ERSTE BOND EM CORPORATE UPDATE 02/2021

FUND

Positive Contributors

- Countries: Argentina, India, China
- Companies: Archer Daniels Midland Co, SSMS Plantation Hldgs PTE LTD, AMS AG

Negative Contributors

- Countries: Hong Kong, Chile, United Arab Emirates
- Companies: Tencent Holdings LTD, US Treasury

MARKET

Opportunities

- Considerations regarding debt cancellation gain wider acceptance
- Positive market sentiment towards EM

Challenges

- Virus mutations and slow vaccine roll out
- Non-targeted investments

Update from the lead manager Péter Varga

As if by magic, a certain calm that was noted in the markets over the last two months fizzled out. Vaccine logistics, viral mutations, fiscal packages and speculative bubbles have created excitement and volatility. The EM Corporates market posted a slightly negative return in January (-0.03% CEMBI Broad Diversified Composite Index, EUR Hedged). This was due to the rise in US yields. There was also spread widening in certain areas and sectors, but at an index level everything neutralised.

Key issues for our market on a global level:

Growth: The optimism with which market participants started into the new year was dampened from several sides. Virus mutations have emerged, and it still must be determined to what extent the existing vaccines can defeat these. Apart from Israel, the US and the UK, the roll-out of vaccines is rather slow. There are various reasons for this, which are being disseminated by the media. In the EM countries, too, vaccine deliveries are lagging far behind schedule (see comparative chart 1 and 2). This has also led to a further delay of the "hurrah scenario" that had already been priced into the market in many cases. The delay is also visible in the analysts' estimates, which now refer the attractiveness of asset prices to 2022 or 2023. In short, although global economic indicators for Q4 or December 2020 were strong, especially in the manufacturing sector, the outlook has dimmed recently.

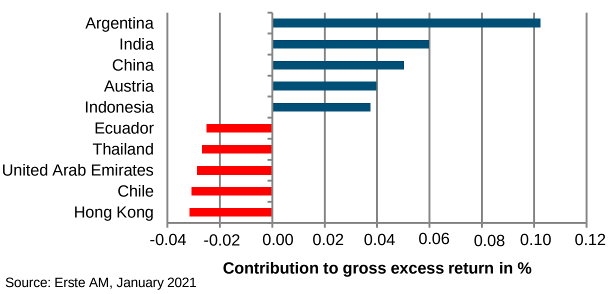
Yields: In the US, Democrats want to get another package through legislature that serves more as a fire extinguisher than as a sustainable growth booster. The package also includes "red rags" such as raising the minimum wage for federal employees, and hence will cause debates and some delays. Nonetheless, market participants are betting on stronger growth and inflation (asset classes perceived as protection against inflation are a consensus trade), which is pushing nominal yields up at a healthy pace (see charts 3 and 4).

Financial stability: The mood in certain market segments resembles the one at a party. Investment banks are reporting massive position closures in hedge funds (short side). The development is triggering a domino effect since this group is "long" in equities as a counterweight (see chart 5), and thus ensures a corresponding dynamic in the unwinding of trades when margin calls spark sales as soon as the equity market falls. Also mentioned in this context should be the massive increase in leveraged long positions (partly through call options), creating additional nervousness. It is partly due to the enormous liquidity in the system (see chart 6), that investment opportunities are sought after. From my point of view, however, it is questionable whether non-targeted broad measures on fiscal and monetary side are really the best strategy to combat the economic consequences of the pandemic…

Gross Performance	January 2021	YTD	1Y	3Y	5Y	10Y
ERSTE BOND EM CORPORATE						
Fund	0.19%	0.19%	9.27%	18.00%	41.38%	85.63%
Benchmark*	-0.03%	-0.03%	4.06%	10.38%	34.86%	56.11%
Difference	0.22%	0.22%	5.20%	7.62%	6.53%	29.53%
ERSTE BOND EM CORPORATE IG						
Fund (USD)	0.06%	0.06%	6.99%	21.36%	34.88%	-
Benchmark**	0.02%	0.02%	5.78%	20.55%	36.80%	-
Difference	0.04%	0.04%	1.21%	0.81%	-1.92%	-
ERSTE RESPONSIBLE BOND EM CORPORATE						
Fund	-0.01%	-0.01%	5.52%	11.24%	22.27%	-
ERSTE BOND EM CORPORATE SHORT TERM						
Fund	0.16%	0.16%	5.85%	16.02%	-	-
Benchmark***	0.35%	0.35%	4.36%	14.83%	-	-
Difference	-0.18%	-0.18%	1.49%	1.20%	-	-

