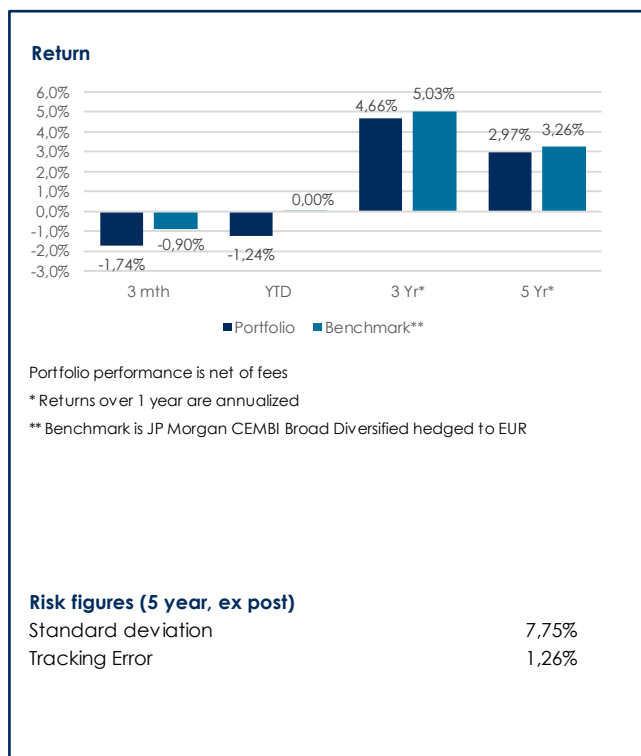


Dear Investor

Please note that information regarding companies (issuers) and financial instruments (e.g. shares or bonds) in this investor letter shall not be considered as investment recommendations to buy, sell or hold any financial instruments. Information about companies and financial instruments shall only be considered as information concerning the fund's portfolio and risk profile for that quarter.

Summary

- EM corporate credit outperformed other EM classes on a risk-adjusted basis for the second year in a row during 2021
- Q4 had returns of -1.74 % for the fund versus -0.9 % for the benchmark gross of fees not least driven by the exposure to the HY sector which underperformed IG credits
- Q4 was volatile with large volatility in the Chinese HY market led by a rising number of defaulting property developers, but volatility also appeared in Turkey driven by unconventional monetary policies and around Russia and Ukraine following fears of military intervention



Dark before dawn?

Returns from emerging markets stayed close to the bottom end of the cross-asset scorecard for much of 2021 relative to developed markets and this trend was particularly evident in the last few months of the year with EM equities, FX, local markets and credit all underperforming their global counterparts. Within EM, corporate debt outpaced all other EM fixed income for the second year in a row however despite the collapse in China property credits. The difference in duration was the main driver of the more resilient returns for the EM corporate issuers which supported total returns relative to sovereign credit, but also confirming the better Sharpe ratio relative to local debt which provided a negative total return of almost 9 %. In fact, the cumulative outperformance for EM corporate debt over the past 4 years is 20 percentage points relative to local EM debt.

One of the most contentious areas in Q4 was Chinese property bonds given the extreme challenges the sector faces. 16 China property issuers with USD 56bn of outstanding bonds defaulted in 2021 and the

majority towards the end of the year. There appears to have been a slight change in the policy stance in the past two months, although market sentiment remains fragile due to pressure on contracted sales, large upcoming offshore maturities and poor disclosures by developers. It has left the sector scarred and while we believe current bond valuations reflect a lot of risk, we continue to expect divergent performance, with gradual spread tightening for performing credits and more defaults by weaker-quality developers which will delay any recovery.

Outside Chinese property names, EM corporate debt performed reasonably well supported by the broadly healthy credit metrics. Notable outliers were, however, credits from Turkey which suffered by the increasingly uncharted monetary policy in Turkey which led to unparalleled currency swings filtering into bank and corporate spreads. TRY traded at 9 vs USD when Q4 began before ending at around 13 having seen intraday highs of more than 18 TRY per USD. The government announcement of it taking all FX risks on TRY deposits subject to specific conditions being met caused the relief not seen for decades. It shows that

BI SICAV Emerging Markets Corporate Debt R (EUR)

the current regime will fight tooth and nail to avoid orthodox monetary policies whilst regaining lost political momentum up to the coming elections in 2023 leading to continued volatility given the prevailing policy mismanagement. Clearly, this is a high-stake political game as the wave of inflation risks bringing discontent people to the streets – which is a generic risk in our view as we experienced during the past wave of food and energy price inflation a decade ago leading to the Arab Spring.

