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EM Debt Q&A

Exploring a more constructive outlook

Grant Webster
Portfolio Manager

For further information on investment team, please see the Important information section.

Following the big drawdowns seen in EM Debt this year, investors are rightly assessing the asset class and considering its future return prospects. History tells us that when valuations reach the extreme levels seen in July, the likelihood of good returns over the medium-term rises. But the complexity of the current global backdrop demands a robust analysis of the asset class. Grant addresses some of the key questions EM Debt investors asked him on his recent roadshow.

Fast view

- While not immune to the recent sell-off in global bond markets, EM Debt has shown resilience in the face of multiple headwinds. This speaks to the fundamental strength of EM economies now compared with other sell-offs seen over the past 25 years.
- Structural improvements in EM include lower levels of dollar debt, free-floating exchange rates and proactive central banks. Stronger balance of payments positions on the back of higher terms of trade should also help EMs cope with a lower growth environment.
- That said, a 'tail' of EM frontier markets appear to have over-borrowed in hard currency and they will face challenges if yields remain elevated and the new issue market closed. While market pricing has already largely reflected some these risks, selectivity is vital.
- Inflation in EM is showing signs of moderation (with a few notable exceptions) thanks to proactive rate-hiking by EM central banks who began tightening policy much earlier than their developed markets peers and are significantly further through their hiking cycles.
- Historically, as interest rate-hiking cycles progress to their later stages, investors have underestimated this progress, reflected in undervalued bonds. Bonds then tend to outperform as expectations catch up with reality. Many EMs are now well-placed in this regard.
- Now at levels not seen since the GFC, EM hard currency yields provide a cushion against volatility. Furthermore, history shows that yield is the dominant driver of bond-market returns, painting a positive picture for return prospects.

1. How has EM Debt performed in the context of a global bond bear market?

Context and perspective on the sell-off

EM Debt has been caught up in the general fixed income bear market, driven by rising inflation, central bank policy tightening, and risk aversion associated with the volatility of inflation and rates. In July, US inflation hit its highest level in over 40 years; investors are understandably concerned. Like other credit asset classes, emerging market (EM) credit has suffered outflows, particularly from the retail investor base. Significant ETF outflows have distorted the market. However, recently outflows have stalled and we are seeing increasing interest from institutional investors. indicating that the asset class could see net inflows in the second half of 2022.

Against this backdrop, Figure 1 shows how EM Debt has performed relative to other asset classes during the broad, secular bear market. There is some comfort for investors in how EM Debt returns compare during this sell off, given all the headwinds faced by the asset class. We believe this speaks to the relative structural strength of EM economies now versus other sell-offs seen over the past 25 years.