*J.P. Morgan CEMBI Broad Diversified Composite Index Hedged in EUR
**J.P. Morgan CEMBI Broad Diversified IG in USD
***J.P. Morgan CEMBI Broad Diversified. Maturity 1-3 years Index

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



Source: Erste AM, January 2021

Selected new issues in January

Issuer	Coupon	Maturity	Rating	Region
Scovcombank	3.4	26.01.2025	BB+	Eastern Europe
Banque Ouest Africaine	2.75	22.01.2033	BBB	Africa
Mercadolibre Inc.	3.125	14.01.2031	BB+	South America
Simpar Europe SA	5.2	26.01.2031	BB-	South America
Amaggi Lux Intl Sarl	5.25	28.01.2028	BB-	South America
Turkiye Sinai Kalkinma B	5.875	14.01.2026	B	Asia

Erste AM EM CORPORATE Strategies (in mn EUR)	
Pooled Funds	1,313.14
Institutional Mandates	492.73
Total	1,805.87

As of January 2021

ERSTE Asset Management

Focus: Emerging Markets Macro

China was able to close 2020 with a growth of just under 2.5% (strong profit growth in the industrial sector but a decline in real consumption) - a remarkable achievement! However, there are increasing signs that the country will more intensively implement the prioritisation of some 2021 targets. As reported, the focus thereby will be on higher domestic consumption and less reliance on real estate and exports. In the past month, the first signs of the realisation of this target have emerged: according to reports, banks in several districts (including Hangzhou, Guangzhou, Shenzhen) have made property loans more expensive or have even restricted them (in-line with the central parameters), which has presumably also caused a liquidity shortage in the market with the upcoming New Year holidays in China (chart 7). The tightening of credit at the beginning of the year is (expected) bad news for the highly indebted firms in the real estate sector. It is possible, for example, that China Fortune Land, a medium-sized industrial park developer, could soon go bankrupt. The company has been heavily dependent on financing for new projects. Also, the fact that China's debt (central and local government) has reached 48% of GDP in 2020 (60% is considered a warning in China) will ensure that the country intends to seriously clean up excesses. This is important news for the rest of the world, as China is now the engine of the global economy. Meanwhile, the number of virus cases is steadily increasing, especially in the north of the country, and due to travel and quarantine regulations for the upcoming holidays as well as the above-mentioned measures, the economy will cool down in Q1 2021. Sensitive assets such as iron ore have already fallen over the last days of January.

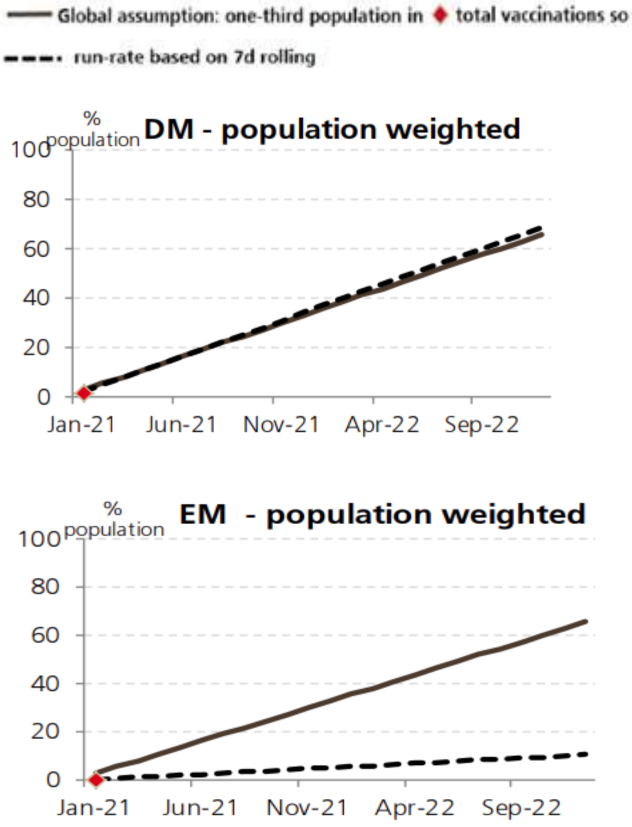
The continuation of virus control will also keep debt issues on the agenda in Africa (as in 2020). Ethiopia announced on 29 January that it will restructure its debt as part of the G-20 agreements and Kenya also laments possible financing problems.

