

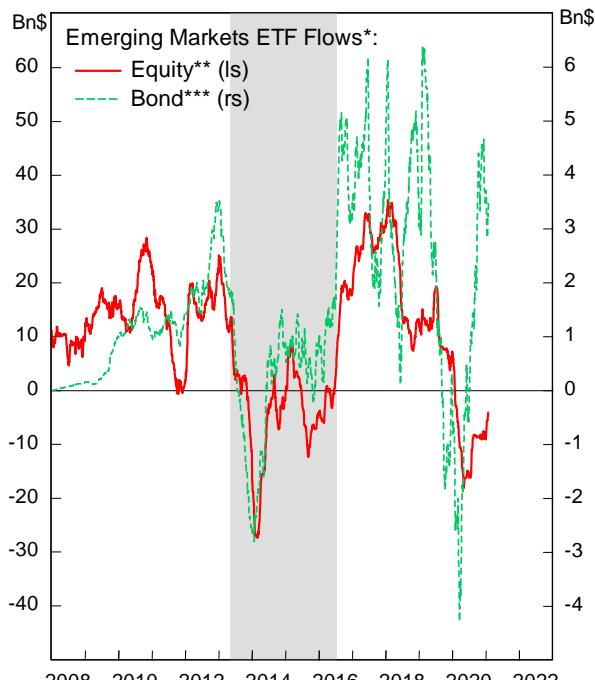
## EM Taper Tantrum *Déjà vu?*

**Potential for Sizable Portfolio Outflow is Limited.** The period before 2013 Taper Tantrum was marked by strong capital flow into EM assets, in contrast to current situation where flow into EM bonds and equities are only beginning to recover (**Chart 1**). More importantly foreign ownership of EM bonds, especially for the more fragile EM countries, are now much lower than pre-taper tantrum (**Chart 2**), further limiting the pressure of outflow from local bond market and currency.

**Yield Pick-Up for EM Bonds is Still Attractive.** Attractive valuation for U.S. bonds and equity manage to pull capital back to domestic assets in 2013. However, **Chart 3 and 4** show the situation today is marked by record-low U.S. yield and extreme valuation in U.S. equity; currently IG and HY bond are trading at only 1.2% and 3.6% spread relative to Treasury, compared to 3.3% and 3.4% for local-currency and USD sovereign EM bonds – in normal circumstances USD sovereign bond should be trading at a significantly lower spread relative to high-yield corporate market due to its higher credit rating (**Chart 5**).

**There Are Little Signs of Complacency.** During the taper tantrum, USD-denominated EM bonds suffered the most while LXR-denominated EM bond spread was relatively flat (**Chart 6**), as the index is dominated by China and the historical incidence of default of local-currency bond is low (**Table 1**). Moreover, capital flight was mostly focused on fragile countries with twin deficits where spread was as low as 2% – a sign of complacency as investors searches for yield – contrary to current situation where yields are widely dispersed according to respective country's outlook (**Chart 8 and 9**).

A scare in the market is an opportunity to further accumulate EM bonds, as the Fed is not likely to hike rates anytime soon and EM bonds is still trading cheap relative to U.S. IG and HY domestic bond market. However, we noted that downside risk remains high for high-profile countries such as Brazil and South Africa, whose fiscal outlooks are bleak and both dollar and local-currency bond spread has already compressed significantly of late. Investors should be cautious on Latam bonds and Asian equities but maintain overweigh on Latam equity and Asian bonds, as a “taper tantrum” is likely to occur alongside strong global growth and commodity demand and a flight to safety should benefit low-yielding EM Asian bonds relative to its Latam counterpart.

