1st Quarter 2022

BI SICAV Emerging Markets Corporate Debt I (USD)

BANKINVEST

Dear Investor

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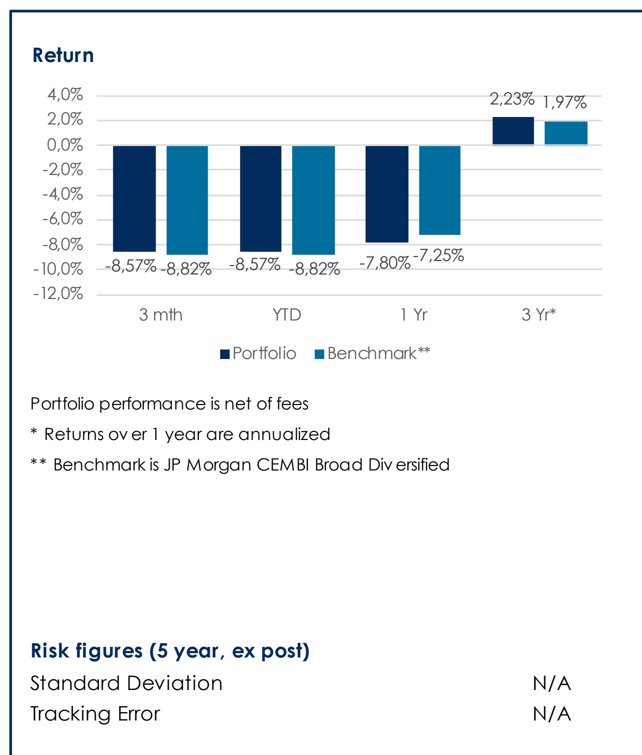
Summary

- Russia's invasion of Ukraine which has not only led to the largest human tragedy on European soil for decades, but also disrupted commodity exports from Russia and Ukraine leading to surging commodity prices
- The real economic impact brought by the war meant that EM corporate debt posted the worst quarterly total return since 2010 and among the worst quarterly returns since the start of the benchmark in 2002.
- The inflationary shock from commodity prices will amplify one of the key risks we anticipated for 2022: the risk of social unrest across developed and emerging markets which is particularly acute for poor countries with energy and food being key components disposable incomes.
- Overall, it will have a moderate negative impact on growth, although the impact will be felt differently across EM with emerging Europe being impacted the most. Conversely, the Gulf countries and Latin America should overall benefit given their net exports of either soft or hard commodities



Risk figures (5 year, ex post)

Standard Deviation	N/A
Tracking Error	N/A

After two years of global pandemic, the economic outlook for 2022 did have rays of light for EM economies despite China's property market and US Fed's tightening on global liquidity conditions. At the same time however, prospects for global growth were promising as advanced economies were ending COVID-restrictions and government infrastructure and energy transition plans suggested a decent outlook for investment and global trade. This should have supported EM economies and the well-signalled increases in US interest rates should not catch EM economies off guard as EM central banks started their hiking cycles ahead of core central banks. This narrative was abrupted by Russia's invasion of Ukraine which not only led to the largest human tragedy on European soil for decades, but also disrupted commodity exports from Russia and Ukraine leading to surging commodity prices and leading the Bloomberg Commodity Index to the largest commodity shock since 1973. Combined with logistic bottlenecks, the consequence is a large stagflationary shock with higher inflation and lower growth through higher input costs and lower real disposable incomes.

The real economic impact brought by the war meant that Q1 2022 posted the worst quarterly total return since 2010 and among the worst quarterly returns over the lifetime of the CEMBI Broad Diversified indices. During Q1 the USD total return for CEMBI Broad Diversified was -8.82 % which was roughly equally driven by US rate rises and credit spread increases. The spread increase was primarily caused by collapsing Russian and Ukrainian bond prices as well as China which saw continued pressure on its property and tech sectors. Most of the remaining EM corporate bonds performed in line with the US IG or US HY peers. The share class managed to outperform its benchmark by 0.25 % net of fees.