Figure 1. Fixed income market characteristics

	Returns						Yield		Spread		Duration	Index
	1m	3m	YTD	1yr	3yr (ann)	5yr (ann)	Current	ΔYTD	Current	ΔYTD		
Government Bonds												
Global Treasuries	1.78%	-0.91%	-13.27%	-16.50%	-3.56%	-1.18%	2.06%	129 bps			7.9	WGBI
Global Aggregate	2.13%	-0.35%	-12.08%	-14.39%	-2.45%	-0.47%	2.60%	128 bps			7.0	BBG Barc Global Agg
US Treasury	1.59%	1.40%	-7.69%	-8.67%	-0.32%	1.02%	2.89%	165 bps			6.4	BBG Barc US Treasury
US Aggregate	2.44%	2.09%	-8.16%	-9.06%	-0.21%	1.28%	3.42%	165 bps	72 bps	18 bps	6.3	BBG Barc US Agg
Euro Treasury	4.13%	0.50%	-8.63%	-10.64%	-2.83%	0.15%	1.31%	118 bps	-10 bps	-11 bps	7.9	BBG Barc Euro Treary
Euro Aggregate	4.43%	0.09%	-9.30%	-10.94%	-2.62%	-0.05%	1.77%	131 bps	16 bps	3 bps	7.5	BBG Barc Euro Agg
EM Bonds												
EM Hard Currency Sovgn	2.89%	-2.99%	-18.01%	-19.19%	-4.70%	-0.79%	8.20%	290 bps	533 bps	166 bps	7.0	JPM EMBI GD
EM LC Sovgn Unhedged USD	0.29%	-1.87%	-14.28%	-18.21%	-6.00%	-2.65%	6.84%	112 bps			5.0	JPM GBI-EM
EM LC Sovgn Hedged USD	1.28%	0.39%	-9.94%	-12.77%	-2.55%	0.06%						JPM GBI-EM
EM Corp	1.05%	-2.41%	-13.04%	-13.60%	-1.07%	1.30%	6.88%	229 bps	393 bps	120 bps	4.5	JPM CEMBI BD
EM IG Corp	0.89%	-0.82%	-12.91%	-13.19%	-1.26%	1.19%	5.12%	196 bps	220 bps	70 bps	5.1	JPM CEMBI BD IG
Asia Credit	0.25%	-2.12%	-10.51%	-12.49%	-1.65%	0.78%	6.32%	215 bps	319 bps	98 bps	4.6	JPM JACI
DM Bonds												
US IG	3.24%	2.03%	-11.61%	-12.53%	-0.12%	1.78%	4.33%	197 bps	171 bps	57 bps	7.7	BBG Barc US Corp
EUR IG	4.70%	-0.17%	-7.74%	-9.20%	-2.29%	-0.10%	2.37%	185 bps	99 bps	49 bps	4.8	BBG Barc Euro Corp
US HY	5.90%	-0.45%	-9.12%	-7.93%	1.95%	3.06%	7.77%	291 bps	484 bps	194 bps	4.0	BBG Barc US HY
EUR HY	5.13%	-3.28%	-9.95%	-9.69%	-0.38%	0.99%	6.77%	351 bps	504 bps	228 bps	3.4	BBG Barc Eur HY
US Leveraged Loans	1.93%	-2.15%	-2.21%	-0.34%	2.79%	3.49%	8.95%	368 bps	607 bps	193 bps	0.3	JPM LILI US
EUR Leveraged Loans	2.34%	-4.48%	-5.03%	-3.37%	1.30%	1.98%	8.40%	407 bps	716 bps	291 bps	0.3	JPM LILI EUR
Equities												
US Equity	9.22%	-0.18%	-12.58%	-4.75%	13.36%	12.83%	1.56%	29 bps				S&P 500 Total Return
EM Equity	-0.69%	-7.35%	-19.34%	-20.65%	-1.41%	-1.40%	3.10%	67 bps				MSCI EM Equity
Cross Asset Class							Spot	ΔYTD				
Gold	-2.46%	-5.40%	-3.59%	-2.05%	7.32%	6.84%	1762.90	-65.7				Gold, 100 Contract
Oil	-6.75%	-6.23%	31.13%	37.64%	18.96%	14.47%	98.62	23.41				Crude Oil
$ Index	1.16%	2.08%	10.70%	14.57%	2.44%	2.66%						USD Index Spot Rate
EMFX	-1.33%	-3.28%	-6.43%	-9.10%	-5.97%	-0.05						JPM GBI-EM FX

Source: Ninety One, Bloomberg, as at 31 July 2022. Returns are in US dollars except for euro-denominated bond indices. For further information on indices, please see Important information section.

Comparing and contrasting with previous sell-offs

EMs have endured some notable bear markets: the 1990's Asian crisis; the Global Financial Crisis (GFC); 'taper tantrum' (sparked by the 2013 Fed hiking cycle); and the COVID-19 pandemic market turmoil of 2020. We think the current bear market (and thus the subsequent recovery) is different to both the GFC and COVID ones. The key difference is that rather than being caused by a major external economic shock that central banks could react to with policy easing and asset purchases, the driver of the current sell-off in fixed income markets – including EM – is monetary policy tightening by major central banks, albeit with the Russian invasion of Ukraine worsening the global inflation dynamic.

We also believe that this episode of weakness is different to taper tantrum. Although monetary policy tightening drove both sell-offs, economic fundamentals in EM today are in much better shape. In contrast with the current account deficits of 2013, EM external balances are stronger, and there are no meaningful 'hot money' inflows. Furthermore, EM currencies are not overvalued and fiscal deficits have improved from COVID levels.