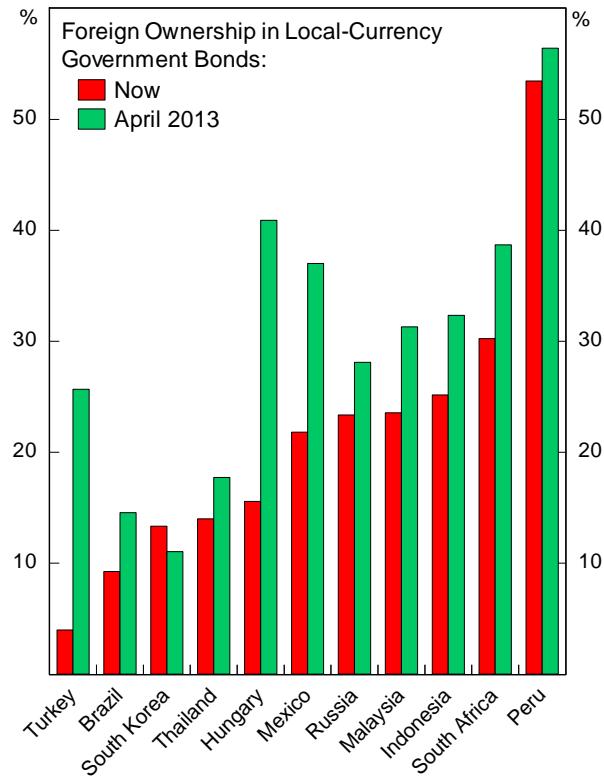
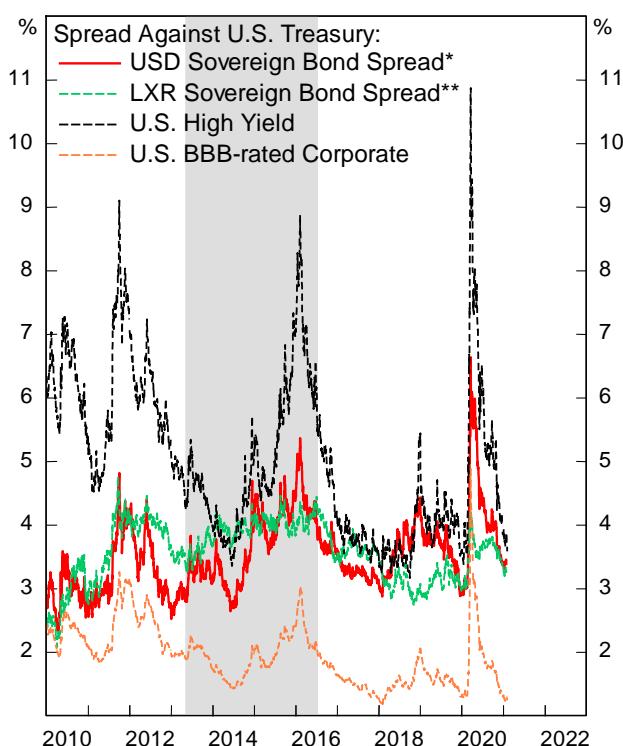
**Chart 1**


\*Shown as 12-month moving sum; source: Bloomberg

\*\*Includes VWO, EEM and IEMG

\*\*\*Includes EMB and LEMB

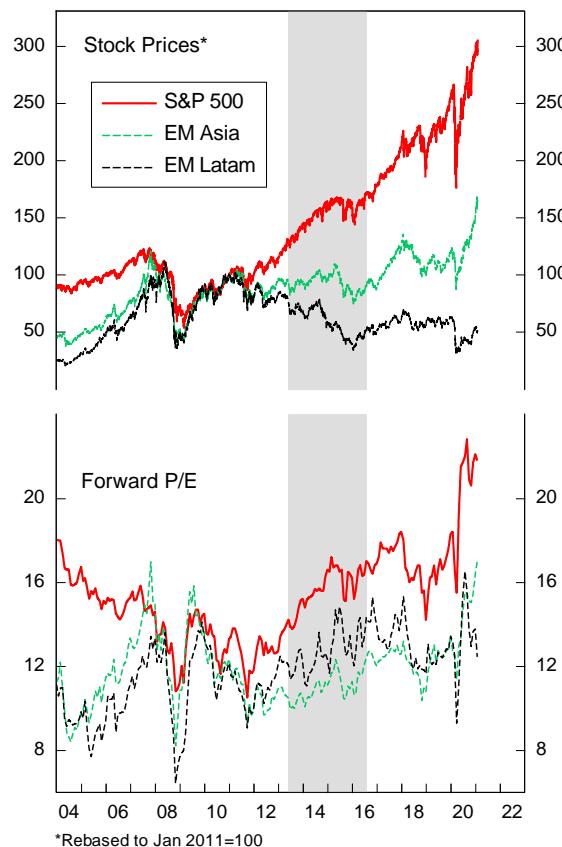
Note: shaded area denotes period of taper tantrum

