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Article

# Why global debt flows matter

## The risk them ahead is 'capitulation liquidation'.

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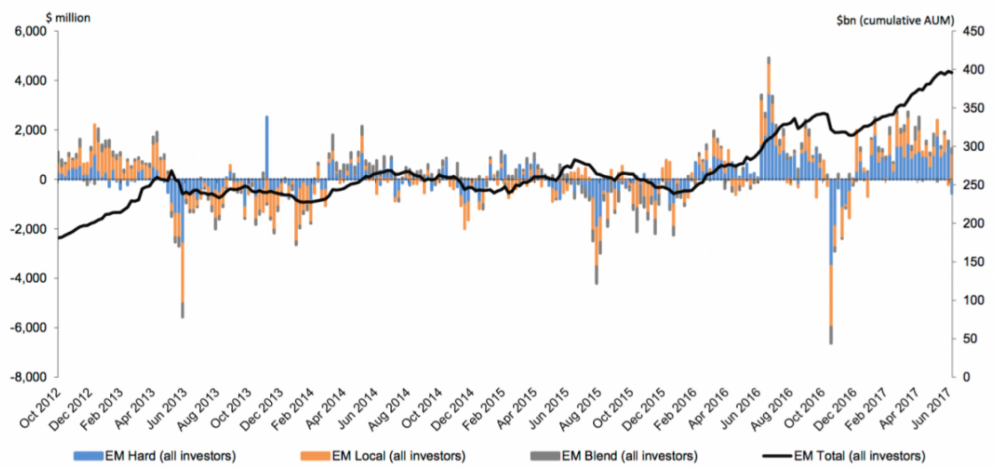
## A possible outflow risk

Short duration short covering has morphed quickly into the build of a more defensive duration positioning as core rates come under material upward pressure. We noted in our recent Emerging Market Strategy Update that EM was susceptible to any material upset to core rates, and we maintain our view that there is an outflow risk stemming from this. There's only mild evidence of this so far, but it is noteworthy that hard currency funds just saw their first outflow in half a year.

**Feature Chart: Emerging Market inflow process under imminent threat**




Source: EPFR Global,ING estimates

## Five things learnt from latest flows data

1) Government funds have seen liquidations in the past week, and outflows from long end funds suggest the re-beginning of a duration reduction process. Inflows to corporate funds remain robust, although this is liable to be muted should the risk asset sell-off continue, which is likely as core markets unwind rich valuations.

2) The inflow process to emerging markets hard currency funds had been especially impressive since the turn of the year, supported by a strong performance from core beta product. The recent rout on core bonds has acted as a catalyst for change, with hard currency funds seeing the first weekly outflow since December 2016.

3) There has also been some rotation in evidence from hard currency funds into local currency funds, but the baseline view is that such inflows to local currency will also morph to outflows as the support from core product in terms of total returns gets pulled as rates test higher.

4) High yield saw another week of outflows. Most of the prior outflows have been concentrated in USD high yield in proportional terms, but the latest week has seen the outflow process become more pronounced in W European space.

5) W Europe high yield has fared better versus USD high yield, but neither has seen anything like the inflows seen into investment grade corporates. This should see fewer outflows from high yield even if, for example, there are large outflows from emerging markets.

## The bottom line

The inflow process to hard currency funds had been especially impressive since the turn of the year, supported by a strong performance from core product. The recent rout on core bonds has acted as a catalyst for change, with hard currency funds seeing the first weekly outflow since December 2016. There has also been some rotation in evidence from hard currency funds into local currency funds, but the baseline view is that such inflows to local currency will also morph to outflows as the support from core product in terms of total returns gets pulled as rates test higher.

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