

Positive Contributors	FUND	Negative Contributors
<ul style="list-style-type: none"> On a company level: Turkiye Is Bankasi AS, Yapi Ve Kredi Bankasi AS On a country level: Turkey, Brazil 		<ul style="list-style-type: none"> On a country level: Venezuela, Argentina
Opportunities	MARKET	Challenges
<ul style="list-style-type: none"> Converging story of Emerging Markets is on track Market remains volatile and slowly returns to interesting levels for tactical positioning 		<ul style="list-style-type: none"> Risks of further devaluation of the Chinese Yuan US economic policy and rising US interest rates disclose the weakness of some EM countries

Update from the lead manager, Péter Varga

Once again, August was marked by a noticeable correction after the markets had recovered slightly. The market corrected by over 2% (EUR-hedged), despite slightly declining US yields (-10 basis points on the 10-year bond). This corresponds to an expansion of risk premia from around 70 to 376 basis points. Other EM markets, such as EM local currency bonds, lost significantly more (between 8-10%).

As so often this year, macro issues on a country level caused concerns. Let us start with the most prominent example: Turkey. The new government and the president want to continue solving the country's economic problems with unorthodox methods. However, the hoped-for effects did not materialize so far. On the contrary, the currency lost 30% against the US dollar in August only. Investors punished the government for delaying the necessary steps. These include the reduction of the budget deficit, reduction of imports in order to improve external financing of the country and increasing interest rates to stop the lira's runaway devaluation spiral. The country has received a USD 15bn credit from Qatar and a swap line of over USD 3bn – good friends help each other. We remember when Turkey was the only country to face Saudi Arabia's sanctions on Qatar's side. President Trump also doesn't give in and imposed new punitive tariffs on the Turkish steel industry (due to the unfairly perceived weak currency and the detained US pastor). In the meantime, president Erdogan and his folks are looking for foreign financial aid. In the near future, a meeting with Angela Merkel is scheduled, where the will for EU integration in exchange for financial help could be brought to the table.

In addition to Turkey, the investors' former EM darling - Argentina - is currently fighting to be able to continue to roll over short-term debt. As in the case of Turkey, it depends on the will of the investors, who have been relatively supportive so far. However, the physical demand for USD within the country itself has been very large, causing the currency (accompanied by position closures of investors focusing on interest rate differentials) to drop by up to 50% against the USD over the past 30 days (see Chart 1). The country announced fiscal tightening at the end of August in order to raise further funds from the IMF.

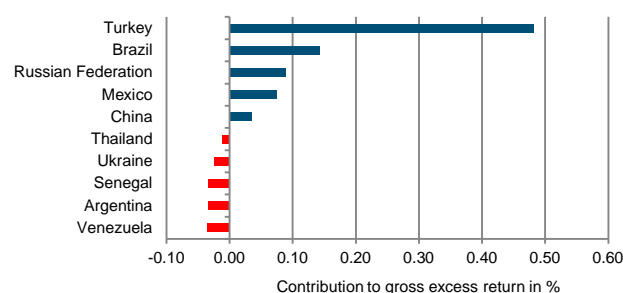
China might face further US sanctions (USD 200bn) in the near future. President Trump has now again pigeonholed a previous reconciliation or agreement with a country and

Gross Performance	August 2018	YTD	1Y	3Y	5Y	10Y
ERSTE BOND EMERGING MARKETS CORPORATE						
Fund	-1.42%	-3.71%	-2.84%	12.07%	25.06%	96.57%
Investment universe*	-2.19%	-5.44%	-4.66%	11.23%	18.63%	66.87%
Difference	0.77%	1.73%	1.82%	0.84%	6.43%	29.69%
ERSTE BOND EMERGING MARKETS CORPORATE IG						
Fund (USD)	0.22%	-1.40%	-0.94%	8.32%	20.22%	-
Investment universe** (USD)	0.31%	-0.89%	-0.48%	10.88%	19.30%	-
Difference	-0.09%	-0.52%	-0.46%	-2.55%	0.91%	-
ERSTE RESPONSIBLE BOND EMERGING CORPORATE						
Fund	-1.35%	-4.24%	-3.99%	4.29%	-	-
ERSTE BOND EMERGING MARKETS CORPORATE SHORT TERM						
Fund	-0.62%	-0.12%	0.82%	-	-	-
Investment Universe	-0.73%	-0.32%	0.31%	-	-	-
Difference	0.11%	0.20%	0.52%	-	-	-

*BoA ML Q505 – Customized EM Corporate Credit Index

**BoA ML Q608 – Bond EM exBB1 Total Return Index until 30.6.2016, JPM CEMBI Broad Diversified IG in USD from 1.7.2016

Best and worst relative performance contributors by country (relative to the investment universe)



