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Emerging Markets Outlook

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Ms. Goodly is the Portfolio Specialist for the TCW Emerging Markets Group, serving as the primary liaison between TCW's Emerging Markets investment team and TCW's client relations and marketing professionals. As part of her role, she also leads the EM Portfolio Specialist team, whose core activities include communicating investment strategies, performance and outlook, in addition to supporting product marketing and development. Ms. Goodly is also a member of TCW's ESG Group and Diversity, Equity, and Inclusion (DEI) Taskforce. Prior to joining TCW in 2013, Ms. Goodly spent eleven years at Morgan Stanley, most recently as an EM Fixed Income institutional salesperson. Ms. Goodly is the co- chair of Diversity and Inclusion for Women in Institutional Investments Network (WIIIN) and was shortlisted for "Ally of the Year" for the Women in Asset Management Awards. She is also a Founding Member of the Los Angeles chapter of Chief, a leadership network for executive women, and a member of the Los Angeles Leadership Committee for 50/50 Women on Boards. Ms. Goodly graduated with a BA in Economics from Stanford University.

The economic and inflation outlook in Emerging Markets (EM) remains benign as global growth continues to exhibit unexpected resilience, China's unbalanced recovery gains steam, and EM inflation gradually decelerates. Several large EM countries, such as India and Brazil, are still growing at a robust pace, while others are beginning to turn after brief economic slowdowns or shallow recessions. In our view, Emerging Markets is heading into a more supportive medium-term environment due to looser monetary policies in major economies, the return of large EM economies to trend growth and inflation targets and a potentially weaker US dollar over the medium term.

Further, while debt/GDP and deficit levels have deteriorated in many developed economies, many EM countries have established a track record of more prudent macro policies including more conservative fiscal management, gradual reduction of subsidies, and a growing commitment to monetary orthodoxy via inflation targeting. Many countries have established or are in ongoing programs with the IMF, some have obtained substantial financial support from regional peers, and others have instituted more orthodox policies post elections to tackle macroeconomic imbalances.

The growth differential between EM and Developed Markets (DM) is at its decade-long peak as the growth surprises in DM, especially the U.S., are starting to fade while EM growth is holding up well, further supported by moderating downside risks in China. Inflation continues to throw upside surprises in DM whereas EM countries are experiencing a faster-paced deceleration in inflation. Supporting the EM growth outlook, commodity prices are holding up due to secular as well as cyclical tailwinds. Reflecting this strength year-to-date, 73% rating agency actions in EM have been either upgrades or changes to a positive outlook.

From a longer-term perspective, rising global economic and geopolitical risks have increased EM's strategic importance to the developed world. The de-risking of supply chains and the resulting regionalization of trade; the strategic demand for base metals to fuel the climate transition and the growth of AI; the structural growth of the EM middle class; and the demographic challenges facing the developed world are all making DM more dependent on alliances with EM countries. Credit metrics in the emerging world, both sovereign and corporate, have improved relative to the developed economies. Further, dominant positioning in commodities and a demographic advantage relative to DM are enabling EM partners to play a more prominent role in this world of shifting alliances.

In our view, these factors have transformed the EM opportunity from one of convergence with the developed world to one of strategic opportunity and diversification. As the role of EM increases in the global economy, the asset class can serve as an important source of diversification in a fixed income portfolio. We believe the broad nature of the asset class with more than 70 countries and 700 corporate issuers enables an investor to construct a portfolio to take advantage of specific themes as well as to benefit from the rising importance of the Emerging Markets in a multi-polar world.

From a valuation perspective, EM sovereign yields are currently at the 94th percentile of the last decade for investment grade (IG) and the 87th percentile for high yield (HY). In the case of corporates, EM IG spreads relative to DM IG spreads are at the low end of the range over that period (40bps) but benefit from relatively stronger deleveraging during the same period. EM HY corporate spreads relative to DM HY corporate spreads are currently 100bps, the high end of the range, while at the same time benefiting from a similar relative deleveraging dynamic. For the balance of the year, we believe carry and spread tightening in markets with idiosyncratic drivers will lead returns. ■

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