Side note: It seems that the very same debt issue “solution”, on which we reported in November, is now slowly gaining wider acceptance - Bluebay's CIO was recently quoted in the Financial Times as saying, "**it's time to think about debt cancellation**".

Selective, relevant corporate news: Companies are now slowly starting to report on the past quarter. So far, the figures have been positive, such as from copper producer Southern Copper (underweight in the fund) or from Mexican bank Banco Inbursa (overweight). We also expect good numbers from other cyclical sectors; the strong rise in commodities will ensure this. The call from our SRI analysts with Unigel went well. The company convinced with its presentation of sustainability measures and targets and so it was cleared for our ESG funds and special funds. The company also went to market in January with a USD 110 million bond issue, bringing its bonds outstanding to USD 500 million. The objectives of the new issue are to finance an ammonia power plant and to restructure short-term debt.

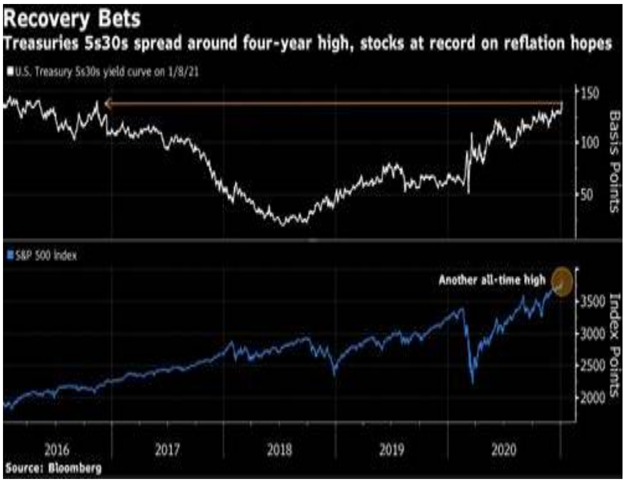
Positioning: Based on growth expectations and yield advantages over developed market bonds, market participants are very positive towards EM - see chart 8.

Graph 1 and 2: Ambitious targets to implement immunisation plans, implementation alone lags far behind in EMs



Source: UBS

Graph 3: Reflation hopes drive US yields higher

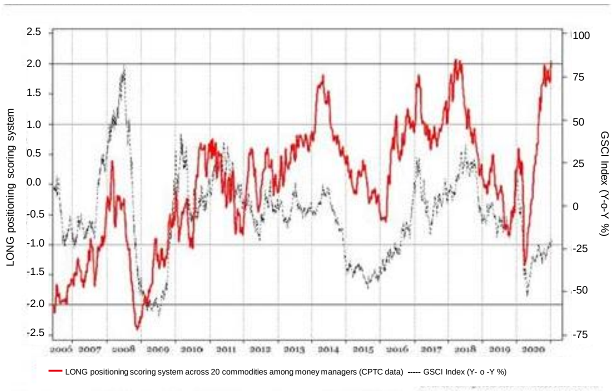


Source: Bloomberg

I can also report large inflows into our EMC funds, which we have invested selectively in new issues (SOVCOMBANK Sustainable-Linked Bond, SIMPAR, BOAD, MERCADO LIBRE and others) and in the secondary market. In the flagship fund, we made profits in convertible and exchangeable bonds, such as with Wilmar, or expanded positioning, as in the Chinese waste incinerator and cement producer Conch Venture and Apple supplier Zhen Ding from Taiwan. We halved the position in Country Garden's convertible bonds by means of a stop loss, in line with the relatively negative outlook for the real estate sector in China (especially in tier 2/3 cities). Despite the difficult environment, we were able to achieve a positive absolute and relative performance in the past month.