There are never any perfect historical analogies to the present, but this bear market may perhaps be more akin to the early 1990s than what we experienced in 2008, 2013 or 2020. During the early 90s, the US Federal Reserve hiked rates and tightened global dollar liquidity, which ultimately pressured emerging markets and led to the 'Tequila Crisis' in 1994. However, once the Fed hiking cycle came to an end in 1995, even though it had to keep rates elevated for some time, EMs began a gradual recovery. Another historical comparison we also consider, although by no means perfect, is the recovery in EM in the early 2000s. Following the bursting of the tech bubble, the global economy again enjoyed a gradual recovery as inflation and yields retreated.

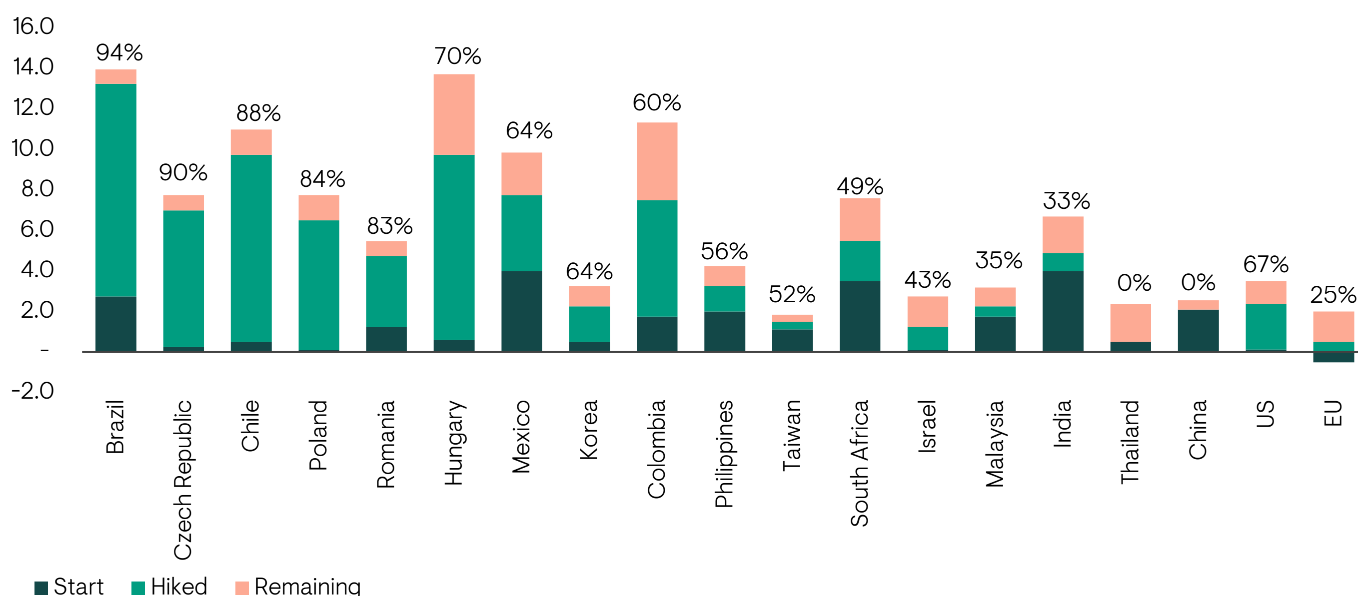
We are by no means saying that we expect a sharp fall in global inflation and thus an easing of policy rates. But we would argue that the recent combined effects of supply-chain disruptions, excessively loose monetary policy, and the Russian invasion of Ukraine led to a period of excessively high inflation from which at least some recovery should be expected as the shock waves from these events diminish.

2. Are EM sovereigns equipped to deal with the low-growth, high-inflation environment?

Much of the rate-hiking pain is already behind EMs

While EMs still have some way to go, on average (excluding China, Russia and Taiwan), the market currently prices them as 65% through their hiking cycles, compared to 67% for the Fed and 25% for the ECB. In June the market priced EM's as being 46% through the cycle.

Figure 2. Progress through hiking cycles by market, relative to market pricing of peak rates



Source: Ninety One as at 31 July 2022. When calculating the EM average progress we consider all EM's except Russia (has been cutting), China (not hiking) and Taiwan (difficult to price). % = the progress through the cycle as priced by the market.

