The Case for Local Currency Emerging Markets Debt

November 23, 2020

We expect emerging markets (EM) debt issues in local currency to outperform other fixed-income asset classes in coming quarters, and several factors underpin this positive forecast.

Watch the video or read the recap below.

Investors have two primary options when it comes to investing in EM sovereign debt. They can choose dollar-denominated bonds or those that are issued directly in the local currencies of EM countries.

Local currency sovereign bonds give investors an avenue to diversify their holdings away from the U.S. dollar and also to benefit from potentially stronger economic growth in emerging markets.

Our expectation is for local markets to outperform other fixed-income asset classes in coming quarters. Several factors underpin this positive forecast.

Headwinds fading. First, performance of local currency sovereign bonds in recent years has been hurt by weaker EM effects, but we believe many of the headwinds that have held back emerging market currencies should fade as the U.S. dollar faces additional downward pressure.

Positive macro trends. Second, we have been encouraged by positive macro trends in the most recent EM data. Emerging market GDP is forecast to recover quickly over the next 18 months, while developed markets could still face a flatter and more prolonged recovery curve.

Rates, valuation, and fundamentals. Third, we expect a combination of positive real interest rates, attractive valuations, and stable-to-improving fundamentals to drive capital flows into local markets.

We believe that the combination of these factors make the outlook particularly positive on a relative basis, when comparing emerging markets debt with developed market alternatives.

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