Emerging Markets

Market Review and Outlook

FIXED INCOME | DECEMBER 31, 2024

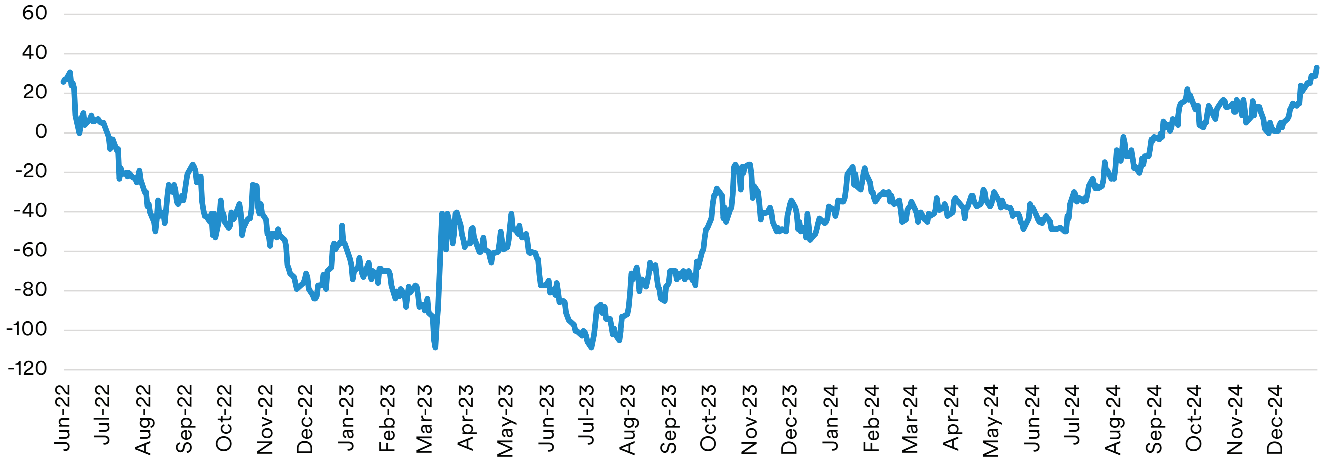
Market Review

While Federal Reserve (Fed) policy continued to impact markets during the fourth quarter (Q4), the US election dominated headlines and drove market sentiment. Despite a close race and expectations of delayed results, Donald Trump was announced as the 47th President of the United States less than 24 hours after voting commenced. As we journeyed into end of year, the markets braced for the uncertainty of a Trump presidency and how quickly policy will change post January 20th.

MetLife Investment Management

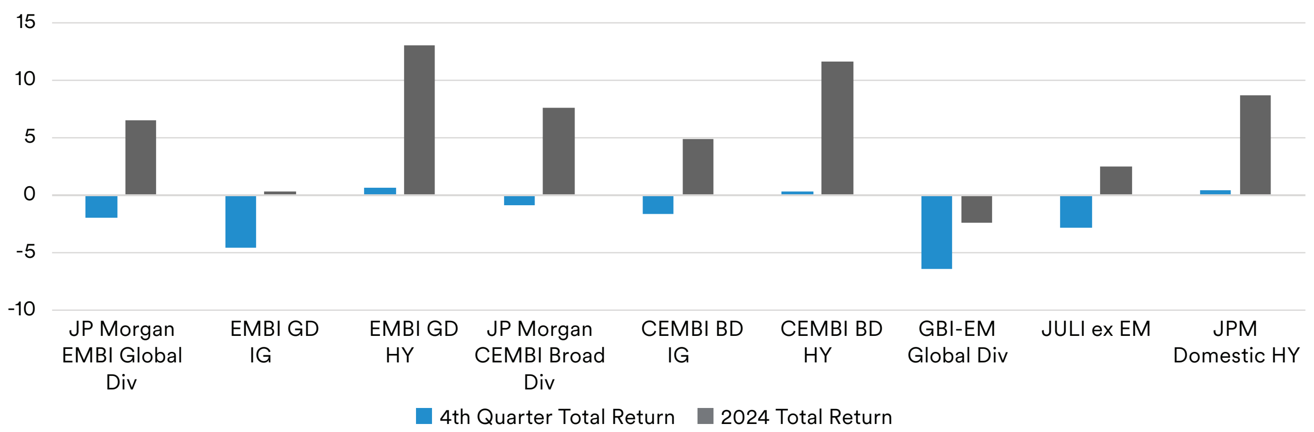
Treasury yields came under pressure during the quarter, with a confluence of stronger than expected economic data and the potential inflationary impact of President-elect Trump's incoming presidency sending the 10-year yield 79 basis points higher. The Fed delivered the expected 25 basis point cut but acknowledged recent economic strength leaving the market less convinced on the path forward. The 10-year treasury ended December at 4.57%, 95 basis points higher than the low for the year of 3.62% in September[1]. As treasury yields rose, they also steepened, pricing in additional risk premium of potential resilient inflation. The 2/10's curve is now the steepest it has been since June 2022. EM credit spreads were resilient but local markets responded negatively with rates selling off and the US dollar strengthening.