Source: Erste AM, August 2018

Selected new issues in August

Issuer	Coupon	Maturity	Rating	Region
ESKOM Holdings SOC Limited	6.35	10.08.2028	Baa3	Africa
China Mengniu Dairy Co. Ltd.	4.25	07.08.2023	Baa1	Asia

Erste AM EMERGING MARKETS CORPORATE Strategies (In mn EUR)

Pooled Funds	984.84
Special Mandates	651.95
Total	1,636.78

As of August 2018

in one breath called the EU a similarly evil manipulator as China is. He also criticized EU citizens for preferring EU products over US products. With all that in mind, I wonder how long the agreement (NAFTA 2.0) with Mexico will last. China's purchasing managers' indices were slightly weaker than before, just pointing to a modest weakening of the economy. If the mentioned tariffs are implemented, China will further devalue its own currency which could trigger a competitive devaluation spiral in Asia. This would hit Indonesia and India relatively hard.

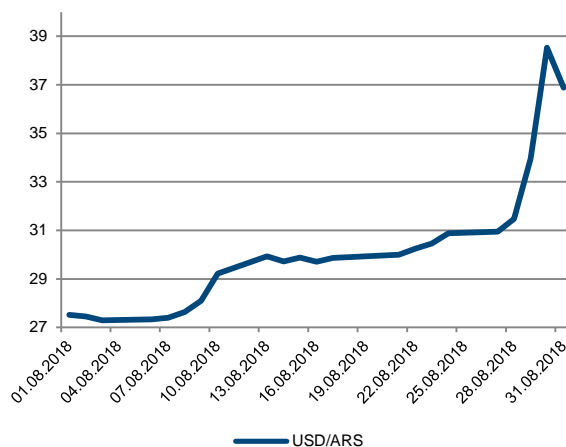
In this environment, company news were again of secondary importance – at least there were hardly any which were able to move prices. Perhaps one exception was MTN, the largest telecom company in South Africa. Nigeria repeatedly reclaimed USD 10bn from MTN with vague arguments. The company produces about USD 1bn cash per year, which makes the claim relatively high. Meanwhile, the stock plunged by more than 20% and bonds fell by 10 points. We waited for the bonds to calm down and set our position to "neutral" at -3 points.

Wondering where the good news is? In Brazil, ex-president Lula cannot compete in the elections and so the best chances are attributed to right-wing populist Jair Bolsonaro (Brazil's Trump). He represents the ultraconservatives of his country and scores with his clean slate, in contrast to the current political elite. Due to extreme uncertainty about the election outcome, the currency came under heavy pressure (USD bond markets to a lesser extent), but here we think that both Bolsonaro and social democrat Alckmin want to stabilize or rather than improve the fiscal situation. We are taking advantage of the market weakness and are looking for opportunities.

Do you remember Hans Christian Andersen's fairy tale "The Emperor's New Clothes"? Many EM countries were much-hyped and able to issue 100-year bonds. The beautiful clothes are gone now and what remains is the blunt truth, the reality of facts: US economic policy and rising US interest rates again highlight the weakness. Many EM countries heavily rely on external financing and can hardly finance themselves without the IMF and China (see Chart 2). This is the sad, yet sobering experience of the past few months. But let us look at the positive side of the story: the convergence towards higher wealth will continue for longer than some have predicted. Thus, for our clients and for active investors like us, there will still be good, long-term investment opportunities.

In August, our strategies benefitted strongly from the convex positioning and title selection in Turkey. In Russia, we do not believe the market (USD bonds) to be prepared for a scenario of tougher sanctions, think only about the possible gain of the democrats in the November elections. We therefore stick with our meanwhile profitable overweight position. The partially off-benchmark overweight in China worked out well, our high-yield construction companies have been able to report good figures and easily refinance their debts. In Argentina, we lost a little bit as the added government bonds performed slightly worse than corporate bonds in recent weeks. The market remains volatile and slowly returns to interesting levels for tactical positioning.

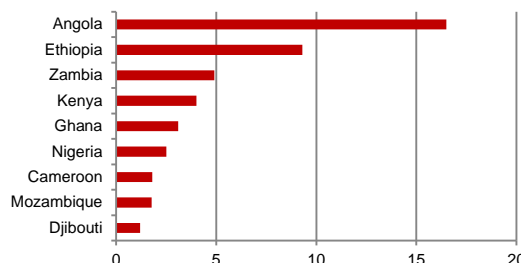
Chart 1: Devaluation of the Argentinian Peso vs. the USD



Source: Bloomberg

Chart 2: African countries indebtedness towards China

	Total overseas debt (bn)	Owed to China
Angola	29	16.5
Ethiopia	22.4	9.3
Zambia	6.7	4.9
Kenya	17	4
Ghana	22.4	3.1
Nigeria	11.5	2.5
Cameroon	5.6	1.8
Mozambique	7.3	1.77
Djibouti	1.5	1.2



Source: China Africa Research Initiative

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