COMMENTARY

Janus Henderson Horizon Emerging Market Corporate Bond Fund

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Fund managers

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Macro backdrop

The JP Morgan Corporate Emerging Market Bond Index (CEMBI) saw its eighth month of negative total returns this year as it was down 2.1%. The index spread widened 42 basis points (bps) while US Treasury yields continued to surge with the US 10-year yield increasing 21 bps to 4.05%. High yield and investment grade bonds saw similar performance, down 2.0% and -2.1% respectively, masking actual dispersion across the region. Asia (down 4.0%) underperformed all other regions.

The Chinese Communist Party congress reconducted Xi Jinping as leader of the nation for the third time, backed by a partially renewed politburo composed of his supporters. Assumed headwinds for private companies in China seem likely to persist in our view. Consequently, the Chinese corporate bond sub-index fell 5.4%. The US dollar appreciated another 1.5% (nominal, trade weighted) and put pressure on energy importing countries such as the Philippines, which saw inflation soar (up 7.7% for September from 6.9%). Philippines corporate bonds underperformed the region, losing 8.0% due to the unusual absence of local buyers. On the other hand, Latin American companies proved resilient, with the region down just 0.5%. Again, the sub-index performance masks regional disparities as Brazil corporate bonds rallied (up 0.7%) after the first round in general elections put Lula and Bolsonaro much closer than polls had predicted. Conversely, Mexican corporates underperformed the region (down 1.8%).

Within this context, there was not much change in terms of primary activity for emerging market bonds, which was around 25% of the previous years' issuance volume. Outflows from the asset class reached $86 billion year-to-date, due to an extra $13.1 billion (of which $6.5 billion was in hard currency) leaving the asset class in October.

Fund performance and activity

The fund underperformed its benchmark over the month.

The fund's exposure to both the Philippines and the issuer Cifi explain this underperformance. The fund had an overweight position to Asia ex-China and Philippines corporate bonds in particular. On top of this Cifi, the Chinese real estate company that benefited from a state-guaranteed scheme to raise new funding onshore, missed a coupon payment on one of its Hong-Kong dollar bonds. Later in the month, the company suspended repayments on offshore bonds, withdrawing from negotiations with bond holders. The rest of the portfolio was and remains defensively positioned, with a short duration bias as the US dollar and US yields kept rising. This helped performance.

Outlook/strategy

Exceptional events affecting global supply chains have pushed the world's imbalances to extreme levels. China and energy exporting countries are now fully responsible for global excess savings, funding all other countries' external deficits. Europe, which has historically been a creditor vis-à-vis the rest of the world, is now a debtor due to higher energy imports. Meanwhile, and contrary to what the fashionable topic of reshoring suggests, China's dominance in the world's goods trade surplus has increased in value terms. While most commenters pin China's woes on abandonment of free market policies by Xi Jinping's administration, it seems that they actually result from years of misallocation of capital into non-productive public sector assets. Such structural imbalances typically depress domestic income and accelerate the accumulation of debt. Domestic consumption, as proxied by retail sales and imports, is still extremely subdued, even if the exceptionally depressed levels are a consequence of the Zero-Covid policy and might see a short term reversal. A slowing in global activity, as predicted by leading indicators, will take a toll on the main engine of Chinese growth so far this year. Across other emerging market countries, several central banks mentioned onshore rates may be

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near their terminal levels; as the US Federal Reserve (Fed) has actually revised its terminal rate higher, the macro theme of this year around the tightening of financing conditions for emerging market countries seems likely to remain intact. The fund remains defensive, with a high cash balance, lower beta than the index and a short duration bias.

Source: Janus Henderson Investors, as at 31 October 2022

Janus Henderson Horizon Emerging Market Corporate Bond Fund

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