Russian troop buildup on the borders of Ukraine brought fears for a pending military action and brought pressure to Ukrainian assets, just as Russian assets came under pressure due to renewed and increased sanctions risks. In our view, Europe has not faced such threats to stability since the end of the cold war and while rationally no side would like to reach military confrontation on Ukrainian soil, it no longer remains a hypothetical scenario. It seems the de-escalation power rests with Moscow alone and it therefore remains to be seen which conditions could bring calm back to the region. For now, we do not anticipate any quick or easy solution and expect the geopolitical premium to remain elevated for both Russian and Ukrainian assets.

No rest for the wicked

In the short run, the rise in inflation is primarily due to a higher demand for goods post the pandemic at a time where disrupted supply chains have caused bottlenecks for several good deliveries. As societies reopen the supply factor should ease and simultaneously demand will be directed towards services rather than goods. This will bring higher equilibrium levels, but not sustained inflation provided there will not be broad based wage increases. Ample capacity in EM and better supply chains should avoid a price spiral scenario, though rising energy prices are risk factors to this – not least for the instigation of social unrest. New Covid variants remain a known unknown in this respect, although data suggests that the Omicron variant could be fast-forwarding normalization rather than extending the pandemic. Consequently, we continue to believe inflation is transitory and that it will taper off by mid-year.

Overall, EM is challenged by inflation, particularly Latin America and Eastern Europe whereas Asia yet has to see inflation pressure. The main challenge is that inflation expectations are not anchored across EM and therefore EM central banks started hiking rates in order to dilute potential currency pressure and avoid inflation from ballooning. Current inflation rates, however, still suggest negative real rates indicating further rate hikes will be looming. Recently the US Fed has become more vocal about rate hikes in 2022 and also begun reigning in on its QE program. While China

might offset some via a looser credit impulse in order to stem its growth slowdown, we believe the pullback in global liquidity will bring more volatility to all risky assets. All assets have benefitted from the increased liquidity injections post Covid-19 and it will be difficult to hide although we believe cashflow generating credits with manageable refinancing and leverage profiles will be more resilient. The crux of this is whether and how underlying US rates will be affected, i.e. will inflation fears turn more permanent and potentially lead to a steeper curve or rather – as has been our base case – remain contained and bring a flatter yield curve. The latter also seems supported by the stable 5y5y forward market expectations. Regardless, both scenarios should see volatility rising impacting both investment grade credits and high yield credits.

As we start 2022, the glass half full narrative for EM is it significantly less vulnerability to flight of global capital versus in previous Fed tightening cycles. As a percent of market cap, total non-resident holdings of EM (ex-China) equities and bonds are lower now than before the pandemic. Positioning could be at useful buffer in 2022 when EM gets past the hurdle on dealing with the pandemic. Moreover, EM growth has been on an upward trajectory and the worst fears about EM's public debt ratios proved too pessimistic. EM current account balances are also exceptionally healthy by historical standards and EM currencies are already cheap by historical standards.

Fundamentally, this means EM credit metrics remain supported and as EM does not remain neither overbought nor expensive relative to DM we still see the asset class being balanced in terms of supply and demand. By itself, this should support excess returns for emerging market corporates given an expectation of still modest default rates outside the Chinese high yield sector. However, as global liquidity is pulled back the rise in volatility will lead to periods of market weakness. For these reasons, and with the risk of sounding like a broken record, we remain convinced that credit selection will remain the main driver of alpha generation and maintain our tilt towards the better part of HY as we believe volatility structurally could increase. At the same time, we believe sticking to well-known issuers with proven longevity provides the better risk reward.

Kind regards,

Chresten Hagelund and Søren Bertelsen

BI Asset Management Fondsmæglerselskab A/S
"BankInvest"

Last edited 31 December 2021