Figure 1 | US 2yr vs. 10yr Yields



Sources: Bloomberg LP as of December 31, 2024

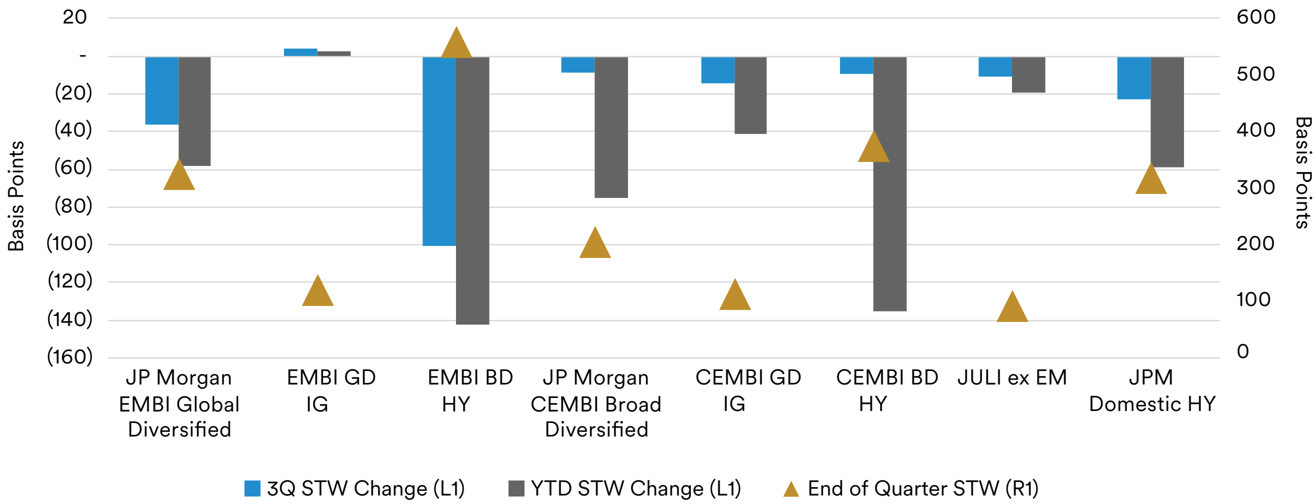
Figure 2 | Indices Total Returns (%)



Source: Bloomberg LP, JP Morgan as of December 31, 2024

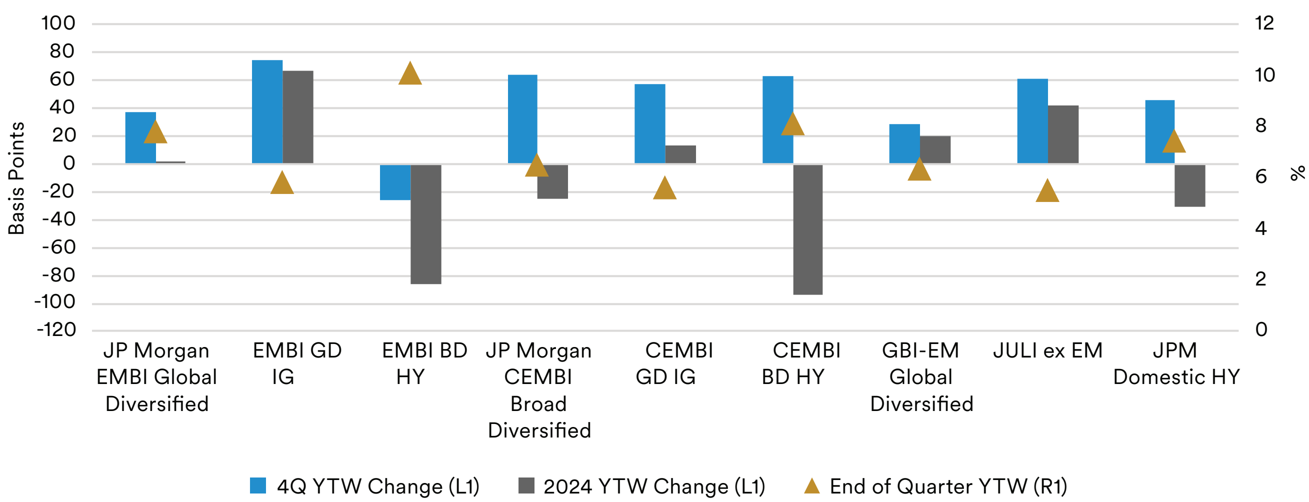
EM assets performed largely in line with Developed Markets (DM) during the quarter. Investment Grade (IG) assets across both EM and DM were heavily impacted by the rate move. On the other hand, risk assets continued to rally, and High Yield (HY) sovereign spreads were able to notably compress. Countries including Pakistan, Argentina, and Ecuador were some of the top performing sovereigns in 2024 as they demonstrated willingness to work with the IMF and took steps in the right direction towards economic reform. Meanwhile, recent corporate credit performance has been under pressure by election uncertainty and rates, causing overall softness in the market. However, corporates had a robust year of performance, supported by sectors including Metals & Mining, Real Estate, and Transportation posting double digit returns[2]. Strong fundamentals and attractive valuations kept crossover investors interested in high yield assets.

