aegon asset management

Commentary
First Quarter 2025

Emerging Markets Debt Global Diversified

Market review

The first quarter of 2025 presented a mixed bag for emerging market debt (EMD), characterized by early resilience in the face of political and economic uncertainty, which eventually gave way to pronounced market volatility by March. The quarter began on a relatively positive note despite the aftermath of President Trump's re-inauguration and the Federal Reserve's shift in policy expectations. The market responded with relief to the absence of immediate, broad-based tariffs, instead interpreting them as potential negotiating tools. High yield sovereigns saw favorable performance, particularly from countries like Venezuela, which navigated significant diplomatic successes, including the repatriation of Venezuelan migrants from the U.S. and the release of six American prisoners. Lebanon also made strides with the election of Army Chief Joseph Aoun as President, which was received positively by market participants. President Trump expressed optimism about ending the Ukraine conflict, with his administration poised to unveil a detailed plan early in the year.

Into February, EMD maintained its resilience despite the evolving trade rhetoric and a seeming pause in Federal Reserve rate cuts. Investment grade credit moved in line with duration, while high yield performance was driven by country-specific dynamics. J.P. Morgan announced the reclassification of Kuwait and Qatar as developed markets, which is expected to incrementally widen index spreads. Ecuador grappled with political uncertainty, with opposition leader Gonzalez significantly outperforming in the first round of elections, contributing to a significant drop in the country's bonds. Developments in Venezuela continued to be mixed; while the nation benefitted from earlier diplomatic wins, the reversal of Chevron's operating license by the US brought new economic concerns.

March, however, brought heightened volatility as the US administration's inconsistent tariff policy introduced a significant degree of uncertainty. Although initial negotiations hinted at a delayed enactment of tariffs on Mexico and China, ongoing indecisiveness unsettled markets. Equity markets reacted adversely with the S&P 500 and NASDAQ suffering notable declines, marking negative returns for the year. The Federal Reserve's March meeting reaffirmed its stance on policy rates, indicating potential rate cuts later in the year and labeling tariff-induced inflation as transitory. Despite this, market anxiety persisted, causing US Treasurys to rally.

EMD was not insulated from this turmoil with spreads widening significantly, particularly within lower-rated credits. High yield sovereigns widened by 33 basis points (bps) and corporates widened by 20 bps, with substantial movement concentrated in single B-rated credits and lower. Overall, the first quarter of 2025 for EMD began with optimism around

Highlights

- The first quarter started with optimism driven by potential diplomatic wins and the markets' initial resilience despite political and economic uncertainties; however, March brought heightened volatility causing notable widening of spreads, especially among lower-rated credits.
- The strategy outperformed the benchmark, gross and net of fees, over the quarter.
- The strategy started the year strong, with security selection and country selection contributing to performance.
- Overall, the strategy's more conservative positioning was beneficial.
- We maintain a cautious approach, staying attuned to political developments and central bank policies to navigate this challenging market environment.

potential diplomatic wins and resilience in the face of changing US trade policy. However, as March progressed, inconsistent tariff policies and global economic uncertainties resulted in market volatility and widening spreads, particularly in lower-rated credits.

Performance review

During the quarter, the Emerging Markets Debt Global Diversified strategy outperformed the JP Morgan EMBI Global Diversified Index, gross and net of fees. The strategy's outperformance during the quarter was partly driven by the modest overweight to interest rate (duration) risk. US Treasury yields declined modestly during the quarter, with the 10-year yield dropping by 32 bps, partly due to the Trump administration's erratic economic policy and its potential impact on economic activity.

An overweight position to two corporates in Hong Kong that were opportunistically added to the portfolio contributed to returns. The overweight to Panama also contributed as the country's bonds were favored after the country approved a pension reform and announced that it intends to engage in renewed negotiations with First Quantum over the shuttered copper mine. Lastly, the overweight to Ethiopia contributed as bonds performed on indications of compromise between the country's government creditors, led by China, and bondholders in debt restructuring negotiations.

Among the detractors, the strategy's small overweight to Ukraine detracted as the market expectations on an imminent cease fire with Russia evaporated. The strategy's underweight to Venezuela's defaulted bonds also detracted as the bonds were a top performer, likely due to optimism that the Trump administration might be able to bring the Maduro regime to the negotiating table. Lastly, a small position in a Chinese defaulted property developer detracted as the industry continues to be under pressure.

Market Outlook

The recent volatility in EMD subsequent to the new US administration taking office is likely to be a feature of 2025 as officials target global trade balances and conflict resolution in Ukraine and the Middle East. The inconsistent approach to tariff policy, particularly regarding China and Mexico, and the resulting market anxiety, emphasizes the ongoing uncertainty. However, total returns are expected to be somewhat supported by the high yield starting point, along with constructive developments at the country level.

Attention within the asset class remains drawn to the anticipated scrutiny of US trade relations with China, Mexico and Europe. The month of March showcased the market's sensitivity to tariff negotiations, indicating that such dispersion could also create relative outperformers – namely countries with low exposure to US trade or potential beneficiaries from increased focus on bilateral agreements. Conflict resolution, specifically in Ukraine, remains on the agenda and may influence market sentiment positively if substantial progress is made.

Broader macro permutations are likely to involve moderating global (ex-US) growth, rising tariffs and increasing EM risk premia. Speculation persists that Chinese policymakers may introduce stimulus measures to mitigate the growth drag from any trade restrictions. However, the short-term outlook for EM also contends with the acknowledgment by the Federal Reserve that inflation driven by tariffs is likely to be transitory, suggesting a potential willingness to ease policy as needed. This may have a stabilizing effect on EM currencies and could support more favorable growth policies.

Additionally, it is critical to recognize that the capacity for EM to enact countercyclical policies remains limited by the ongoing need for fiscal consolidation following pandemic-related spending. Despite fiscal constraints, EM external balances are relatively well-positioned to endure adverse reactions in funding costs and market access.

March's heightened market volatility, underscored by significant equity market declines and widened spreads in lower-rated EMD credits, also highlights a crucial theme across fixed income: spreads were historically tight relative to other asset classes as we began 2025. This tightness, while incrementally improving year-to-date, necessitates better entry levels before adding further risk to our portfolio.

In summary, the outlook for EMD in 2025 is nuanced. While we can expect volatility driven by US trade policies and geopolitical developments, the high yield starting point and country-specific positive developments offer some cushioning. We maintain a cautious approach, staying attuned to political developments and central bank policies to navigate this challenging market environment.

Emerging Markets Debt Global Diversified Composite

As of 3/31/25	QTD	YTD	1 yr	3 yr	5 yr	10 yr	Since inception*
Composite - Gross (%)	2.57	2.57	7.76	4.08	4.86	3.58	6.00
Composite - Net (%)	2.46	2.46	7.32	3.63	4.36	3.05	5.54
Benchmark (%)	2.24	2.24	6.75	3.41	3.49	3.16	5.21

Past performance is not indicative of future results. Returns are gross and net of management fees and include the reinvestment of all income. Returns for period longer than 12 months have been annualized. *Inception date: 4/1/2006. The benchmark is the JP Morgan EMBI Global Diversified Index.

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