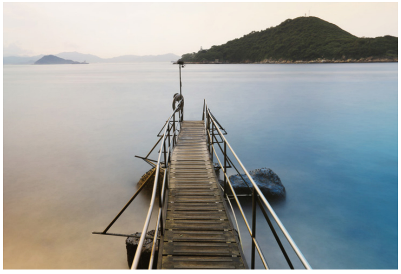
For professional investors only*

Quarterly Newsletter
Emerging Market Debt

Nordea
ASSET MANAGEMENT



Third quarter 2019

Market Review and Outlook[1]

Highlights for EM Debt

- EM debt posted positive returns in Q2: benefiting from investors' search for yield amid expectations for Fed rate cuts and below-trend growth in most developed markets
- The recent stagnation in global trade, the dovish effort by major central banks and China's expected stimulus lie at the core of current macroeconomics factors

Emerging Markets

Economic activity in the major emerging market economies has continued the decelerating trend that took hold late last year. Notably, Q1 saw the largest number of Emerging Markets (EM) with negative growth (on a quarter-to-quarter basis) since the global financial crisis, and the available data show little evidence of a broad-based rebound in Q2. One common factor behind this soft performance has been the recent stagnation in global trade.

Idiosyncratic country factors also have restrained growth. In South Africa, for example, the newly elected parliament and president have not yet taken decisive policy actions to stimulate growth after years of poor economic management and rampant corruption. The new government has promised such actions, but it will be a long journey. In Brazil, persistent uncertainties have amplified the economy's structural growth shortcomings to render a rather lackluster recovery; indeed, growth is now poised to come in near 1% for the third consecutive year. The Argentine economy remains mired in recession as the implementation of the IMF-backed adjustment program continues to correct macroeconomic imbalances. But an expected recovery through the second half of 2019 should improve the backdrop for the upcoming general elections. Heightened uncertainty in Mexico over the direction of economic policy under the AMLO administration has become a headwind to an already soft growth outlook. This factor partly justified the downward revision of Mexico's credit rating and outlook by Fitch and Moody's, respectively. The risk that trade tensions with the U.S. resurface over immigration adds to the challenges.

Going forward, the efforts by major central banks to provide stimulus and China's expected stimulus should provide some support for economic activity among the EMs. In addition, the authorities in these countries will likely implement growth-supporting measures. In Russia, macroeconomic stability is well entrenched, and the central bank has embarked on an easing path in conjunction with an ambitious infrastructure investment program. Also, the threat of sanctions seems to be receding. In Latin America, the central banks of Brazil and the Andean region may inject additional monetary stimulus. In Asia, further monetary easing is projected across the board with fiscal stimulus also accompanying the effort in India. Further, the generally market-friendly outcome of elections in India, Indonesia, and the Philippines should help reduce the political uncertainties that these countries have faced.

What does it mean for EM Debt?

Each emerging market debt sub-sector posted positive returns in Q2 (while not shown below, unhedged local bonds outperformed with a Q2 total return of +5.64%). The sector continued to benefit from investors' search for yield amid expectations for Fed rate cuts and ongoing, below-trend growth in most developed markets. The prospects for a global recession in the near to medium term also remain faint given the relatively healthy growth in the U.S. and expectations for additional stimulus from China. The prospect for avoiding a full-blown U.S./China trade war is key for EM as further slowing in global trade and EM growth would pose a headwind regardless of policy accommodation from DM central banks.

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.

*investing for their own account - according to MiFID definition

Emerging Markets Debt Performance

	Total Return (%)		Spread (bps)/ Yield Change (%)		OAS (bps)/ Yield %
	Q2	YTD	Q2	YTD	30.06.19
EM Hard Currency	4.08	11.31	−5 ps	−69 bps	346 bps
EM Local (hedged)	3.22	5.26	−0.48 %	−0.77 %	5.69 %
EMFX	2.07	3.57	−0.96 %	−0.22 %	5.08 %
EM Corporates	3.50	8.83	−3 bps	−38 bps	333 bps

Source: J.P. Morgan as of June 30, 2019. **Past performance is not a guarantee or reliable indicator of results. An investment cannot be made directly in an index.**