Figure 3 | Indices Yield to Worst



Sources: Bloomberg LP, JP Morgan as of December 31, 2024

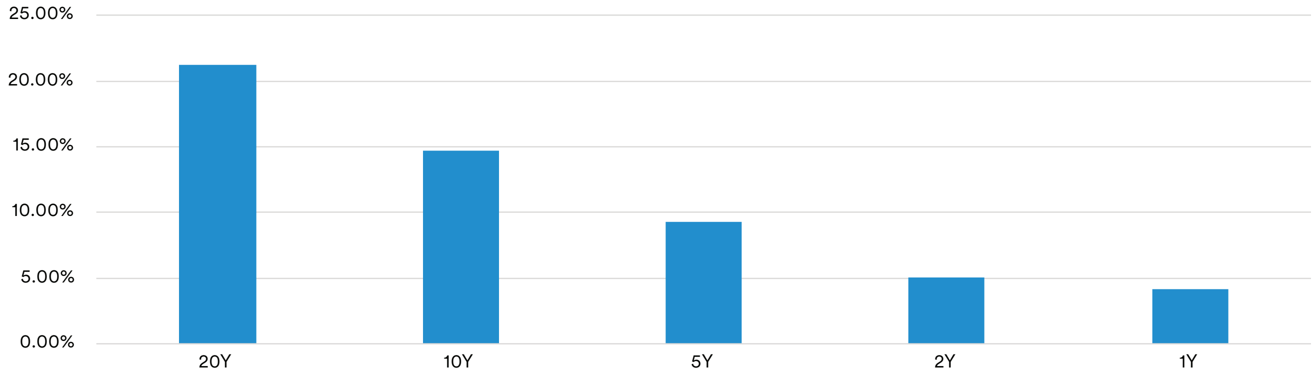
Figure 4 | Indices Spread to Worst



Source: Bloomberg LP as of December 31, 2024

Local markets faced pressure from both a strong dollar and US rates leading global rates markets higher in yield. Given elevated risk premiums across many of the higher yielding sovereigns, central banks are either moving into a tightening mode (i.e. Brazil) or are easing less than originally forecasted (i.e. Mexico, Chile, Colombia, Hungary), therefore making it more expensive to short or be underweight those currencies. At the same time, the looming uncertainty around US led global trade protectionism is weighing heavily on interest rate and foreign exchange risk premiums. Latin America underperformed in Q4, as Brazil FX and rates sold off with local investors growing more concerned around the country's fiscal sustainability into year-end. Further, Mexico local positioning has been under pressure since the country's less favorable election outcome in June, which was further exacerbated by the US election outcome, with tariff concerns surrounding the Trump victory weighing on bond prices.

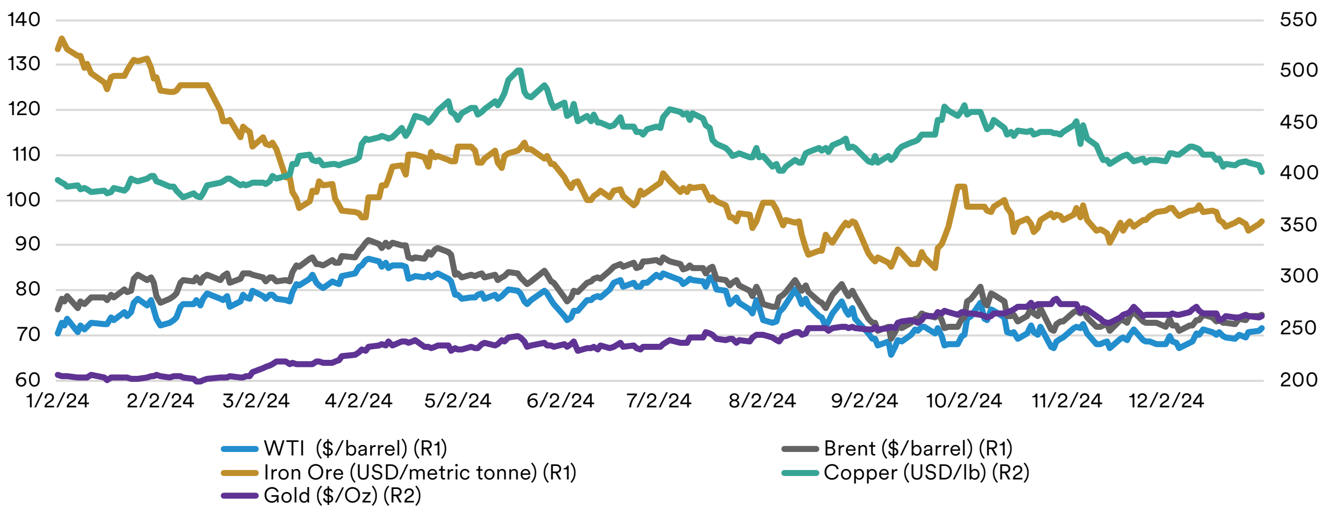
Figure 5 | Current Real Effective Exchange Rate (REER) vs. Average