Graph 4: Commodity prices also pick up as institutional investors see them as inflation protection

Money managers total LONG positioning across 20 commodities * (standardised) vs. GSCI commodity index (Y-o-Y %)



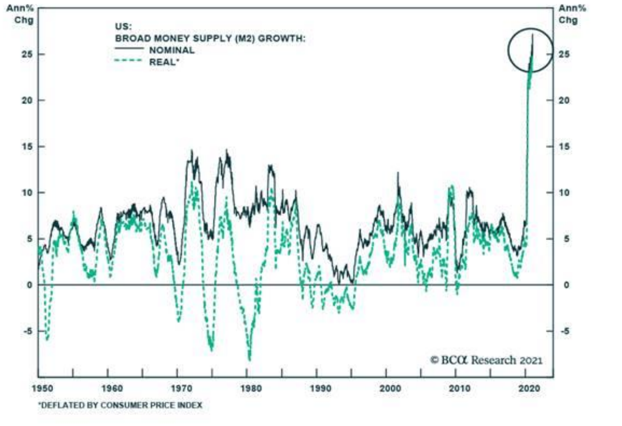
* The 20 commodity futures included in this measure are: Brent, WTI, Gasoline, Natural Gas, Fuel Oil, Ethane, Copper, Wheat, corn, Soybeans, Lean Hogs, Live Cattle, Cocoa, Cotton, Sugar, Coffee, Oats, Milk, Orange Juice, and Cheese.

Source: Longview Economics, Macrobond

Graph 5: The US retail sector is showing record-high call option holdings right now

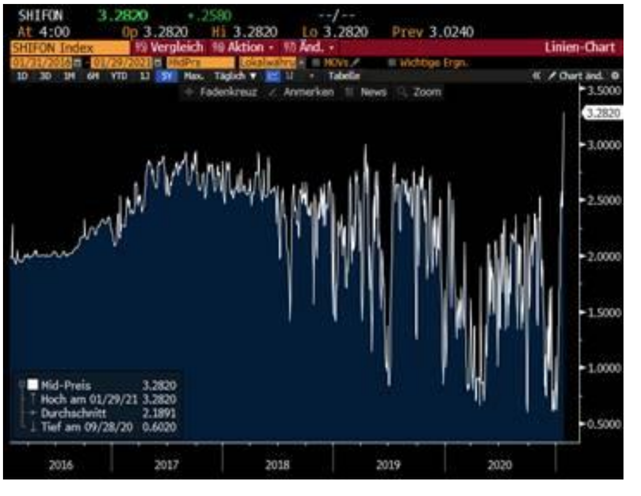
Source: OCC, Deutsche Bank Asset Allocation

Graph 6: The extremely high liquidity in the market further fuels potential excessive risk taking



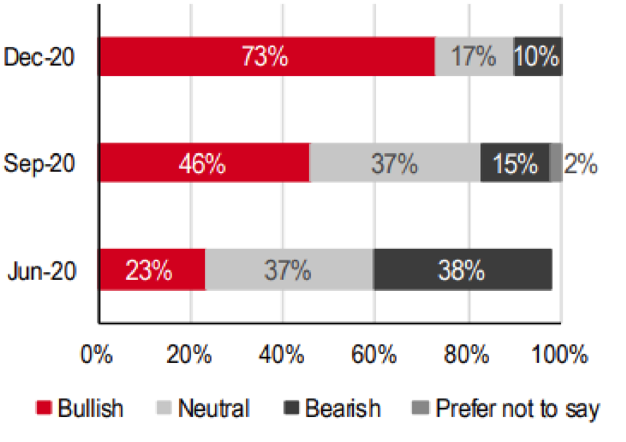
Source: BCα Research 2021

Graph 7: Daily rate for interbank loans shows liquidity shortage



Source: BBG

Graph 8: Survey of market participants show bullish stance on EM for the next three months



Source: HSBC-Survation Emerging Markets Sentiment Survey

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ABOUT US

From a strong Emerging Europe position Erste Asset Management, part of Erste Group, has become a successful global emerging market investment house over the last 10 years.
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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