For professional investors only*

Quarterly Newsletter
Emerging Market Debt

Nordea ASSET MANAGEMENT

Second quarter 2019

Market Review and Outlook[1]

Highlights for EM Debt

- The first quarter of the year marked a rally of EM debt, with Hard Currency outperforming Local rates and EM FX
- Expectations for broadly dovish global central banks, recovering growth in China, and progress on the trade front, are supportive for the perspective on EM assets – being attentive to country-specific developments

Emerging Markets

Over Q1 2019, the moderation – and in some cases reversal – of global economic headwinds has afforded emerging markets additional degrees of freedom to maintain accommodative policy stances. In this context, we now project a slower pace of policy normalization by most Emerging Markets (EM) central banks and, in some cases, additional policy relaxation. At the end of last year, we expected generally higher or steady policy rates through year-end 2019. As the external backdrop turned more favourable, coupled with the general absence of inflationary pressures and the lingering slack in several economies, we revised our forecasts and now pencil in a more gradual policy normalization or stable rates for Latin America and most of EMEA. In Asia, we now anticipate additional policy loosening in many countries (India, Indonesia, Malaysia, Philippines and Thailand). Hungary is a notable exception since concerns over core inflation dynamics and a positive output gap will likely prod authorities to moderately tighten policy.

Beyond the global drivers, the outlook for emerging markets has also been shaped by a broad set of country-specific developments. In Latin America, the new administration of Brazilian President Jair Bolsonaro validated market expectations by submitting to congress a relatively robust pension reform bill, which is expected to be passed by year end. In Mexico, the stalled opening of the energy sector, along with the lack of a clear strategy by the AMLO administration to address the state oil company's structural vulnerabilities without compromising fiscal accounts, has further eroded confidence in the country's investment narrative. Argentina's struggle to consolidate financial stability has continued amidst an inconsistent implementation of the revamped IMF program, with political constraints becoming more binding ahead of October's general election. Ecuador reached an agreement with the IMF to engage in a three-year Extended Fund Facility (EFF) aimed at addressing the challenging funding and balance of payments positions. A vexing political backdrop poses risks to the execution of this program, nonetheless. In Venezuela, the emergence of a parallel government under Juan Guaido – recognized by the United States, the European Union, and a majority of regional peers – amidst heightened sanctions against the regime of Nicolás Maduro, has upped the ante on a potential transition; the ongoing stalemate, however, underscores the uncertainties about the eventual outcome.

Elsewhere, presidential elections in South Africa and Ukraine will be crucial for the future of these two major EMEA countries. In South Africa, very low growth, poor service delivery, frequent black - outs, and corruption scandals have severely dented the ruling ANC party's popularity and put Moody's investment-grade credit rating at risk. President Cyrill Ramaphosa's likely victory may be the last chance for the country to avoid becoming a sub -investment grade credit. Ukraine's elections will determine whether the country's effort to clean -up corruption and pursue economic adjustment will continue along the path prescribed by the IMF program.

What does it mean for EM Debt?

The turn of the year roughly marked the bottom of the EM fixed income selloff. In Q1 2019, the hard currency Global Diversified index outperformed, led by higher risk countries such as Argentina (+6.88%), Ecuador (+15.35%), Venezuela (+30.28%), Iraq (+8.81%), and Angola (+13.49%). Hedged

1) Views from PGIM Fixed Income Emerging Markets Team. PGIM Limited is the investment sub-manager of the Nordea 1 – Emerging Market Bond Fund and Nordea 1 – Emerging Market Bond Opportunities Fund.

local bonds and EM currencies lagged hard currency but had respectable positive returns. In hedged local bonds, the winners included previously unloved Mexico (+6.79%), Philippines (+7.56%), and South Africa (+3.51%). The rally was driven by global macro and emerging market factors. The Fed and ECB's shift to a more accommodative stance was augmented by increased China stimulus, more positive news regarding Argentina's external accounts and IMF program, and optimism that pension reform in Brazil may be passed in Q3.