Source: Bloomberg LP as of December 31, 2024

Energy remained rangebound during the quarter, while metals were softer on the back of a stronger dollar environment. Brent oscillated from $71/barrel - $81/barrel, supported by the resilient economy, further talks of China stimulus, and the ongoing conflict in the Middle East, while simultaneously pressured by potential roll-off of OPEC+ cuts and concerns of the economy cooling[3]. While gold recorded a standout year, other metals including iron ore, lithium, and copper have been under pressure, largely due to China's drawn-out economic slowdown, supply stress, and more recently exacerbated by the resilient dollar as President-elect Trump's administration prepares to take office.

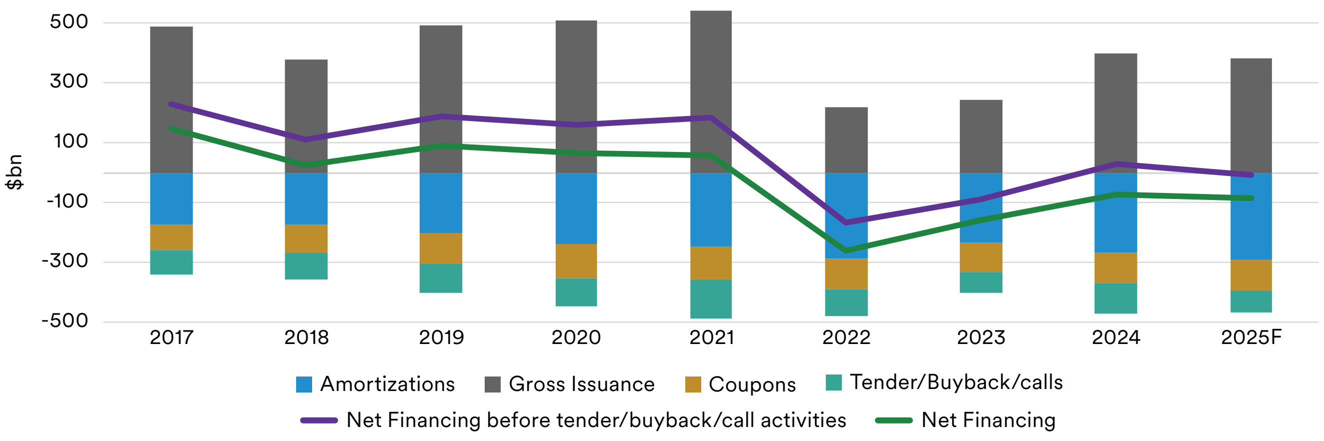
Figure 6 | Commodities



Source: Bloomberg LP as of December 31, 2024

Supply during the quarter was relatively subdued given election worries and interest rate volatility, but the window remained open for issuers that sought to come to the bond market. For full year 2024, the sovereign market witnessed $181.5 billion of new deals, issuance volumes we haven't seen since 2021. While 75% of primary deals came from IG sovereigns, the 25% of high yield issuance highlighted that down in quality issuers were still able to access the market as needed (ie Turkey, Brazil, Colombia). Corporate issuance of $400 billion increased 62% year-over-year (y/y) and was in line with the historical average. The lack of China issuance in 2023 recovered materially in 2024, up 74% y/y but remained below the years of real estate bliss. Ex-China issuance of $338 billion was well above the average of $267 billion but the net financing numbers remained solidly negative (-$73 billion) due to an increase in liability management and a heavy redemption schedule[4].