Slava Ukraini

The atrocities and far-reaching consequences of the Russian assault on Ukraine are hard to describe in few sentences. Our expectation was that Russia would use its troop build-up for negotiation wins and that the use of military force would be contained to Eastern Ukraine Hence the fund had decreased its exposure to Russian assets prior to the war but kept exposure to Ukraine on

the assumption that the economy would not be devastated, and the sovereignty would only be confirmed and supported by the West. Sadly, we were only partially right on these assumptions and the war made trading of Russian and Ukrainian bonds dysfunctional just as bonds from neighbouring countries were hurt by rising risk premia. It is not only on the battlefield that Ukraine has proven extremely brave and valiant. So far, bond issuers have been adamant to honour its debt obligations and only few bond issuers have asked for consents for grace periods to support near term liquidity. Russian bond prices have been affected by ongoing sanctions and Russia's position as international pariah state. Consequently, the fund sold its exposure to Russian issuers where possible due to ethics and the dire longer-term consequences for the Russian economy.

For the global economy, the consequences are plentiful. Most notably is the inflationary shock from the disrupted commodity channels ranging from soft commodities to metals and energy prices which will only amplify one of the key risks we anticipated for 2022: the risk of social unrest which is particularly acute for poor countries with energy and food being key components for disposable incomes. At the same time, this will further magnify the trend of de-globalisation, more state involvement in economies and higher fiscal spend in developed markets and we suspect that 'just-in-time' principles will be moved backwards towards 'just-in-case' economics and larger inventories.

An interesting realisation upon the war is that while the Western response has been characterised by impressive unity, the non-Western (in terms of values) response has been opaque as evidenced by the UN resolution where 73 % of countries voted in favour but the majority abstained if weighted by population. While this can be viewed as self-interest or flagging Western hypocrisy, it could also be seen as the desire to differentiate from the West and potentially creating other 'Economic value blocks' via sustaining supply-chains with 'like'-minded' allies. Sanctioning of the Central Bank of Russia's reserves might only support this and lead to attempts to diversify reserves through various currencies, including large EM currencies, and real assets.

In past quarterly letters, we argued that higher inflation due to disruptions of supply chains would be temporary and recede over 2022, but the war in Ukraine made this unlikely. Higher energy and food prices will last for a while and affect real disposable incomes. Still, we do not envision a lasting vicious wage and price spiral as central banks in both developed and emerging markets will hike rates to avoid this scenario. We are somewhat comforted by the market's inflation view which is only marginally higher from the highest prints over the past 12 months. A notable break higher here might change our view on the stickiness of inflation.

Overall, it will have a negative impact on growth, but as growth is coming from relatively healthy levels, we expect it to moderate at decent levels relative to history although the growth impact will be felt differently across EM with emerging Europe being impacted the most. Conversely, countries from the Gulf and Latin America should benefit given their net exports of either soft or hard commodities. African countries are a bit of a mixed bag in this respect as some countries benefit from large commodity windfalls whereas others are exposed to social discontent.

Outlook

The difficult market environment has taken its toll on the new issue market and issuance in Q1 was the lowest supply since 2016. There are good chances that the first part of Q2 could continue this favourable supply technical as high scheduled cashflows are expected, but as the new issue market is only gradually opening. Moreover, surveys indicate that cash balances are high among investors given the anticipation of a pent-up demand in issuance which should support if the asset class does not experience material outflows.

Fundamentally, most emerging market corporates have robust credit metrics and the rise in default rates for the asset class is expected to come from Russian and Ukrainian issuers directly impacted by the war as well as the Chinese property developer sector which is still on its way to recovery. As Russia is now uninvestable and both Ukrainian and Chinese developers are trading at levels close to traditional recovery levels we would argue that most of these risks are priced in.

The main uncertainty relates to the outlook for higher US rates and how global inflation trends will evolve, just as developments relating to the war in Ukraine could affect sentiment. Altogether we believe that volatility is here to stay in global markets and that this could bring decent swings in both market directions. Consequently, focus on credit selection over the medium term and sticking to known issuers from the better part of the high yield segment and investment grade companies is prudent. At the same time, our preference is for issuers from commodity exporting countries and producers which should thrive in environments of rising commodity prices whereas issuers from countries with weak balances and large energy and food imports would remain vulnerable as this could lead to social unrest and runaway inflation pressuring FX and banking sectors.

Kind regards,

Chresten Hagelund, Søren Bertelsen

BI Asset Management Fondsmæglerselskab A/S "BankInvest"

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