THE OMNIVEST MARKET VIEW

Investments

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Searching for Yield in a Zero Rate Environment

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It may sound risky but Institutional and Retail investors are left with no choice but to search for yield in emerging market countries. The average 2-year yield of G-7 less Italy is at a staggering low of 0.24% and likely to head lower as the ECB moves its official rate to a zero bound level. Moreover, Industrialized European countries continue to be butchered by the rating agencies, giving investors little confidence that they will receive their principal when short term notes mature.

Conversely, high nominal and real interest rates can be found in the Latin American short term fixed income markets. Credit quality for Latin American sovereign debt continues to benefit from superior balance sheets and subsequent favorable credit rating changes. In addition, real yields in this part of the world remain high in comparison to many other countries. For example, the overnight Central Bank real rate in Brazil is around 3.00%, Chile 2.30%, Columbia 2.00% and Peru 0.25%. This is in sharp contrast to the negative 2.30% in the UK, -1.65% in Europe and -1.60% in the US.

Investors should be attracted to high real interest rates with the potential for modest capital gains. There are six Latin American and Central American Central Banks set to meet between now and August 29th to set interest rate policy. And while they may elect to keep interest rates unchanged, there is still room for potential rate cuts later in the year. In local markets, the 2-year note yield in Mexico is currently at 4.50%, Chile at 4.90% and Brazil at 7.80%.

The income differentials between the US 2-year note and the yields stated above range between 4.28% to 7.58%. These attractive yields do come with currency risk. However, it is our view that high real interest rates will help to dampen the potential for unfavorable currency trends. Another factor contributing to the attractiveness of short term emerging market yields is the lack of rate movement expected by the Federal Reserve over the course of the next 1 to 2 years.

Investors can find many opportunities either in Mutual funds, Exchange Traded Funds (ETFs), or Separately Managed Accounts (SMA's) that specialize in short duration local Latin American bond markets.

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