EM Hard Currency Sovereigns: In EM sovereigns, the performance by country reflected the UST rally and idiosyncratic developments. Some higher rated, more UST sensitive names outperformed, including Qatar, Russia and Romania, all returning over 6 % and tightening between 20-30 bps. The other outperformers were those with positive developments, including Ukraine (+10.2 %), Mozambique (+17.1 %), and Tunisia (+8.6 %). The underperformers reflected political risk and uncertainty, including Venezuela (−33.2 %) and Zambia (−5 %). Looking forward, there may be opportunities for the underperformers to post attractive returns later in the year. In the case of Argentina, a victory by incumbent President Macri would lead to a marked repricing as its bonds are trading with a default probability of over 50 %. Turkey, downgraded to B1 by Moody's on June 14, remains mired in economic and policy uncertainty, but the recent victory of an opposition candidate in Istanbul prompted a rally and more upside is likely. While South Africa was able to stave off a Moody's downgrade to high yield in Q2, remaining challenges to President Ramaphosa's generally orthodox stance amid a weak economy could pressure its last IG rating.

Local Rates: While the global backdrop for EM local rates remains constructive on the back of slowing inflation, below-trend global growth, and generally positive real rates, the recent rally in EM rates seems over extended as interest-rate cuts in many countries are now priced in, and the 5.69 % yield on the GBI-EM benchmark is at a five-year low. Furthermore, almost every country experienced curve flattening as the global data surprised on the downside, central banks turned dovish, and yield-hungry investors added duration. That said, there are countries where rate cuts are not priced in, but may still materialize.

FX: The case for EMFX remains uncertain even after the U.S. dollar returned −1.19 % vs. G10 and −2.07 % vs. EM in Q2. Going into Q3, the trade uncertainty is not particularly supportive of FX. On the other hand, the Fed appears likely to cut rates, and if it reverses the slide in inflation breakevens, this will be a net positive for FX as will potential infrastructure and property stimulus out of China.

What we are watching...

In terms of positioning, we continue to favor spreads, particularly select, lower-rated sovereign issuers with proven market access and/or IMF support, including Ecuador, Ukraine, and issuers in sub-Saharan Africa. We remain overweight to Argentina on the expectation that a favorable election outcome will significantly reduce default probabilities. We also find select quasi-sovereigns attractive. We continue to see value in Pemex at current levels of +300 bps (and potentially more) wide to the sovereign as Mexico views Pemex as inextricably linked and will follow with measures to support it more explicitly. The continued inclusion of the Gulf Cooperation Council countries in the index provides opportunities in those IG names. Other higher-quality exposures include Indonesia considering its domestically-oriented economy and Russia given its very strong credit fundamentals. In EM corporates, we like the Brazilian protein sector amid swine flu epidemics elsewhere, select higher-rated China property issuers with access to onshore debt market liquidity, and Indian quasi-sovereigns given the government's strong mandate. EM corporate fundamentals remain solid and while new issue supply has picked up recently, it is still running below last year's levels.

In EM rates, our active overweight duration positioning is in countries where we expect easing central bank policies (China, Mexico, Indonesia, and Russia) in the second half of 2019. Regionally, our largest exposure is in Asia (China, Indonesia, Thailand, and Philippines), and our second largest exposure is in Mexico. Except for Mexico, we are close to neutral duration in Latin America. In CEEMEA, our active overweight is in Russia and Poland with underweights in Hungary and Romania. Our active FX positioning is net short the U.S. dollar with a focus on relative value in EMFX. We reduced our net long in the dollar from a high point in May. Our major overweights are in Russia, Mexico, India, and Egypt – currencies with high real yields, manageable external accounts, and attractive valuations in the case of Mexico and Egypt. Major underweights include Chile, Brazil, Hungary, and China – currencies exposed to global trade slowdown (Chile and China), easing central banks (Chile, Brazil, and China), weak growth (Brazil), and/or unattractive real yields where the central bank is politically influenced (Hungary).

We hold a conditionally constructive outlook for spreads, select local bonds, and EMFX – assuming a reasonable outcome to trade negotiations and clearer evidence of growth in China. With the caveat that a supportive backdrop could fail to materialize, there is scope for attractive spread tightening in investment grade and high yield countries and corporates. The outlook for EMFX and rates is less clear, but attractive relative value opportunities remain.