Emerging Markets Debt Performance

	Q1 Total Return (%)	Q1 Spread/ Yield Change (bps)	OAS (bps)/ Yield (%) as of 31.03.2019
EM Hard Currency	6.95	−64	351 bps
EM Local (hedged)	1.98	−0.29	6.16%
EM FX	1.48	0.74	6.04%
EM Corporates	5.15	−35	336bps

Source: J.P. Morgan as of 29.03.2019. **Past performance is not a guarantee or reliable indicator of results. An investment cannot be made directly in an index.**

Our forecast for EM growth this year is 4.6%, only slightly below last year's 4.7% pace. Importantly, the differential between EM and Developed Markets (DM) growth is working in favour of the former given the slower activity in the US and euro zone. Even with slower growth in China compared to last year, our base case is that it will bounce back in coming quarters. This is key to our view on EM more broadly. The impact of China's stimulus measures taken to date should begin to show up in Q2. In the context of a supportive developed market central bank framework, with the absence of the "tighter" global liquidity that dominated last year, growth in China of between 6.0-6.2% should be supportive of EM assets. Healthy growth in other pockets of EM, including India and Indonesia, and a recovery in Brazil should keep overall EM growth at the 4.6% level. The accommodating DM environment is echoed in EM tame inflationary pressures with a few outliers (e.g. Argentina and Turkey). EM external liquidity, solvency, and balance of payment dynamics are stable compared to 2018. While trade has not driven growth (even with more attractive EMFX), multilateral support and issuers' market access has kept external dynamics in check.

Technicals remained supportive amid elevated investor cash levels after the 2018 selloff, meagre new issue sovereign supply (USD 171 billion vs. USD 148 billion YTD 2018), and robust inflows into hard currency funds of USD 27.4 billion. The strong primary market performance indicated the support. A recent Ghana deal was more than seven times oversubscribed, and a Sri Lanka 10-year offering that priced in early March traded 50 bps tighter. The inflows into local currency funds were a much smaller USD 7.3 billion, which was reflected in the relative performance of local assets.

What we are watching...

Going forward, we remain positive, particularly on EM spreads and local rates. Spreads rallied 70 bps YTD but are still around 100 bps wider than early 2018 levels. IMF programs in Argentina, Ecuador, Pakistan, Ukraine, Ghana, Egypt, and other countries should keep macro policies heading in the right direction while providing a liquidity backstop if needed. Select EM local bond markets, such as Mexico, Russia, Russia, and Indonesia, offer real yields in excess of 4% on a forward basis, compared to nearly zero to negative real yields in the developed world. These EM local markets should be buttressed by declining levels of global inflation. In EM FX, we hold a less directional view. The dovish Fed and low levels of market volatility should be generally positive for EM FX, but this is offset by global growth uncertainty. This keeps us focused on relative value positioning—generally long Latin American and Asian currencies vs. shorts in CEEMEA.

The risks to our generally positive view include weaker than expected global growth, a re-ignition of the US/China trade spat, or geopolitical turbulence associated with Russia, Venezuela, or other countries. The upcoming elections in Ukraine, Turkey, and Argentina could be additional sources of volatility, as could the relatively untested new governments in Mexico and Brazil. But with rates expected to stay low and valuations attractive, we think that returns on EM assets will be solid through the end of the year.

With expectations for broadly dovish global central banks, recovering growth in China, and progress on the trade front, EM assets will likely continue performing well. Notwithstanding the strong performance in EM hard currency assets, valuations in select segments remain attractive. EM rates may also benefit from the broader backdrop, and EM FX could perform once US dollar dominance recedes and EM growth outperformance becomes more apparent. We continue to focus on relative value opportunities in EM FX.

Nordea 1 – Emerging Market Bond Fund

Performance Q1 2019

Nordea 1 – Emerging Market Bond Fund (BP-USD)	7.16%
Nordea 1 – Emerging Market Bond Fund (BI-USD)	7.28%
Benchmark[2]	6.89%

Source: Nordea Investment Funds S.A. Period under consideration: 31.12.2018 – 29.03.2019. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of shares can greatly fluctuate as a result of the sub-fund's investment policy and cannot be ensured, you could lose some or all of your invested money.** 2) JP Morgan EMBI Global Diversified.

Overweights to Venezuela, Ecuador and Ukraine along with an underweight to Poland drove performance. Venezuela outperformed as risk-on assets rallied in conjunction with EM hard currency's strong outperformance. Also, recent political developments indicate President Nicolas Maduro's regime could be coming closer to an end, which boosted the country's assets. Ecuador rallied after the IMF executive board formally approved the country's three-year, USD 4.2 billion extended fund facility with an immediate disbursement of USD 652 million. Overweights to Turkey, Brazil and Argentina along with underweights to Uruguay and Colombia offset some of these gains. Brazilian assets faced pressure as increased friction between President Bolsonaro and some of his allies in Congress threaten to slow or even derail the pension overhaul seen as critical to controlling the fiscal deficit.

