BB Bellevue
Asset Management

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Gems in the corporate bond world: Blue chips in emerging markets

When yields are low, the temptation is great to go lower in credit quality in order to extract an extra return. This would increase the portfolio risk. We think this is not a good idea as a low yield environment offers more downside than upside. One area we think enables us to add extra yield not at the detriment of credit quality are specific corporations in emerging markets.

We especially appreciate blue chip companies there, which are exporters, family owned, and went through many crises. These companies are managed for the long term and tend to be resilient to crises. Exports allow them to build a natural hedge to their foreign currency borrowings and to access offshore funds in case of macroeconomic crisis in the country they operate. They exhibit a much stronger credit profile than high yield companies located in developed markets but, because they operate in an emerging market, their credit rating is similar.

We currently like Turkey
Turkey is currently going through difficult macroeconomic conditions. Its currency has depreciated by almost 30% in 2018 following US sanctions. This has forced the central bank to increase interest rates successively up to 24% to support the currency and fight inflation, resulting in an economic slowdown. The big stress is now behind us. The currency has regained a lot of ground and the central bank was able to lower interest rates again. However, the situation remains uncertain and still crisis-prone due to the tense geopolitical scene and the low level of foreign exchange reserves at the Turkish central bank. Consequently, Turkish corporates offer a premium versus high yield issuers in developed markets and other emerging markets such as Brazil, Mexico, Russia and South Africa.

We especially like to invest in Turkish exporters such as Arcelik and Sisecam. Arcelik manufactures electronics and house equipment such as refrigerators, washing machines, etc. Sisecam is a world leading glass producer. About 66% and 69% of their revenues, respectively, are generated abroad either from exports or international operations. If the Turkish lira devalues, they can gain market share in their export markets, mitigating the negative impact on their domestic operations. In addition, their foreign currency exposure offers a natural hedge against their foreign currency debt and allows them to access offshore liquidity in the event of foreign exchange controls. Both corporations are controlled by long-term owners: the Koc family for Arcelik and Isbank for Sisecam. Isbank is itself in the hand of Ataturk’s CHP party. There are currently discussions that the CHP party’s stake in Isbank is transferred to the government. Both Arcelik and Sisecam are BB rated. We estimate that these corporate bonds offer a total yield to maturity of between 4.5% and 7.5% for a duration of between 3 and 5 years. This corresponds to a spread of between 3% and 4% over US Treasuries and a premium of around 1% versus similar Brazilian and US corporates. We think this is attractive in the current low yield environment, especially for issuers of this credit quality.

We are aware that there is a potential that Turkey undergoes another wave of volatility. BB Global Macro has currently an exposure of 2% on Turkish bonds. We understand very well these investments and keep ready to add on in times of stress.

Conclusion
Turkey is one case. We adopted similar approaches for Brazil in 2015, Mexico in 2018, European financial subordinated bonds with the successive European crises. We are looking forward to the next crisis.