**Chart 2**

**Chart 3**


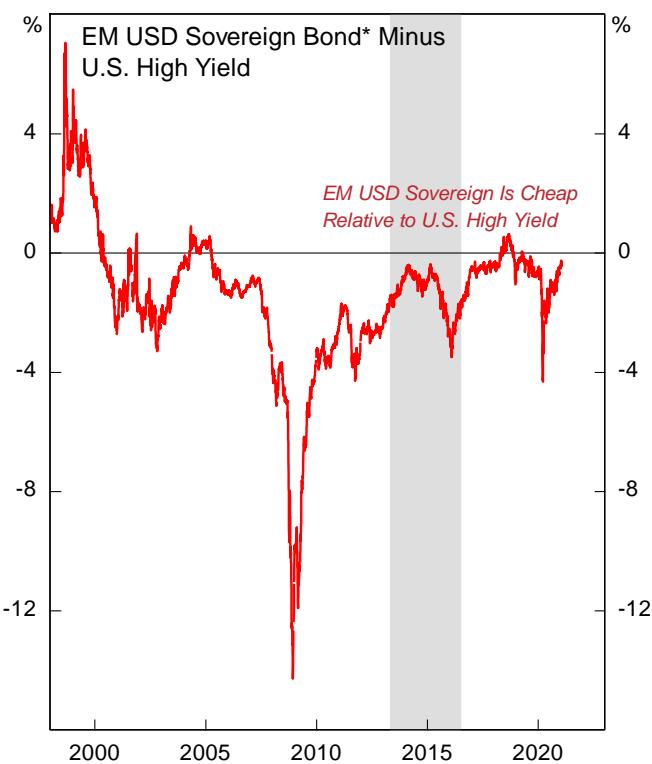
\*J.P. Morgan EMBI Global

\*\*J.P. Morgan GBI-EM Broad

Note: shaded area denotes period of taper tantrum

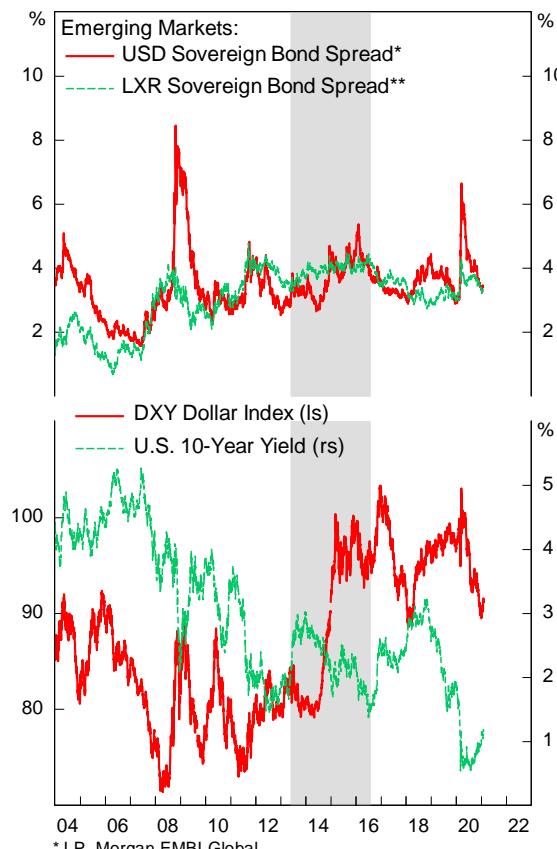
**Chart 4**


\*Rebased to Jan 2011=100

**Chart 5**


\*J.P. Morgan EMBI Global

Note: shaded area denotes period of taper tantrum

**Chart 6**


\*J.P. Morgan EMBI Global

\*\*J.P. Morgan GBI-EM Broad

Note: shaded area denotes period of taper tantrum

**Table 1**
**EM USD Bond Index**

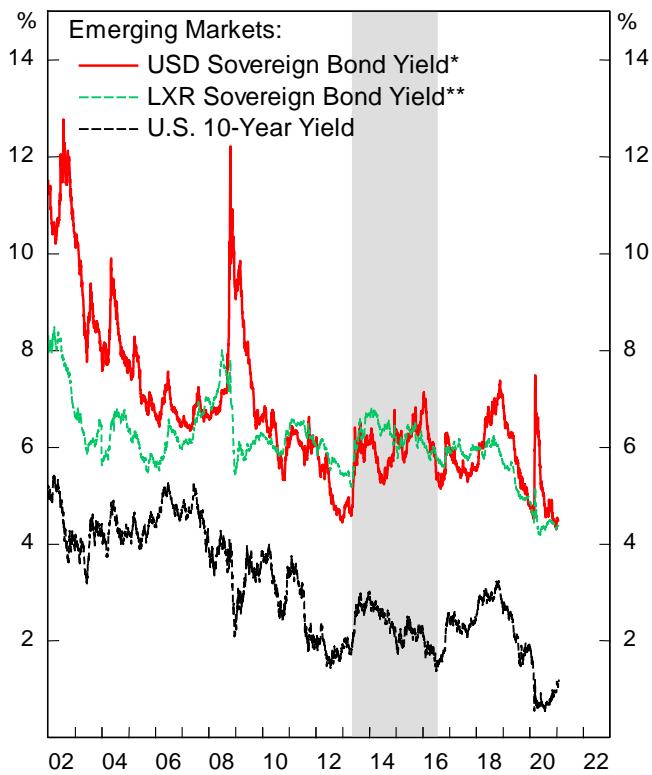
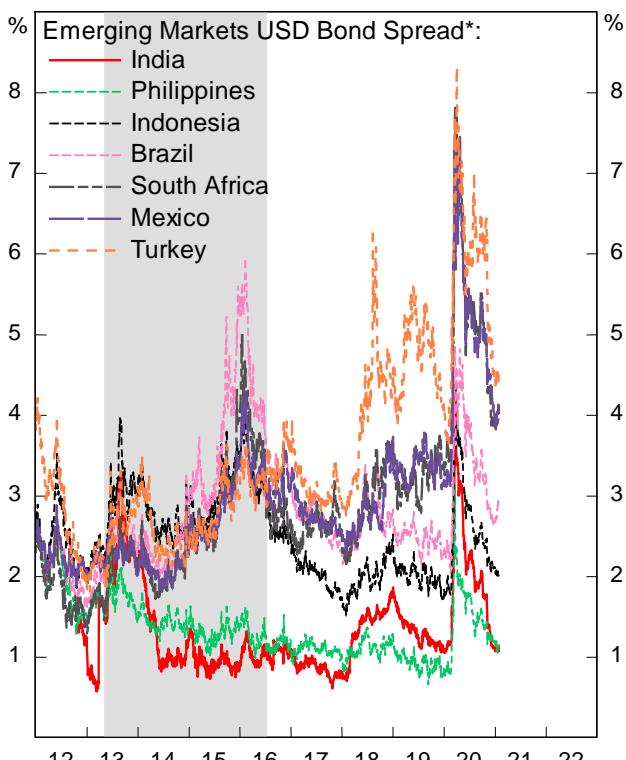