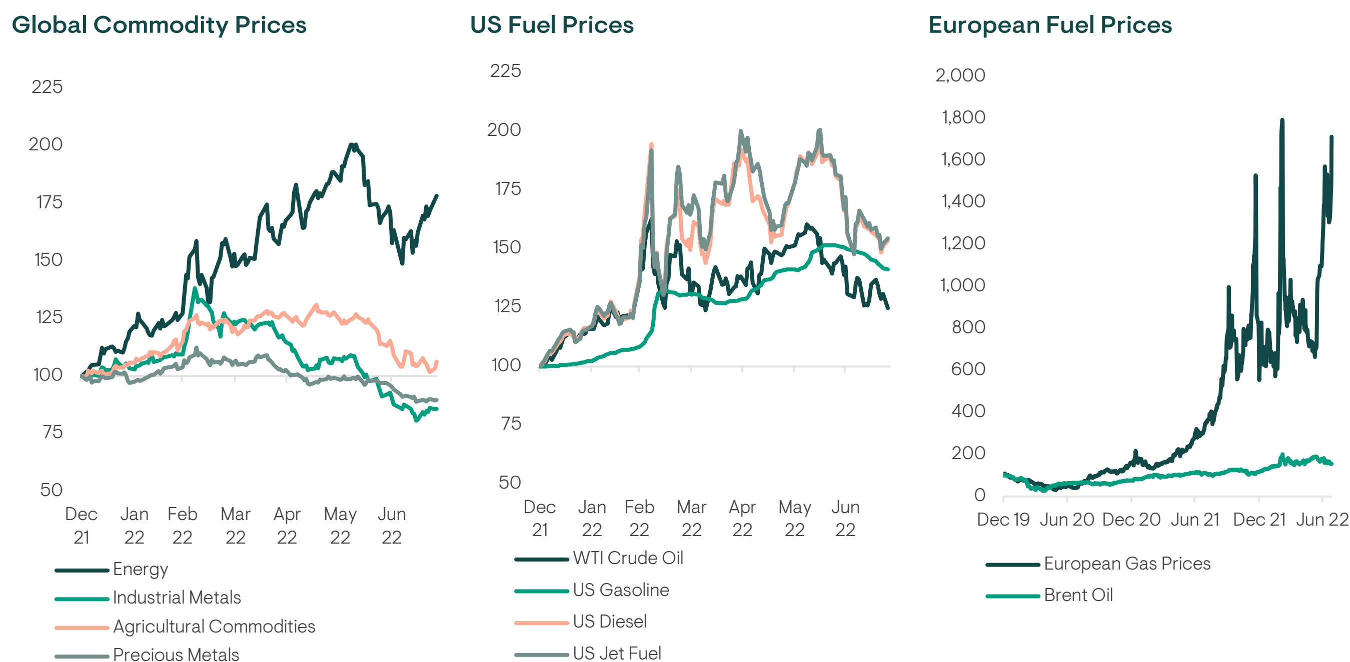
Inflation pressures are starting to reduce in EM

In addition, we expect inflation to moderate next year, while higher nominal growth rates have actually boosted fiscal positions in many EMs.

The underlying drivers of global inflation are already starting to show signs of easing, with the exception of European gas prices. This increases the chances that US rates will not rise as high as the market had previously thought and that rate hikes in the EU will be limited due to the widespread economic slowdown already being felt (gas prices have risen to almost 20x their 2019 levels at the time of writing).

Figure 3 shows that commodity prices are well off their 2022 highs and even US gasoline and diesel prices have fallen, but Europe is an entirely different story.

Figure 3. Commodity prices – coming off their highs



Source: Bloomberg 26 July 2022. Energy = Bloomberg Energy Index, Industrial Metals = Bloomberg Industrial Metals Index, Agricultural Commodities = Bloomberg Agricultural Commodity Index, Precious Metals = Bloomberg Precious Metals Index, US Gasoline = Bloomberg Average US Gasoline Price Index, US Diesel = US Gulf Coast Ultra Low Sulphur Spot Diesel, US Jet Fuel = US Gulf Coast Spot 54 Grade Jet Fuel, European Gas Prices = Netherlands TTF Natural Gas Forward 1 Month. Charts are rebased to 100; the first two at 31 December 2021, the third (European fuel prices) at 31 December 2019.

We see EM inflation showing signs of moderation (with a few notable exceptions) thanks to the proactive rate-hiking by EM central banks, who began tightening policy much earlier than their developed markets peers. Figure 4 shows that food prices in EM are moderating; this is positive for EMs given the large share (30%) food represents in EM consumption baskets.