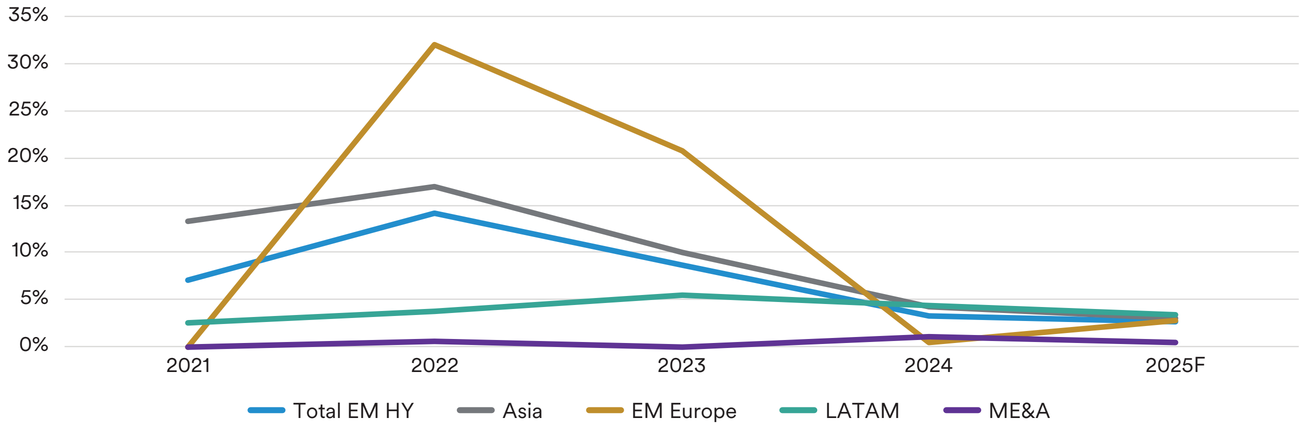
Figure 7 | Cumulative Gross Sovereign Issuance



Source: JP Morgan as of December 31, 2024

EM corporate default rates continued to moderate during 2024 despite some pressure from the China property space. The real estate sector accounted for 46% of full-year default volumes across 10 companies, raising Asia's overall default rate to 4.7%. Latin American companies within Brazil, Mexico, and Argentina led to a regional default rate of 4.6%. Largely suppressed defaults out of Europe, Middle East, and Africa helped pull the overall EM rate down to below the long-term average, ending the year at 3.5%[5].

Figure 8 | EM Corporate Default Rate



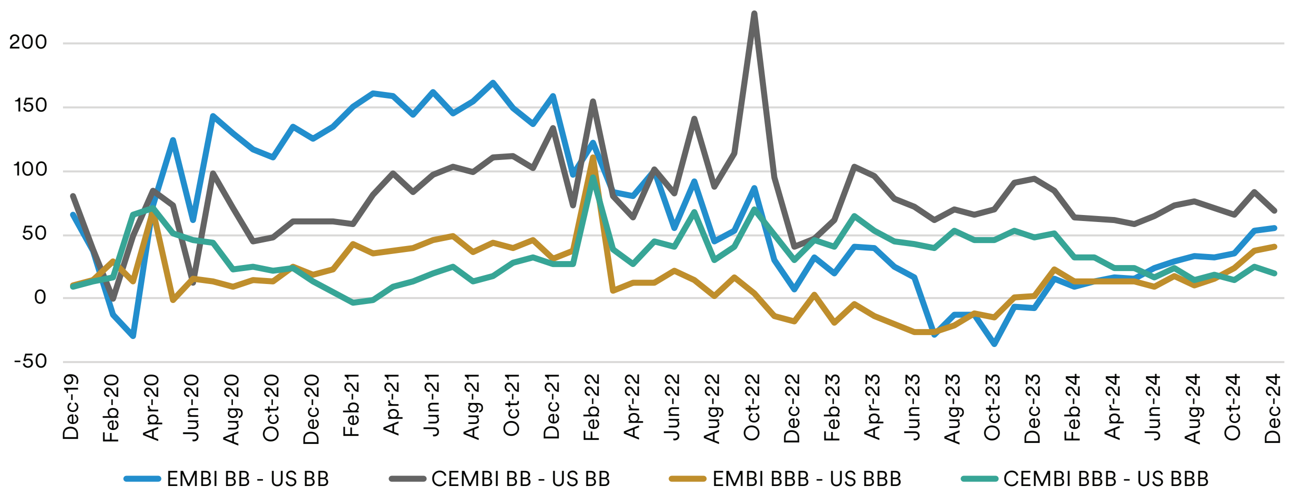
Source: JP Morgan as of January 6, 2025

Outlook

US economic data has been strong but softening from previously elevated levels. The Fed continues to be very data dependent, and the path for interest rate cuts remains delicately intact but unclear at what pace. Given the thoughtfulness of the Fed during this most recent cycle with regards to the path and speed of rate moves, they continue to play the see-saw game of keeping the economy balanced and supported. With the US election now behind us, all eyes are shifting to the upcoming Trump administration's impact on financial markets. Investors are digesting and thus far reacting positively to critical cabinet picks, with the hopes that the appointees will respond more moderately than the rhetoric from the campaign. Focus points will continue to include trade, global conflicts, and international relations. We remain comfortable with Emerging Markets fundamentals and are hopeful that the new US administration will focus on mutually beneficial deals with foreign governments.