Sovereign positioning in Egypt, Hungary, Kazakhstan and Indonesia contributed to performance, while positioning in Argentina, Ecuador and El Salvador detracted from performance. Corporate and Quasi-sovereign positioning in Mexico (PEMEX), Indonesia (IDASAL), Brazil (PETBRA), China (SINOPE) and India (POWFIN) contributed to performance, while positioning in Venezuela (PDVSA), Jamaica (DLLTD) and Argentina (BUENOS) detracted from performance.

The fund's largest hard currency overweights are Argentina, Brazil, and Ukraine, and the largest underweights are Poland, Philippines, and Chile. The biggest changes in the quarter were reducing Bahrain, UAE, and Turkey while adding to China and Ghana.

Nordea 1 – Emerging Market Bond Fund: Top 10 Country Exposure

	Portfolio (%)	Benchmark[3](%)	Difference (%)
Mexico	5.65	4.74	0.91
Argentina	5.28	2.58	2.70
Indonesia	5.14	4.34	0.80
Brazil	4.96	3.08	1.87
Turkey	4.30	3.35	0.94
Ukraine	4.19	2.43	1.75
Ecuador	3.77	2.56	1.21
Russian Fed.	3.73	3.25	0.48
South Africa	3.61	2.60	1.01
Sri Lanka	2.68	2.42	0.26

Source: PGIM Ltd. as of 29.03.2019. Note: Figures based on the model portfolio allocation and can deviate from official fund data. 3) JP Morgan EMBI Global Diversified.

Nordea 1 – Emerging Market Bond Opportunities Fund

Performance Q1 2019	
Nordea 1 – Emerging Market Bond Opportunities Fund (BP- USD)	5.71 %
Nordea 1 – Emerging Market Bond Opportunities Fund (BI- USD)	5.85 %
Benchmark[4]	4.98 %

Source: Nordea Investment Funds S.A. Period under consideration: 31.12.2018 – 29.03.2019. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of shares can greatly fluctuate as a result of the sub-fund's investment policy and cannot be ensured, you could lose some or all of your invested money.** 4) 50 % JP Morgan EMBI Global Diversified and 50 % JP Morgan GBI-EM Global Diversified.

In hard currency, overweights to Ecuador, Ukraine, Argentina, Nigeria and Angola drove performance. Muhammadu Buhari's re-election in Nigeria's presidential race drove outperformance. Buhari promises to revive the Nigerian economy and tackle security threats. An overweight to Turkey along with underweights to Chile, Uruguay, Philippines and Peru offset some of these gains. Regarding local rates, underweights to Russia, Czech Republic, Thailand, Romania and Argentina contributed to performance. Overweights to Indonesia, Malaysia and Brazil detracted from performance.

Sovereign positioning in Indonesia, Kazakhstan and Colombia added to performance, while positioning in Pakistan, Ecuador and El Salvador detracted. Corporate and quasi-sovereign positioning in Mexico (PEMEX), Brazil (PETBRA), China (SINOPE) and India (POWFIN) added to performance, while positioning in Venezuela (PDVSA), Argentina (BUENOS) and Jamaica (DLLTD) detracted. Local rates positioning in Mexico, Brazil, Hungary, Thailand and Colombia added to performance, while positioning in Turkey detracted from performance.

Exposure to the Indian rupee along with exposure to the Hungarian forint contributed to performance. Exposure to the Argentine peso and Turkish lira along with exposure to the South African rand detracted from performance.

The fund's largest hard currency over/underweights and changes throughout the quarter were similar to the ones mentioned for the Nordea 1 – Emerging Market Bond Fund (see earlier). In local rates, the fund added to Chile and Mexico while reducing Poland. In FX, the fund added to the Czech koruna and South African rand, and reduced Thai baht and Colombian peso.

Nordea 1 – Emerging Market Bond Opportunities Fund: Top 10 Country Exposure

	Portfolio (%)	Benchmark[5](%)	Difference (%)
Indonesia	9.25	7.16	2.08
Mexico	8.48	7.36	1.12
Brazil	8.06	6.54	1.53
South Africa	6.26	5.54	0.71
Colombia	4.23	5.24	-1.01
Turkey	4.11	3.62	0.49
Poland	4.02	5.53	-1.51
Malaysia	3.90	4.17	-0.27
Argentina	3.32	1.53	1.79
Thailand	3.10	4.26	-1.16

Source: PGIM Ltd. as of 29.03.2019. Note: Figures based on the model portfolio allocation and can deviate from official fund data. 5) 50 % JP Morgan EMBI Global Diversified and 50 % JP Morgan GBI-EM Global Diversified.