Flash Notes – Fund Update & Manager comments

April 2020

Vontobel Emerging Markets Debt

Dear Partners,

Please find below a summary of actions taken by Portfolio Managers investing in the **Emerging markets debt**, severely impacted by the liquidity crisis sparked by the development of the pandemic outbreak.

Vontobel Emerging Markets Debt

Market update

- Currently, **flows are driving price action** more than underlying fundamentals. In many cases, we see bonds being re-priced due to forced sellers, resulting in large daily price swings.
- Considerable **discrepancies exist among bid-offer spreads**, making it challenging to buy as well as to sell, depending on the direction of the market, on any given day.
- Dislocation also means that for most bonds there is no market makers around. This means that most official **Bloomberg prices were, and still are not the true prices**. Certain EM Debt **ETF's traded almost 6 to 7% lower than their indicated NAV**. This gives an indication where true prices might have been.

Portfolio valuation impact

- Consequently, Vontobel decided to **apply the Single Swinging Pricing** policy during the last two weeks in order to protect current investors.
- Moreover, they also decided to install **a Pricing Committee** which, together with the PM's, evaluates the true and fair prices of the underlying bonds. By doing so, they act conservatively, as they are pricing bonds lower than in Bloomberg quotes, for instance.

The fund lies behind its benchmark

- Small underweight in duration (0.4 year) started to weigh on relative performance since mid-February.
- Slight overweight in High Yield (52% vs 44%)
- High-yield EM exposure such as Ivory Coast and Angola have proved to be a detractor on performance.
- On the other side, their underweight in mainstream oil countries has proved positive.

Fund outlook

- The most prominent risk for the asset class would be continuous **outflows**. Consequently, the portfolio managers have built up cash reserves (~7%), so as to avoid being forced sellers in current markets. So far, they have not seen any significant outflows (<10%).

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- Their current strategy is; **selling lower credit quality bonds** that have outperformed, and **switching into higher quality, more liquid** names that they also believe will recover faster whenever the market rebounds.
- At times during the past week, the market completely ceased functioning. It will result in **numerous mispricing opportunities to arbitrage** for active and high-conviction managers in the coming period.
- For the Emerging Market Debt fund, the **current yield of the portfolio is above 8% in US dollars**. The contribution to total yield coming from risk-free rates (US Treasury market in this instance) is currently quite compressed. Therefore, spreads are driving most of the yields. The current yield ratio (the relationship between yield contribution coming from risk-free rates and credit spreads respectively) is at historically high levels.

WSP Analyst conclusion

During periods of dislocated markets, the main factors we use to evaluate portfolio managers are the ways they are **managing liquidity**, **protecting current investors** and how they are **benefiting from mispricing effects**. In this regard we are pleased with measures which have been taken in the Vontobel's fund, in particular; the swinging price policy, the conservative pricing policy for protecting remaining investors, and the pro-active cash creation to avoid being forced sellers.

In our view, **it is way too early to evaluate the relative performance of this active fund** versus its competitors, even more versus its benchmark, since the dislocation started. The month-to-date underperformance versus its benchmark (-400bps as of 30.03.2020) is mainly **due to negative technical factors** such as ; the swinging price and the pricing methodology, which are deemed to reverse later. For those same reasons, it is almost impossible to compare Portfolio Managers amongst themselves, as the NAV calculation can differ substantially from one to the other.

Finally, some Portfolio Managers are ready **to give up part of the current performance to opportunistically take advantage from mispricing conditions**, expected to bounce-back later when market environment stabilise. When that will happen, i.e. the extreme liquidity stress will subside, then it will be time to draw some better conclusions about the way the different Portfolio Managers went through this difficult period.