# RBC Emerging Markets Bond Fund

## Commentary as at December 31, 2023

Emerging-market government bonds delivered their best gains in four years, mostly due to a rally in the late stages of 2023, as falling inflation put the U.S. Federal Reserve (the “Fed”) in a position to wind up almost two years of interest-rate increases.

The move higher in bond prices (and falling bond yields) reflected investors’ view that the emerging-market governments may get a reprieve from borrowing costs that earlier in the year touched the highest levels since 2007. Bonds of countries at distressed levels or in default rallied strongly as investors anticipated that these countries would have an easier time meeting their repayment schedules and be able to resume issuing bonds sometime in 2024.

The solid performance however, masked the volatility and uncertainty that prevailed for most of 2023, which was characterized by lingering concern about inflation, disappointing Chinese growth, and geopolitical tensions. The year-end gains in emerging-market fixed income mirrored significant rallies in other types of riskier assets such as U.S. high-yield bonds and equities.

The Fund’s relative performance was aided by its above-benchmark exposure to high-yielding issuers such as El Salvador, the Dominican Republic, Argentina and Nigeria, and below-benchmark positions in Bolivia and Lebanon.

Countries with high credit ratings tracked Treasuries most closely, and the Fund’s below-benchmark exposure to bonds with a high sensitivity to U.S. rates, including Poland, Chile, and China, slightly hurt relative performance. However, the Fund’s below-benchmark exposure to Pakistan, whose sovereign bonds are trading at distressed levels, and Sri Lanka, which is in default on its obligations, had a more significant negative impact on relative returns as issuers perceived to be the riskiest performed best.

Valuations of emerging-market government bonds appear to be stretched after the recent rally. As a result, investing in emerging-market fixed income is, in the view of the portfolio manager, a less attractive proposition given the possibilities of a U.S. recession, another disappointing year for the Chinese economy and election-related turmoil in a number of emerging-market countries.

Under these circumstances, the portfolio manager plans to maintain healthy allocations to less risky emerging-market issuers. The caution is offset by the recognition that economic activity is likely to start improving as emerging-market central banks carry on with their easing cycles. Stability in borrowing costs or further declines would especially help emerging-market countries that are at most risk of missing debt payments.