

Positive Contributors	FUND	Negative Contributors
<ul style="list-style-type: none"> Countries: Israel, Russian Federation Companies: YPF S.A. 		<ul style="list-style-type: none"> Countries: Mexico, Brazil, Argentina Companies: YPF Energía Eléctrica S.A., Transportadora de Gas del Sur S.A.
Opportunities	MARKET	Challenges
<ul style="list-style-type: none"> Selected corporates in Argentina 		<ul style="list-style-type: none"> Low purchasing managers' indices worldwide, while negative yield environment Weakening of EM currencies vs. US dollar

Update from the lead manager Péter Varga

The massive decline in US yields in August was not enough to allow for a positive performance in EM Corporates. 10-year US yields closed the month at 1.49%, 55 basis points lower than the previous month. The performance of the asset class was slightly negative. Depending on the index, risk premia widened by around 40-50 basis points.

The trade war between the US and China has intensified. President Trump is playing with China like with a pet dog, which is slowly but certainly getting too exhausting for the Chinese. The Chinese have established import duties of about USD 75 billion on US cars and other goods, whereupon the US have imposed a tariff of 5% on Chinese goods worth about USD 550 billion. Meanwhile, the Chinese currency is slowly depreciating in a controlled fashion and the country is initiating further measures to support SMEs (reference rate for corporate loans). China is preparing for a continuation of the difficulties with the US. Trump is prompting US companies to leave China as a location. This is anything but positive for the global economy, as confirmed by the low purchasing managers' indices worldwide. Recently, the US ISM has also fallen below 50. The new export order component is at the level of 2009. In this environment, in which the FED has already started to cut interest rates (so Trump can keep his tough stance), long-term US and Euroland yields were much sought after. The share of companies and government bonds trading with negative yields has risen to an unprecedented level. Pension funds worldwide are increasingly under water.

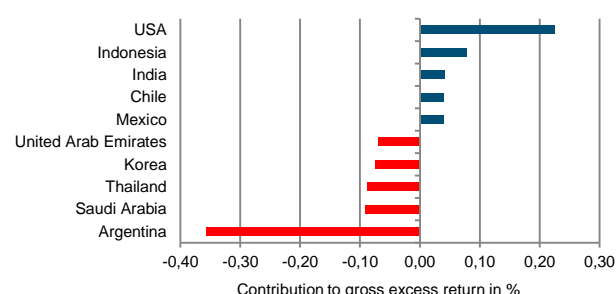
Fears about a weakening of the global economy and about growth in China in particular have also put pressure on commodities. The CEO of BHP (the world's largest mining company) recently warned that commodities have already passed their zenith due to increasingly protectionist tendencies in the world. August was one of the worst months for iron ore (we have already reported on possible market manipulation here). The commodity deteriorated by 25%, copper by more than 6%. Gold, silver, platinum and palladium alone were positive. At the same time, EM currencies weakened against the US dollar. To date, the emerging markets central banks have used the tailwind from the US to lower interest rates. Massive currency weakness could, however, soon put an end to this. This would be fatal for the local economies, which are weak anyway.

Argentina: Politics is a full contact sport, the winner takes it all. The second big topic in August was Argentina. Most of it is well known therefore, at this point only a brief summary. The primary elections in mid-August were won by the left-wing section (of Cristina Fernandez de Kirchner with Alberto Angel Fernandez as the main candidate) well ahead of President Macri. With such a result they would even win the elections that are going to take place in about 50 days on 27 October in the first round.