Nordea 1 – Emerging Market Bond Fund

Performance Q2 2019	
Nordea 1 – Emerging Market Bond Fund (BP-USD)	4.12%
Nordea 1 – Emerging Market Bond Fund (BI-USD)	4.25%
Benchmark[2]	4.08%

Source: Nordea Investment Funds S.A. Period under consideration: 31.12.2018 – 30.06.2019. **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 and Argentina along with underweights to Kazakhstan, Philippines and Panama drove negative performance. Argentina underperformed following higher than expected inflation and uncertainty surrounding the upcoming presidential election. Pressure on the currency caused CDS to widen, which pressured front-end short maturity bonds. Philippines outperformed after the country's central bank cut its benchmark interest rate by 25 bps. Overweights to Ukraine, Brazil and South Africa along with underweights to Poland and China offset some of these losses.

Sovereign positioning in Oman detracted from performance, while positioning in Venezuela contributed. Corporate and Quasi-sovereign positioning in Venezuela (PDVSA) and Mexico (PEMEX) detracted from performance while positioning in South Africa (ESKOM) contributed.

The fund's hard currency overweights are Argentina, Ukraine, and Brazil and the largest underweights are Philippines, Poland, and Chile. The biggest changes over the quarter were adding to Sri Lanka and Ukraine, and reducing the UAE, Qatar, and Saudi Arabia.

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 Federation	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 June 30, 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 Q2 2019	
Nordea 1 – Emerging Market Bond Opportunities Fund (BP-USD)	4.55%
Nordea 1 – Emerging Market Bond Opportunities Fund (BI-USD)	4.67%
Benchmark[4]	4.86%

Source: Nordea Investment Funds S.A. Period under consideration: 31.12.2018 – 30.06.2019. **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 Ukraine, Brazil, Indonesia, South Africa and Turkey drove performance. Turkey outperformed after the Turkish opposition candidate secured a landslide victory in a rerun of mayoral elections in Istanbul, ending months of uncertainty that weighed on Turkish assets. Overweights to Argentina, Sri Lanka and Zambia along with underweights to Philippines and Kazakhstan offset some of these gains. Zambian assets were hit by a slew of negative headlines; Zambia's debt was downgraded to Caa2 with a negative outlook by Moody's, they started electricity-supply restrictions after one of the worst droughts on record and filed notification of plans to take over Vedanta Resource Ltd.s' domestic copper assets.

Looking at hedged local rates, underweights to Argentina, Poland, Romania, Hungary and Czech Republic contributed to performance. Underweights to Turkey and Russia detracted from performance.

Sovereign positioning in Romania and Venezuela added to performance, while positioning in Mexico detracted from performance. Corporate and quasi-sovereign positioning in South Africa (ESKOM) and Brazil (PETBRA) added to performance, while positioning in Mexico (PEMEX) detracted from performance. Local rates positioning in Mexico, Turkey, Brazil, Thailand and Colombia added to performance, while positioning in South Africa detracted from performance.

Emerging market currencies were stronger during the quarter, posting a total return of +3.22% measured by the JP Morgan ELMI+ Index. Exposure to the Argentine peso along with exposure to the Colombian peso and Chilean peso contributed to performance. Exposure to the China renminbi along with exposure to the Brazilian real and Turkish lira 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 Thailand and Indonesia, while reducing Poland and Brazil. In FX, the fund added to INR and THB, and reduced BRL and TWD.

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

	Portfolio (%)	Benchmark[5] (%)	Difference (%)
Indonesia	5.44	4.21	1.23
Mexico	5.03	4.51	0.52
Argentina	5.02	2.39	2.62
Ukraine	4.65	2.45	2.20
Brazil	4.64	3.01	1.63
Turkey	4.33	3.22	1.11
Ecuador	3.85	2.49	1.36
Russian Federation	3.84	3.19	0.65
South Africa	3.33	2.54	0.79
Sri Lanka	2.92	2.19	0.73

Source: PGIM Ltd. as of June 30, 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.