EMERGING MARKETS CORPORATE BONDS UPDATE 03/2019

Positive Contributors	FUND	Negative Contributors
▪ On a company level: Companhia Siderurgica Nacional, Mironovsky Khleboproduct/MHPSA ▪ On a country level: China, Chile		▪ On a company level: Petrobras, Petroleos Mexicanos ▪ On a country level: Mexico, Turkey

Opportunities	MARKET	Challenges
▪ China announced tax cuts of several trillion yuan and other measures aimed at generating growth ▪ The Chinese real estate market stabilised		▪ The market is likely to have reached a peak ▪ S&P changed the rating outlook for Mexico (BBB+) to negative

Update from the lead manager, Péter Varga

General Market Description

Again, February presented itself in the best light. Supported by stable US yields and 20 basis points tighter risk premia, our asset class delivered a performance of around 1.2% in euro terms. Risk premia closed at 325 basis points, down from 400 at the end of 2018. There were continuous inflows, mainly from Asia, which further supported the market.

Commodity prices also had a supportive effect in February and oil and industrial metals were able to deliver a positive performance.

Company News

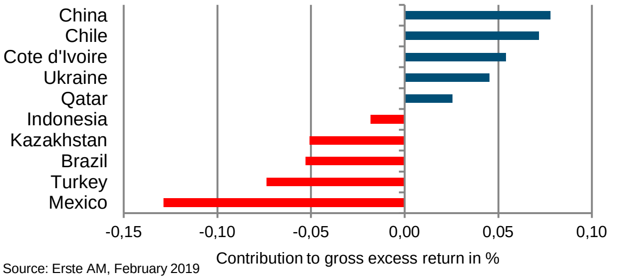
S&P changed the rating outlook for Mexico (BBB+) to *negative*. The rationale behind the change was the suspension of the previous government's oil reform (i.e. more oil production) and its replacement with more refinery activity (i.e. to build more refineries). Faced with globally low profit margins at refineries and falling oil production at Pemex, this step seems to be somewhat out of place. In addition, the government has further confirmed that Pemex can count on immediate aid in case of emergency. Also, Moody’s commented on its rating: the rating of Mexico (A3) has plenty of leeway and there will certainly be no rating change this year. The risk premia of Pemex reached the range of 280-300 basis points again, which is equivalent to the widest spread on the market between a sovereign and a company (wholly owned by the state). In comparison, there are companies such as the Peruvian oil company Petroperu, which has debt of over 30 times its operating profit and only trades 80 basis points above Peru's government bonds. Mexico would be able to reduce 20-25 percentage points (!) of annual tax payments in favour of Pemex and Mexico would still remain *Investment Grade*, since a significant portion of Mexico's rating directly depends on Pemex. At these levels, we are going to be a little more constructive for valuation reasons, but will remain underweight for the time being as the EUR bonds in particular are very expensive.

On the earnings side, the picture is heterogeneous. Petrobras and Marfrig reported good figures, while Minerva and BRF (former Brasil Food) reported rather poor figures. Caribbean Digicel bonds heavily dropped in value (see chart 1) as the company is unable to meet its own restructuring plans. We have been underweight for some time. Bharti Airtel has announced a USD 4.5 billion capital increase in order to avoid a downgrade to high yield. This worked out fine as S&P confirmed its BBB rating. Here we are positioned neutrally or slightly overweight depending on the fund and risk requirements. CSN from Brazil also reported good figures, partly due to the preceding sale of iron ore to Glencore for USD 500 million. As a result, the bonds rose by 5-6%. CSN has long been a speculative overweight in the fund. In view of the expected refinancing of the 2019/2020 bonds, we seized the opportunity to reduce the position at these price levels.

Gross Performance	Feb 2019	YTD	1Y	3Y	5Y	10Y
ERSTE BOND EMERGING MARKETS CORPORATE						
Fund	1.22%	3.77%	1.22%	18.85%	23.58%	176.46%
Investment Universe*	1.22%	3.66%	-0.57%	18.61%	16.66%	131.85%
Difference	0.00%	0.11%	1.79%	0.24%	6.92%	44.61%
ERSTE BOND EMERGING MARKETS CORPORATE IG						
Fund (USD)	1.17%	2.84%	3.50%	12.82%	17.64%	-
Investment Universe** (USD)	1.35%	3.00%	3.66%	15.21%	16.39%	-
Difference	-0.19%	-0.16%	-0.17%	-2.38%	1.26%	-
ERSTE RESPONSIBLE BOND EMERGING CORPORATE						
Fund	0.99%	2.55%	-0.99%	7.02%	14.66%	-
ERSTE BOND EMERGING MARKETS CORPORATE SHORT TERM						
Fund	0.74%	2.20%	3.90%	-	-	-
Investment Universe***	0.79%	2.10%	3.85%	-	-	-
Difference	-0.04%	0.11%	0.05%	-	-	-

*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
***JP Morgan CEMBI Broad Diversified (1–3 years)