Gross Performance	Aug 2019	YTD	1Y	3Y	5Y	10Y
ERSTE BOND EMERGING MARKETS CORPORATE						
Fund	-0.44%	7.98%	8.33%	11.09%	21.83%	103.68%
Investment Universe*	0.04%	8.58%	8.79%	9.23%	15.56%	79.74%
Difference	-0.47%	-0.60%	-0.46%	1.86%	6.26%	23.94%
ERSTE BOND EMERGING MARKETS CORPORATE IG						
Fund (USD)	1.90%	11.35%	12.08%	14.18%	21.75%	-
Investment Universe** (USD)	2.02%	11.80%	12.15%	14.82%	21.02%	-
Difference	-0.13%	-0.45%	-0.08%	-0.64%	0.73%	-
ERSTE RESPONSIBLE BOND EMERGING CORPORATE						
Fund	0.14%	7.36%	6.98%	4.81%	13.53%	-
ERSTE BOND EMERGING MARKETS CORPORATE SHORT TERM						
Fund	-0.89%	4.51%	6.28%	-	-	-
Investment Universe***	-0.47%	4.78%	6.98%	-	-	-
Difference	-0.42%	-0.28%	-0.70%	-	-	-

*BoA ML Q505 – Customized EM Corporate Credit Index until 30.06.2019, JP Morgan CEMBI Broad Diversified EUR hedged Index from 1.7.2019
 **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, August 2019

Selected new issues in August

Issuer	Coupon	Maturity	Rating	Region
Cel. Arauco y Constitución SA	5.5	02.11.2047	BBB	Latin America

Erste AM EMERGING MARKETS CORPORATE Strategies (In mn EUR)	
Pooled Funds	1,001.1
Institutional Mandates	492.54
Total	1,493.65

As of August 2019

To put it mildly, the market was positioned differently. Argentine equities gained 10% in USD terms in the last 3 days before the elections. On Monday, however, they lost up to 30%. Both, the currency and the bond markets reacted similarly. It was virtually impossible to move larger positions until prices fell by about 25-30 price points. The goal of the opposition is relatively clear: to make "tabula rasa" on the backs of investors, actually their own people and thereby to blame President Macri for a debt rescheduling and to blame him for all the problems in the country. In fact, this was successful, because shortly after Fernandez's meeting with the IMF and the subsequent market movement, Macri initiated a delayed payment of short-term debt. Only a few days later, capital controls were introduced (including exporters having to convert foreign exchange into pesos within 5 days) to curb capital flight.

We were overweight in our funds due to good fundamentals in Argentinian corporate bonds. In the beginning, we tried to reduce our positions as much as possible. Later, we switched positions: we sold short-dated bonds or titles, which in our view are well sustained, and instead tried to build positions in "punished" names, but were sometimes a little too early. The new possible government of the Kirchner Party may maintain good relations with China as it did under the administration of Kirchner before Macri. There are reports that the opposition under Fernandez is in daily contact with the Chinese. China will possibly be a reliable partner in case IMF no longer offers help. We have built positions in two titles: YPF LUZ, a generator company owned by YPF (about 75%) and previously by GE (25%). GE's share was taken over by the Chinese Sovereign Wealth Fund. The second title is Stoneway, another generator company that the Nores family from Argentina controls via a Canadian company. The Chinese state-owned power producer China Huadian Engineering announced at the end of July that they would buy approximately 50% of Stoneway and 687MW of its capacity, subject to government approval. (Between 2005 and 2017, China invested 6 times more in energy projects in Latin America as the World Bank). Both issuers have contracts with CAMMESA, the state-owned energy regulator. If the regulator was to set prices for a longer period of time as a result of government measures, the providers would suffer massively. This is our worst case scenario, which Fernandez has already hinted at.

We are maintaining our rather neutral to slightly positive weights in the funds (as far as we are allowed to keep the securities below B-). No matter which government it is going to be in the end, it will have to generate dollars, hence the focus will be on the development of the Vaca Muerta shale gas and oil fields. This is also something that the advisors of Fernandez have hinted at, i.e. the government cannot take completely investor-unfriendly measures. In addition, some companies have already started to buy back their bonds. The situation remains very fragile. Our position can also change due to material positive or negative news.

After the benchmark change in the previous month, our positioning has become somewhat less yield-sensitive compared to the benchmark. Unfortunately, our US government bond purchases were not sufficient to compensate for this. This cost about 20 basis points. In Argentina, we lost 35 basis points.

Chart 1: Trump's tariffs put the Yuan under pressure



Source: Bloomberg

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