COMMENTARY

Janus Henderson Horizon Emerging Market Corporate Bond Fund

May 2019

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Fund manager names: Steve Drew

Overview

The Corporate Emerging Markets Bond Index (CEMBI) continued its positive path during the month returning 0.5%, while spreads widened 27 basis points (bps), leading to a year-to-date return of 6.5%. The move is mostly justified by a tightening of 38bps in US Treasuries. Emerging market bond supply was stable with $29.8 billion bond issuance in May, mainly coming from Asia.

By the end of the month, outflows from emerging market bond funds continued to slow as flows into hard-currency funds turned positive and investors pulled money out of local-currency funds at a reduced pace (so far this year bond fund inflows, including institutional, now stand at $37.7 billion). Emerging market investment grade underperformed US investment grade by 39bps while emerging market high yield outperformed its US counterpart (-0.3% versus -1.3% respectively), while the benchmark yield is slightly higher than the previous month (5.6% versus 5.3%) with a 7.5% yield in high yield and a 4.2% yield in investment grade.

Performance in emerging markets remains strong, led by the rally in Treasuries. Trade negotiations between US and China are expected to take longer. Also on the trade side, the US announced a potential tariff increase of 5% against Mexico should it not find a solution to immigration flows across the Mexico-US border. The market perceived the Mexican deal to be more likely to get resolved, which happened in the first week of June. However, Mexican parliament will still need to vote the agreement and Trump is keen on lifting the tariff suspension if this is the case. Also, Fitch downgraded Mexican sovereigns to BBB from BBB+ and Moody's changed its outlook to negative from stable (still A3), while Pemex got downgraded to BB+ (high yield status). Mexican assets rallied on the news of a trade deal with the US, and the peso is trading back in the low 19s to the US dollar, while Mexican assets recovered part of the losses from the downgrade. Mexican CEMBI ended the month with a total return of 75bps and spreads widening 22bps.

May was a positive month for the Argentine CEMBI, up 3.4% with spreads tightening 23bps. The positive momentum was supported, among other factors, by a local poll where Macri was expected to win against Fernandez and Cristina in the next elections. That was enough for Argentine assets to rally during the last week of the month, despite weak industrial production and construction activity numbers.

One last note on data releases during the month; US Non-Farm Payrolls printed a weak number that moved 10-year UST up to 2.05% on the lows, while China showed a weak purchasing managers' index (PMI) but strong exports, probably due to orders placed before the tariffs took place. The falling PMIs of China's major trading partners is suggesting further weakness in the global economy and this may weigh on exports gain in China over the remaining seven months of 2019.

Performance and activity

We have been increasing the fund's holdings by further diversifying across the board (especially in the Middle East, Latin America and South Africa), while replacing Treasury duration with defensive investment grade issuers. The fund ended the month slightly long duration, given exposure to Treasury futures, and midweight spread against the benchmark. This led to minor underperformance versus the index and its peers.

By country, the fund continues to be underweight Russia and the Middle East, and slightly underweight Chinese property, while we reduced the exposure to Mexican and Brazilian debt. We continue to look for opportunities in investment grade bonds, defensive sectors and with market duration.

Outlook

Following the broadening of trade tensions, with the unexpected US announcement of potential tariffs on Mexico, and the continuing deterioration of the global growth outlook, markets appear to expect the US Federal Reserve to deliver a pre-emptive 'insurance cut'. A rate cut looks priced in for June with a probability of 15% and it has been increasing rapidly. In such a case, emerging market assets may continue to perform if a hard drop in global growth remains a low-probability event, and crude prices hold at levels that work for oil exporters and importers alike. We believe this narrative should provide some anchor to emerging market flows in the near term, particularly in the hard-currency space.

Source: Janus Henderson Investors, as at 31 May 2019

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For further information on the Luxembourg-domiciled Janus Henderson fund range please contact your local sales office or visit our website: www.janushenderson.com.

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