2023 Midyear Investment Outlook: Focus on Emerging-Markets Debt

Positive global developments help to build a constructive outlook on the asset class in the second half of 2023.

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Key Points

- China's reopening and a potential pause in U.S. Federal Reserve (Fed) rate hikes are positive developments for the asset class.
- Consumer activity in China will be closely watched.
- We think select emerging markets (EMs) may provide attractive relative-value opportunities in the second half of 2023.

The prevailing headwinds of 2022 have subsided, paving the way for a brighter emerging-markets (EM) outlook in 2023. The U.S. Federal Reserve (Fed) has decelerated rate hikes, and China has abandoned its zero-COVID-19 policy and reopened its economy. Additionally, key EMs have implemented prudent monetary and fiscal measures, buttressed by significant reserve buildups.

The U.S. economy's resilience and China's gradual recovery, combined with worldwide central banks nearing the end of their tightening cycles, underpin our cautiously optimistic view on the asset class. EM growth in 2023 has proven resilient, with positive surprises in Latin America (like Brazil) and EM Asia. As inflation moderates with dissipating energy and food shocks, rate cuts are being considered in some EMs.

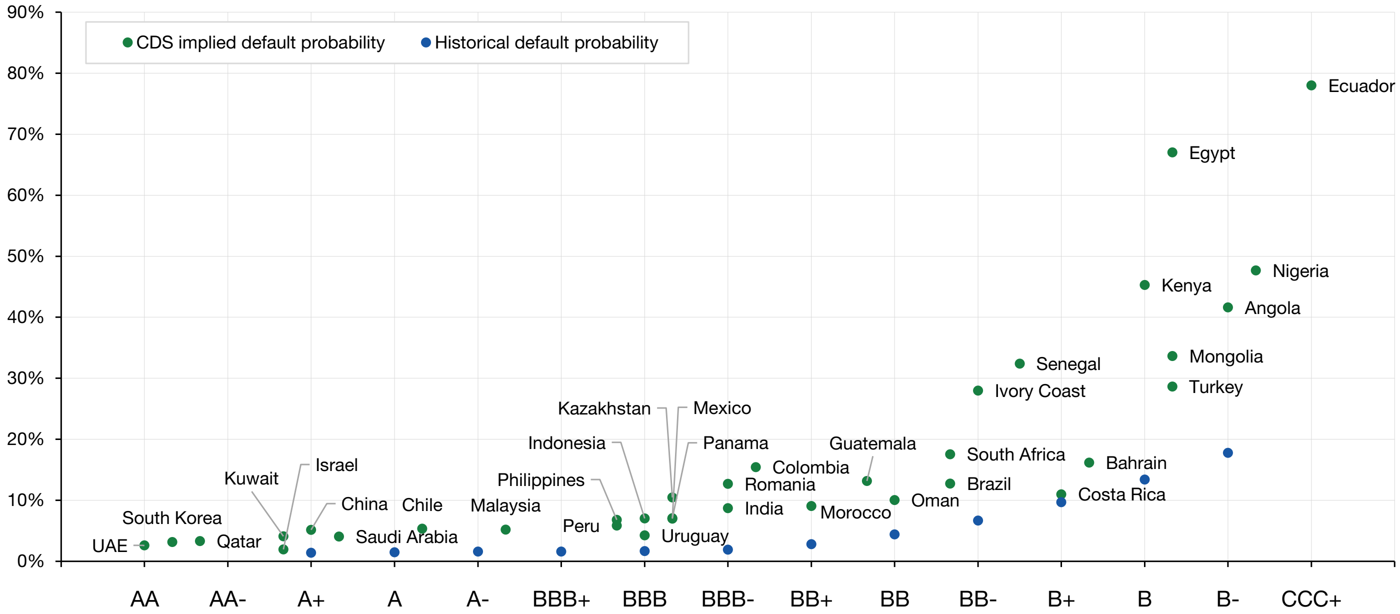
That backdrop gives rise to select opportunities. We expect that progress in stalled debt restructurings, for example, could allow distressed sovereigns to regain good standing with the investor community. Another trend we are watching is ambitious reforms in frontier/high yield issuers like Nigeria and Angola, which have the potential to stabilize those economies amid external challenges. Finally, the recalibration of supply chains is creating interesting investment opportunities in Mexico and some EM Asia countries.

Looking Ahead

In the latter half of 2023, we prioritize fundamental analysis as returns are expected to continue to bifurcate, and geopolitical considerations remain paramount. Notably, we will continue to watch China's consumer-led recovery, where the uneven industrial sector contrasts with a recovering services sector, which we expect will create millions of jobs over several years.

Figure 1. Wide Dispersion in EM Sovereigns Suggests Selective Opportunities

Default probabilities derived from valuations for five-year term credit default swaps (CDS) of sovereign issuers



Source: Bloomberg. Data as of May 31, 2022. A credit default swap (CDS) is a contract between two parties in which one party purchases protection from another party against losses from the default of a borrower for a defined period of time. **Past performance is not a reliable indicator or guarantee of future results**. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

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The **U.S. Federal Reserve (Fed)** is the central bank of the United States. The **federal funds (fed funds) rate** is the target interest rate set by the Fed at which commercial banks borrow and lend their excess reserves to each other overnight.

J.P Morgan EMBI Global Investment Grade Index tracks returns for the U.S. dollar-denominated debt instruments issued by emerging-markets sovereign and quasi-sovereign entities, Brady bonds, loans, and Eurobonds.

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