Figure 4. Food Price Index, % change (3-m rolling average, yoy)

Source: Bloomberg, 30 June 2022. UN FAO Food Price Index.

Stronger foundations to withstand weaker global growth

We believe that having stronger balance of payments positions on the back of higher terms of trade will also help EMs cope with a lower growth environment. Many EMs front-loaded their issuance last year, reducing short-term maturities. Thus, EMs appear better positioned – relative to taper tantrum and the immediate aftermath of COVID-19 (mid-2020) – to endure a period of lower growth.

That said there is a 'tail' of EM frontier markets which appear to have over-borrowed in hard currency and they will face challenges (and particularly lower commodity prices) if yields remain elevated and the new issue market closed. In this space we are closely monitoring markets like Ghana, while among the larger markets, Turkey is a key one to watch.

However, a prolonged period of low growth and higher rates is not our base case expectation. We believe that developed markets (DM) household and corporate balance sheets remain strong and unemployment is unlikely to rise dramatically. Furthermore, the IMF is working with members to transfer SDR allocations from those countries not needing them (predominantly DMs) to the most vulnerable EMs. (More on this in Question 6).

3. Will the agricultural commodity constraints lead to another (Arab) Spring?

We do not think we will see a repeat of the widespread unrest of the 'Arab Spring' (2010 – 2012), which precipitated a complete overhaul of the current political system. Firstly, while food prices have risen, raw agricultural prices themselves have barely risen at all over 2022. We believe it has been the effects of higher energy prices and supply-chain constraints that have pushed food prices higher and that as these effects dissipate, we will see some relief to end-food prices. There is also some room for fiscal support from governments as we have already seen. Some key countries like Egypt have done a good job of reducing youth unemployment and making food subsidies much more targeted. We also need to distinguish between mild discontent (which is a global phenomenon) due to rising prices and something more fundamental - such as the Arab Spring. We think that broad-based socio risks are lower now in MENA for several reasons:

- **Improved macro-management:** Many EM countries have largely moved away from ineffective subsidies in favour of targeted food subsidies, providing a buffer to lower income families. Most countries now have inflation targeting and fixed exchange rates are less prevalent, giving policymakers better leverage.
- **Weaker appetite for political change:** Unfortunately, a level of political apathy set in post the 2011 Arab Spring, either because those protests were either unsuccessful in effecting change (like in Libya) or because where there was change to a more democratic regime, economic improvements have been slow to follow (like in Tunisia).

We continue to monitor levels of social protest in EM. There has been a meaningful pick up in protests in Latin America prompted by rising cost of living, subsidy cuts and populist movements. However, this social discontent has been met with a mix of fiscal relaxation and political change. Where we are more worried about broader socio-pressures is in economies that are depleting reserves and running poor macro and fiscal policies, which exacerbate the impact of a tightening global liquidity environment. This is what happened in Sri Lanka, which exhausted its external reserves and the entrenched political class refused to accept economic realities, as we noted here.

4. EM crises has been hallmarked by rising borrowing costs. Is this time different?

We think there are some fundamental differences to the situation today, compared with other crises in EM. Firstly, higher nominal growth rates that are typically associated with higher inflation are boosting EM public coffers via higher tax revenue collection relative to budgeted expenditure; this is providing support to fiscal balances in EM. Secondly, as EM central banks hiked rates pre-emptively, the benefits of this should become evident as inflation comes down into 2023, affording them greater flexibility than their DM counterparts.

We also see the current global backdrop of US dollar liquidity withdrawal as different to the Latin American (1980s) and Asian (1990s) crises given lower external borrowing, flexible exchange rates and stronger balance of payments positions in most EMs. That said, we have some concerns in Africa where we have seen excessive borrowing in hard currency. Below we make some points on frontier vs. non-frontier markets, although within each of these groupings there remains significant divergence, warranting a highly selective approach.

Frontier EM

- High-yield EMs have very little debt due over next three years as most took advantage of lower rates to significantly lengthen their maturity profile.
- The majority of CCC rated markets are already trading well below historic recovery levels, so even in the event of a restructuring, we are likely to see NPV's above current levels, even assuming much higher exit yields.
- There will be winners and losers, but in large part we see willingness and ability to implement required reforms across a significant portion of this market segment.

