Kames warns of risks from ‘overbought’ EM debt

London – Investors need to treat emerging market debt with caution following a strong period of performance in 2016, with the more hawkish tone now emanating from the US Federal Reserve a potential threat, Kames Capital’s Scott Fleming (pictured) has warned.

Emerging market debt has delivered double-digit returns year to date, with the JP Morgan Emerging Market Bond Index Global Diversified returning 14.2%.

Such eye-catching gains – ahead of many types of fixed income, as well as other asset classes – have prompted increased interest from investors, with emerging market debt seeing 11 consecutive weeks of inflows. However, risks are now emerging which threaten returns, according to Kames.

Fleming, manager of the Kames Emerging Market Bond Fund, said this shift in the Federal Reserve’s stance – and recovering US inflation data – are a rising threat to the sector.

“A recent shift to a more hawkish tilt by the Fed, coupled with an upward trajectory for core Personal Consumption Expenditures (PCE) inflation, are early warning signs for emerging markets,” he said. “Both represent rising threats to the sustainable nature of the performance of the higher yielding portion of emerging market bonds in particular, where spreads reflect levels which are currently ‘overbought’.”

As well as a potential threat from shifts in central bank policy, Fleming added there were a number of other risks for the sector.

He noted banks in some emerging markets had issues with an increase in the number of non-performing loans, while there is also a risk that growth expectations may not prove to be all that sustainable.