Looking back at last time Trump was president, EM was resilient as the administration's focus out of the gates was more domestic focused rather than souring the mood by prioritizing global issues. This time around, it appears he and his trade representative, Jamieson Greer, are much more prepared to quickly implement tariffs. Additionally, we foresee a focus on domestic policies including regulatory roll backs, immigration and deportation issues, and energy as first priorities. Larger tax cuts and broader spending adjustments will take more political capital due to the need for congressional support. We expect flows in dedicated accounts over the near term to remain spotty given Trump uncertainty and impact to US dollar strength. However, with EM valuations screening attractive on a rating basis versus DM, we do expect crossover interest in the space, notably within BBB more liquid sovereigns.

Figure 9 | EM vs DM Yield Advantage (bps)



Source: Bloomberg LP, JP Morgan as of December 31, 2024

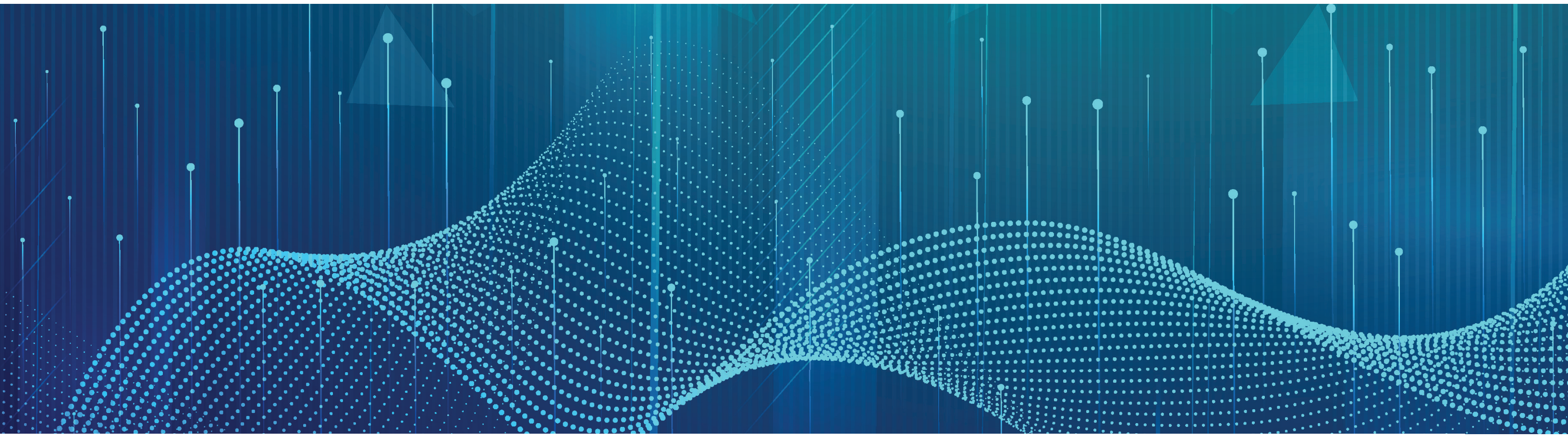
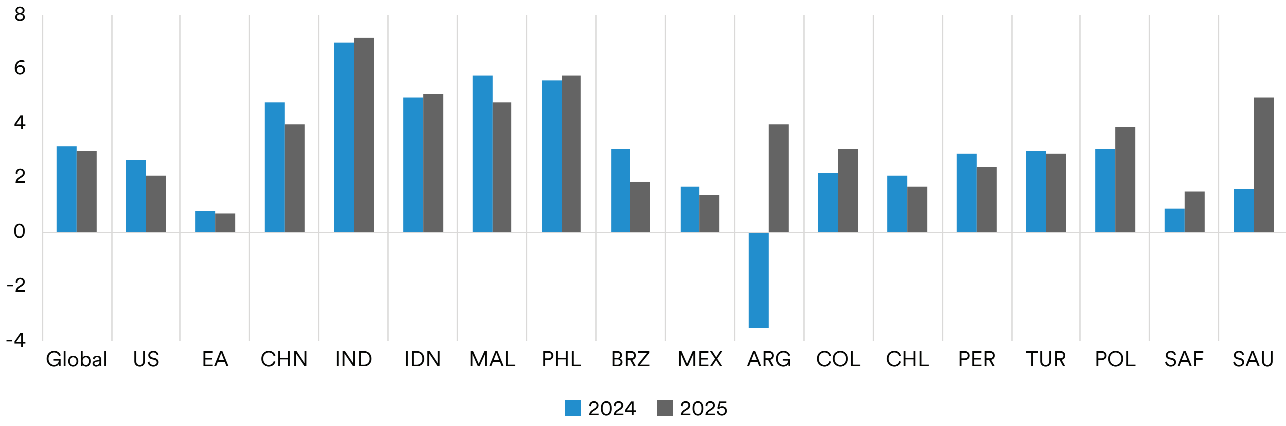


