	1.66	0.62	19	14	BBB
MEXICO	11/01/2028	17/04/2028	2.01	0.84	17	16	BBB
MEXICO	22/04/2029	09/04/2029	2.41	1.16	21	29	BBB
MEXICO	16/04/2030	17/01/2030	2.62	1.13	3	5	BBB
MEXICO	08/04/2033	25/10/2033	3.41	1.57	-34	-59	BBB
MEXICO	11/01/2040	08/04/2039	3.97	2.32	-6	4	BBB
MEXICO	21/01/2045	06/03/2045	4.05	2.48	4	29	BBB
MEXICO	27/04/2051	25/10/2051	4.12	2.57	6	27	BBB
MEXICO	12/10/2110	15/03/2115	4.72	3.38	18	151	BBB
MOROCCO	15/12/2027	30/03/2026	2.38	0.99	9	13	BB+
MOROCCO	15/12/2032	27/11/2031	3.07	1.70	29	39	BB+
PERU	23/01/2026	30/01/2026	1.22	0.11	5	4	BBB+
PERU	20/06/2030	01/03/2030	2.00	0.50	7	15	BBB+
PHILIPPINES	21/01/2024	03/02/2023	0.43	-0.02	48	44	BBB
PHILIPPINES	15/06/2027	17/05/2027	1.85	0.49	-9	-29	BBB
PHILIPPINES	14/01/2029	03/02/2029	1.66	0.59	37	32	BBB
POLAND	17/03/2023	19/01/2023	0.35	-0.49	1	-2	A-
POLAND	22/01/2024	15/01/2024	0.40	-0.41	10	6	A-
POLAND	06/04/2026	19/01/2026	0.80	-0.29	11	6	A-
ROMANIA	22/01/2024	24/04/2024	0.72	0.05	22	19	BBB-
ROMANIA	14/02/2031	16/07/2031	2.42	1.47	59	64	BBB-
ROMANIA	22/01/2044	02/12/2040	3.77	2.35	20	22	BBB-
ROMANIA	14/02/2051	28/01/2050	3.79	2.69	55	110	BBB-
RUSSIA	27/05/2026	04/12/2025	1.72	0.67	15	13	NR
RUSSIA	23/06/2027	20/11/2027	1.88	1.09	49	41	NR
RUSSIA	31/03/2030	20/11/2032	1.59	1.84	95	301	BBB-
SAUDI ARABIA	03/02/2027	09/07/2027	1.55	0.14	-16	-18	A
SENEGAL	23/05/2033	13/03/2028	5.04	3.65	34	59	B+
SERBIA	01/12/2030	26/06/2029	2.49	1.19	36	44	BB
SOUTH AFRICA	14/04/2026	24/07/2026	3.16	1.82	-18	-12	BB-
SOUTH KOREA	19/06/2024	10/06/2024	0.42	-0.23	31	28	AA-
SOUTH KOREA	03/11/2025	16/09/2025	0.77	-0.22	13	7	AA-
TUNISIA	30/01/2025	17/02/2024	7.63	7.93	137	140	B
TURKEY	06/04/2023	11/04/2023	3.23	1.98	-41	-40	B+
TURKEY	14/04/2026	15/07/2026	4.26	7.76	466	438	B+
TURKEY	13/03/2025	31/03/2025	3.98	2.90	-4	11	B+
UKRAINE	01/09/2026	20/06/2026	5.22	4.61	61	73	B
UKRAINE	01/11/2028	27/01/2030	6.08	4.99	20	-31	B

**Author:****Guillaume Tresca**[Guillaume.tresca@generali-invest.com](mailto:Guillaume.tresca@generali-invest.com)[www.generali-investments.com](http://www.generali-investments.com)

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