EMERGING MARKETS CORPORATE BONDS UPDATE 06/2019

Positive Contributors	FUND	Negative Contributors
▪ Countries: Mexico, Indonesia, Russia ▪ Companies: Capex SA, Kaisa Group Holdings LTD		▪ Countries: Chile, Zambia ▪ Companies: First Quantum Minerals LTD, Kazmunaygas

Opportunities	MARKET	Challenges
▪ Settlement in trade dispute ▪ Subdued issuing activity supports EM Corporates		▪ No agreement in trade dispute between USA and China ▪ Impending recession

Update from the lead manager, Péter Varga

The intensifying trade conflict between the US and China caused the global markets to act in a negative way in May. The current spread level is at 345 basis points. The spread widening of 25 basis points was more pronounced and faster than expected. However, this was fully offset by the Treasuries rally. 10-year US interest rates fell from 2.5% to 2.1%. In the end, our fund was able to generate a plus of +0.32%.

USA/China trade conflict: The US is reportedly considering new, tough sanctions against more Chinese high-tech companies (similar to Huawei). In return, China announced a boycott of rare earth supplies to the US. No further rounds of talks are currently planned between the Trump administration and the Chinese government on a possible solution.

The resulting concerns about the global economic situation and the associated oil consumption also put oil prices under pressure - favoured by surprisingly higher US inventories. Brent lost 13% over the month while WTI trades were down by 16%. In addition, EM mandates (mainly equities and local currency funds) recorded net outflows for the second consecutive week. The good news, however, is that some idiosyncratic, positive developments, such as in Brazil, Argentina and India, have somewhat dampened global negative events.

At country level, the following news were decisive

Argentina traded mainly firmly in May. Cristina Fernandez de Kirchner had announced that she wanted to run in the presidential elections as vice president together with her former chief of staff Alberto Fernandez. The prospect of a more moderate policy under Alberto Fernandez provided relief and helped the upswing.

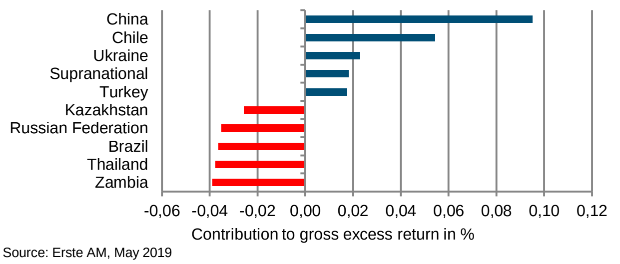
In addition, the IMF was positive that Argentina was on the "right track" to comply with the budget plans agreed with the government. The IMF also noted that "Argentina has made important progress in reducing macroeconomic vulnerabilities that should not be overlooked". Nevertheless, economic growth in March fell faster than expected, with real GDP down 6.8% on an annual basis.

The focus in **South Africa** was on the presidential and parliamentary elections. President Ramaphosa's ruling ANC party came first with about 57.3% of the vote followed by the DA with 22%. In 2014, the ANC achieved about 62% of the votes. A result of 55-60% of the votes was expected to strengthen President Ramaphosa's position within the party and his ability to implement economic reforms. After the Cabinet's announcement, however, relief came as some important positions for the reform agenda were retained, such as Finance Minister Mboweni and Public Enterprise Minister Gordhan. In addition, ministerial positions were reduced from 36 to 28.

Gross Performance	May 2019	YTD	1Y	3Y	5Y	10Y
ERSTE BOND EMERGING MARKETS CORPORATE						
Fund	0.40%	5.77%	5.27%	14.61%	21.26%	127.69%
Investment Universe*	0.37%	5.81%	4.14%	13.07%	14.49%	97.25%
Difference	0.03%	-0.04%	1.13%	1.54%	6.76%	30.44%
ERSTE BOND EMERGING MARKETS CORPORATE IG						
Fund (USD)	0.82%	6.22%	8.03%	12.54%	17.27%	-
Investment Universe** (USD)	0.93%	6.51%	8.14%	14.09%	16.34%	-
Difference	-0.11%	-0.29%	-0.11%	-1.54%	0.93%	-
ERSTE RESPONSIBLE BOND EMERGING CORPORATE						
Fund	0.39%	4.53%	2.88%	5.15%	12.48%	-
ERSTE BOND EMERGING MARKETS CORPORATE SHORT TERM						
Fund	0.58%	3.66%	5.45%	-	-	-
Investment Universe***	0.53%	3.65%	5.66%	-	-	-
Difference	0.05%	0.01%	-0.22%	-	-	-

*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, May 2019

Selected new issues in May

Issuer	Coupon	Maturity	Rating	Region
KAISA GROUP HOLDINGS LTD	11.50	30.01.2023	B	China
MEDCO OAK TREE PTE LTD	7.38	14.05.2026	B	Indonesia
ECOBANK TRANSNATIONAL	9.50	18.04.2024	B-	Togo

Erste AM EMERGING MARKETS CORPORATE Strategies (in mn EUR)	
Pooled Funds	999.69
Institutional Mandates	475.11
Total	1,474.80

As of May 2019

Colombia was more on the weaker side. This was driven by weak macroeconomic data, including weaker than expected real GDP growth of +2.8% instead of +3.0% on an annual basis, a current account deficit of just under 5% of GDP and a lack of concern from the central bank about the weak peso.