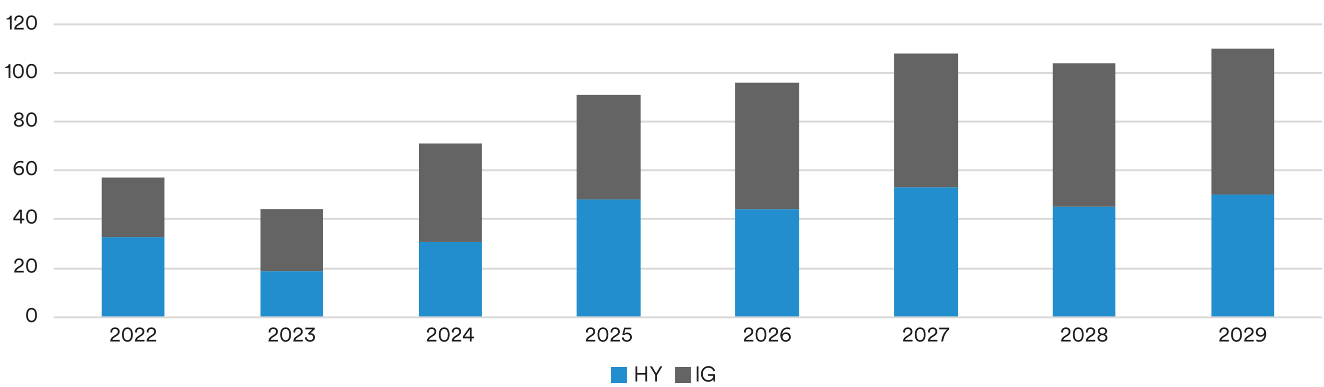
Figure 10 | Real GDP Forecasts (%y/y)



Source: Barclays Resesach as of December 31, 2024

Sovereign issuance tends to be robust at the start of the new year, and we expect more of the same for this year, while elevated rates may sideline some issuers that can be more opportunistic. Year-over-year projections are comparable for sovereign issuance volumes in 2025; however, net issuance is projected to decline as amortizations are expected to rise. Given the upcoming elevated maturity wall over the next 5 years, the number of sovereigns expected to come to market is projected to increase to 25 (versus 20 sovereigns we saw in 2024) as debt servicing needs will increase. Corporate issuance is also expected to remain largely consistent y/y with the assumption of a supportive backdrop for issuers. Further negative net financing and investors' continued demand for yield should keep supply well absorbed.

Figure 11 | Upcoming Sovereign Amortizations ($bn)



Source: JP Morgan as of December 2, 2024

We continue to have a bias towards high yield over investment grade sovereigns based on valuations coupled with risk appetite, but to a lesser degree given their outperformance as of late. We have started to make room for heavy new issuance during the first quarter and are preferring a barbell approach of front-end risk coupled with long-end BBB sovereign exposure where we can pick both spread and liquidity versus Developed Markets. We expect energy prices to see some pressure in 2025, therefore our bias is to shift away from some of the higher cost exporters such as Angola and Nigeria.

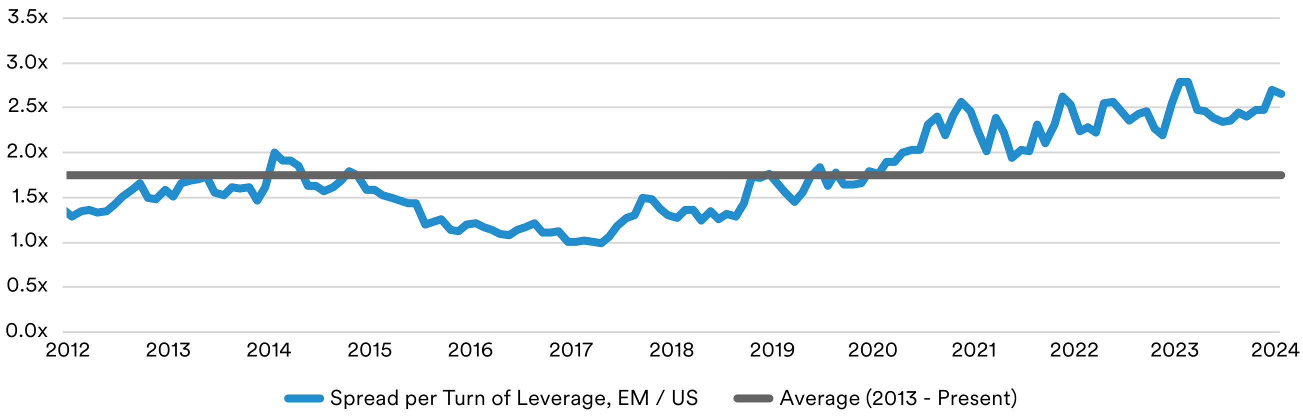
Figure 12: Sovereign Fundamental Trajectories