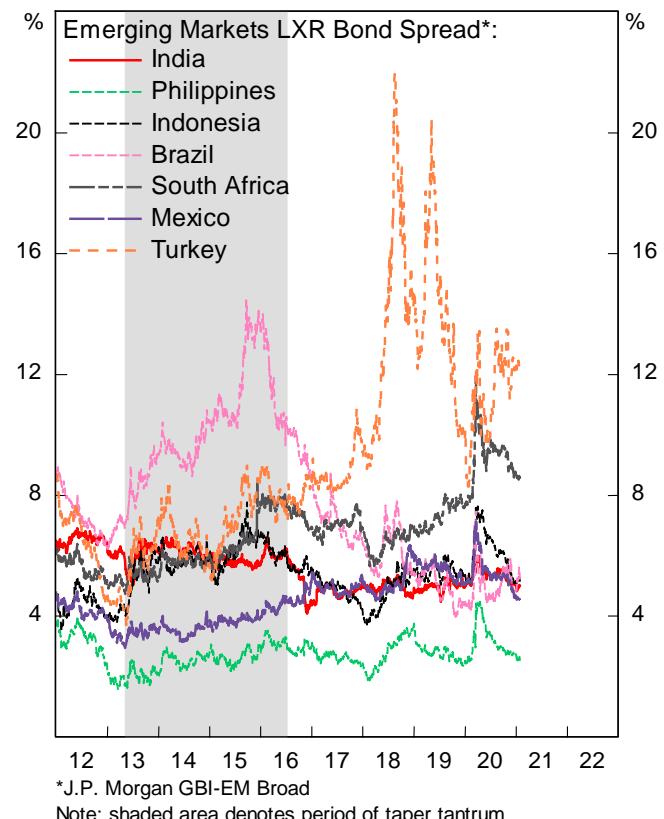
as of Feb 05, 2021

Type	▲ Fund ►
Mexico	5.60
Indonesia	4.91
Saudi Arabia	4.43
United Arab Emirates	4.13
Qatar	4.10
Turkey	4.07
Russian Federation	3.84
Philippines	3.57
China	3.54
Brazil	3.40
Colombia	3.33
Peru	3.24

**EM LXR Bond Index**

as of Feb 05, 2021

Type	▲ Fund ►
China	14.90
Indonesia	6.65
Mexico	5.79
Brazil	5.03
Turkey	4.65
South Africa	4.56
Dominican Republic	4.56
Uruguay	4.53
Russian Federation	4.48
Colombia	4.48
Philippines	4.48
Poland	4.48

**Chart 7**

**Chart 8**

**Chart 9**


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