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



Source: Erste AM, February 2019

Selected new issues in February

Issuer	Coupon	Maturity	Rating	Region
Turk Telekom. AS	6.875	28.02.2025	BB+	Asia
MashreqBank PSC	4.25	26.02.2024	A	Asia
GLP China Holdings Ltd.	4.974	26.02.2024	BBB-	Asia
Crédito Real, S.A.B de C.V.	9.5	07.02.2026	BB+	Latin America

Erste AM EMERGING MARKETS CORPORATE Strategies (in mn EUR)	
Pooled Funds	991.36
Special Mandates	569.82
Total	1,561.18

As of February 2019

Argentinian bonds, on the other hand, were the losers of the month, with significantly negative performance. Reasons for this are the continuously high inflation and the still weakening economy. The currency was also weaker in February, but with inflation in mind it still has some room for further depreciation. However, figures from companies and from most of the provinces were okay. In the run-up to the important elections in October, with app. 65% chance of a reformist candidate versus app. 35% in favor of Kirchner, we are keeping our slight overweight in the fund.

Vale is not coming to rest. S&P reduced its rating to BB+ with a negative outlook two weeks after the confirmation (mid-February). Unexpected, not yet calculable liabilities are a cause for concern. Compared to Fitch, S&P seems to prefer to stay on the safe side, while Fitch for its part takes a very analytical view on the development and sees the situation more relaxed due to the extremely low level of debt and the high annual free cash flow. Basically, we agree with Fitch, but are still waiting with an increase of the position. With the downgrade by S&P, long-term bonds first fell by 4 points, only to return to their original price an hour later... The latest news was not exactly positive either. According to the news, the safety inspectors were changed in September last year (to TÜV Süd) as they did not want to classify the dams as safe. The CEO resigned at the end of February and took the responsibility.

„Corruption Corner“

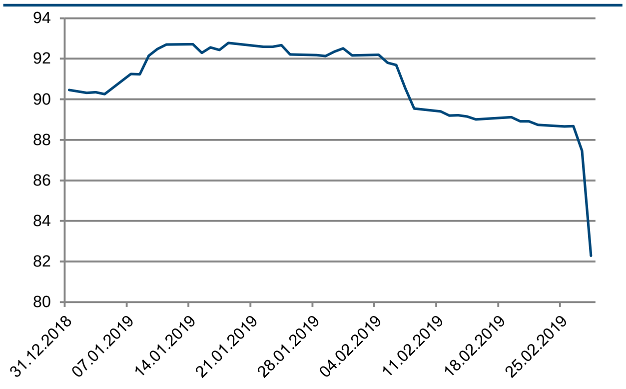
In Ecuador, a local journalist uncovered how the brother of the current president (Lenin Moreno) accepted bribes for the Coca Codo Sinclair (hydroelectrics) project worth USD 18 million.

Outlook

In our opinion, at these levels the market is likely to have reached a peak and could enter into a consolidation phase. There are several reasons for this: A positive negotiation outcome between the US and China seems to be priced in at least to 80%, a complete breakdown of the negotiations or an ambiguous deal would be a negative surprise. China has announced tax cuts of several trillion yuan and other measures (resulting in a higher deficit, see chart 2) aimed at generating growth of 6-6.5% (officially). The real estate market (possibly the main pillar of the economy) also stabilised in February. Increasing demand is being reported. Aoyuan, Logan Property reported positive sales trends (YoY, %) in February. Since November 2018, we have been using short-term (1-2 years) Chinese companies in the residential construction sector for carry trades.

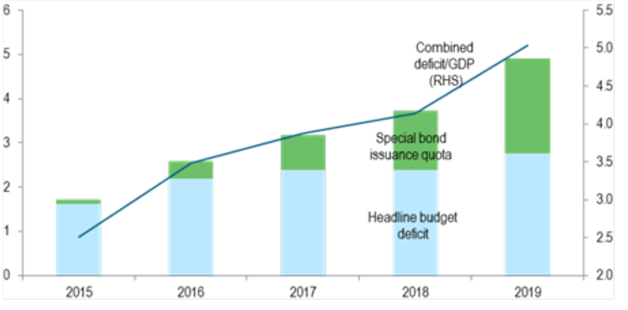
The general valuation of the market can be described as fair in light of the current economic situation and current risk premia. Currently, we only see limited opportunities for further, significantly positive price movements. It seems as if the markets are ahead of the current economic situation, so we are not in a hurry to find new opportunities at the moment.

Chart 1: 6% Digicel Group Ltd. (2021)



Source: Bloomberg

Chart 2: Broad budget deficit continues to rise



Left-hand side: CNY tn, right-hand side: %

Source: State Council, MoF, Standard Chartered Research

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ABOUT US

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We believe that active management is the best way to generate value in inefficient markets. Emerging markets corporate bonds offer these kind of investment opportunities. Our clients appreciate and benefit from the integrative research and portfolio manager team approach that provide the basis for a structured and efficient decision making process. This stable process and our focus on excellence has made us the partner of choice for institutional clients all over Europe.

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