Total Countries = 81	Total		IG	HY
Debt trend stable or improving 2-3 years	48	59%	50%	64%
Ratings stable or improving 2-3 years	68	84%	69%	91%
Significant downgrade ~18 months*	9	11%	15%	9%

* "Significant" means falling from one rating bucket to the next (ie. BBB to BB)
Source: MIM as of December 31, 2024

We see opportunities in BB and BBB corporates, in sectors that generate hard currency revenues or have effective FX liability management. Even with spread tightening of EM corporates exceeding DM credit in 2024, the spread per turn of leverage remains over double, 37 bps/x for US credits versus 103 bps/x for Global EM[6]. In the utility space, we see value in assets with consistent cashflows that have strong structures, especially within Latin America. Infrastructure projects in the Middle East are enticing, where we can get a pickup of ~75bps over comparable DM credits. Companies that are expected to fare well in a “U.S. First” Trump policy world will be a focus, as will those that are export focused.

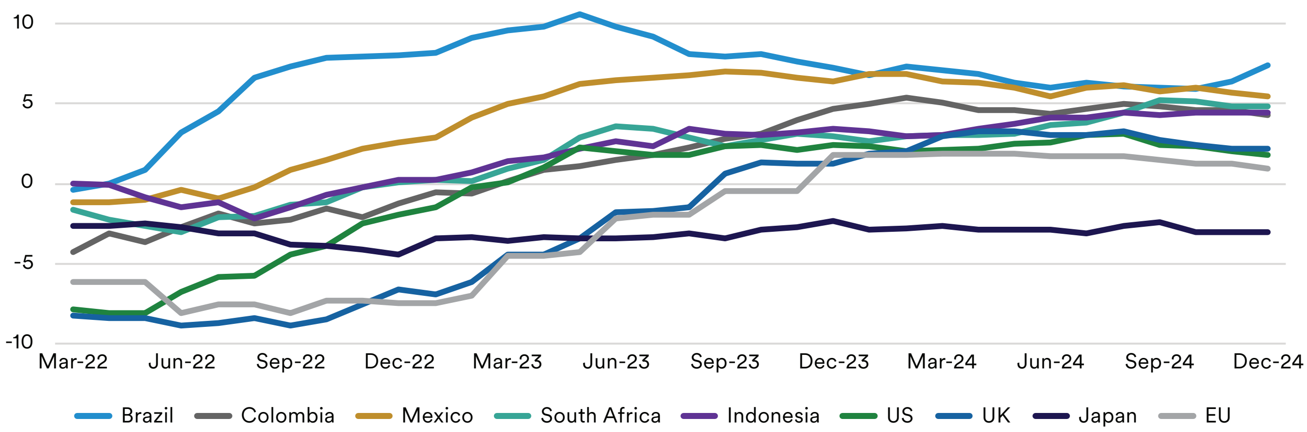
Figure 13 | Spread per Turn of Leverage EM / US for Corporate Credit



Source: BofA Global Research. Fundamental Data as of June 30, 2024. Spreads data as of December 31, 2024.

From a real rate and currency perspective, local currency valuations continue to look attractive relative to hard currency assets. While EM inflation has been steadily receding, in many markets EM bond yields have moved considerably higher, resulting in a widening of real rates versus the US. While the growth and trade backdrop remains challenging in the near term for local, we believe valuations are compelling enough to maintain selective local duration overweights while maintaining underweight positions in FX. We are more cautious on the Asia region, where there is a direct link between anticipated trade policies, expected FX weakness, and a lower cost of carry. While we await more clarity in the coming months, our preference remains within local currency markets which are less US rate sensitive and rather more of a real yield carry play such as Turkey and the Dominican Republic.

Figure 14 | EM & DM Real Rates (%)



Source: Bloomberg LP as of December 31, 2024

Endnotes

1 Bloomberg LP
2 Information in this paragraph sourced from JP Morgan
3 Bloomberg LP
4 Information in this paragraph sourced from JP Morgan
5 Information in this paragraph sourced from JP Morgan
6 BofA Global Research

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