While Moody's raised the outlook for Colombia from 'negative' to 'stable' (a rating downgrade had been expected in some cases), Fitch surprisingly announced the opposite shortly afterwards and lowered the outlook from 'stable' to 'negative'. Fitch cited risks in fiscal consolidation, rising public debt and other external imbalances as the main reasons. Basically, we have been underweight in Colombia for some time now. One of our heavyweights is Millicom International Cellular, a telecommunications company with a broad range of countries and products, whose share price development has been unimpressed though.

India: The election victory of President Modi and his ruling coalition (NDA) helped Indian assets to appreciate this week - the coalition wins 351 of the 545 seats (272 seats were needed to form a government). Here we were a little too cautiously positioned, which cost some performance.

Mexico showed itself to be an underperformer at the end of May, which was mainly driven by the announcement of US President Trump to impose 5% tariffs from June onwards. Trump even floated a gradual increase to 25% by October. Such announcements and their actual implementation are unpredictable and hardly profitably tradable, so we were positioned defensively. In the meantime Trump has revoked this plan, which confirmed our approach.

Reports on a company level

Pemex burned ~USD 2.7 billion in free cash flow in Q1, partially offset by ~USD 1.6 billion in government support. Net debt increased by USD 1.2 billion to USD 103 billion as support was not sufficient to contain liquidity shortages. All eyes are now focused on the expected access to Mexico's stabilisation funds. The Ministry of Finance has prepared a plan to grant Pemex access to around USD 5.3 billion from the Mexican budget stabilisation fund. In addition, more support "as needed" can also be expected for the years 2020-2021. We believe that a small portion of these funds could be used to replenish liquidity, although virtually everything will be needed to cover the remaining maturities and close the free cash flow gap. From our point of view, these are not measures to close this "liquidity gap". We have been critical of Pemex for some time and therefore remain underweight.

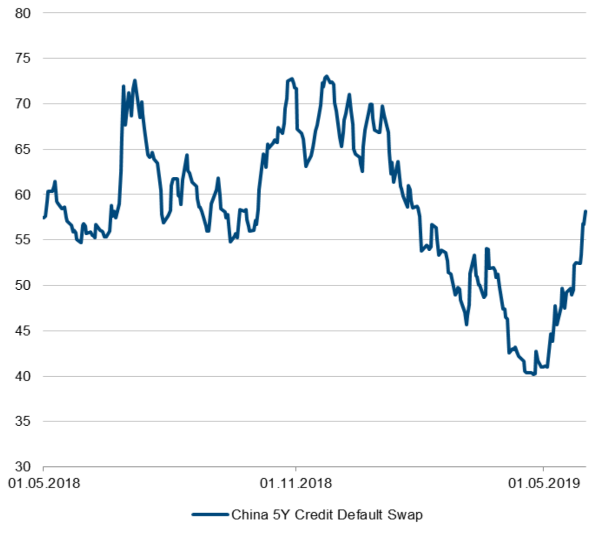
We remained overweight in **First Quantum Minerals**. The "persistent noise" has deterred some investors - as a reminder: **Zambia** has been downgraded by Moody's from 'Caa1' to 'Caa2'. However, we expect business in Zambia to continue as usual.

The Brazilian meat producer **BRF** (not a holding in the fund) is in talks to acquire **Marfrig** Global Foods ('neutral' weight). A merger would create the fourth largest meat company in the world. Marfrig bonds rose by up to 2 points in price. BRF's bond price reactions, on the other hand, were mixed.

Outlook

The general price levels have become more attractive, but the hope for an amicable settlement of the American-Chinese trade dispute has disappeared. The 5-year Chinese CDS reacted immediately to this situation (see chart). It seems to be only a matter of time before the remaining USD 325 billion in import value is given a 25% duty rate. Also, US consumers would be burdened if the threatened tariff increase for Mexican imports into the USA would ultimately be implemented. The R-word (recession) is therefore taking on ever stronger forms, so that it still seems sensible for us to remain defensively positioned in this environment.

Chart 1: Massive increase in the price of the 5-year Chinese CDS



Source: Bloomberg

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