Non-frontier

- For non-frontier EMs, external debt is a much lower part of their overall debt balance and they do not face the same risks they did in the 1980's and 1990's (pegged exchange rates, high levels of dollar debt, short-term rollover risks) and their risks are very different today.
- Markets like Brazil or Mexico have very little US dollar debt as a percentage of total debt and their currencies – rather than debt structuring – are the main source of adjustment in the economy.

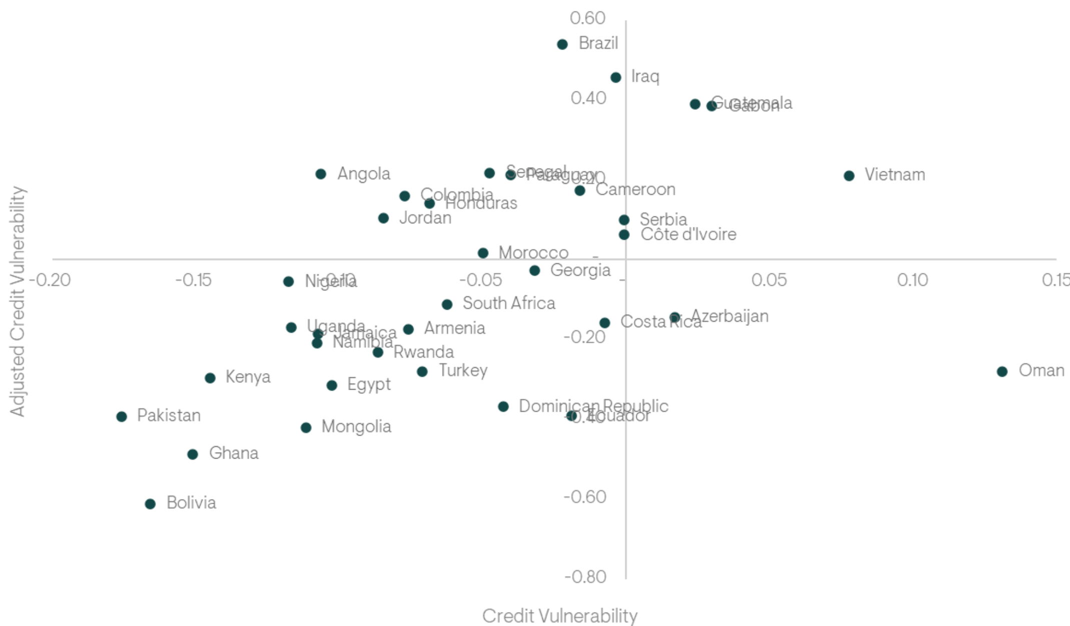
5. Which countries are most exposed to funding pressures?

Excluding CCC rated markets and defaulted debt, Turkey is the most worrying market in the EM debt investment universe. It is furthest away from seeking additional external support, its monetary policy is unorthodox, and it has a large amount of external debt due over 2022/2023.

If we see a severe global liquidity squeeze, Egypt could also be at risk, although the significant reduction in foreign ownership has reduced vulnerabilities, an IMF support package is imminent, and the Gulf Cooperation Council has also announced significant support.

Figure 5 shows credit vulnerability on the x-axis (which looks at current economic, fiscal, external and institutional factors of country relative to peers and history) and then combines this with external liquidity vulnerability (looking at reserves + gross external financing needs) on the y-axis so we can see which countries are most vulnerable to tighter global liquidity conditions.

Figure 5. Credit vulnerability vs adjusted credit vulnerability



Source: Ninety One. July 2022. For illustrative purposes only. For further information on investment process, please see the Important information section.

The lower left quadrant of the chart above highlights the most vulnerable countries. These have large short-term gross financing needs and poor credit fundamentals (Egypt, Ghana, Pakistan, Kenya). However, we believe market pricing has already reflected these risks to a great degree, with low cash prices of long-end bonds: 45c (Ghana) and 80c (Kenya) at the time of writing. Liquidity conditions are likely to improve on the margin for Egypt, Tunisia, Ghana, Kenya and Pakistan as all of these are on or working towards an IMF program. Most foreign investors have left, meaning the financial-account drain (i.e., impact from tightening financial conditions) will be lower as there is little foreign capital and currencies have adjusted significantly.

We believe the frontier-market segment has already experienced its 'sudden stop' moment (characterised by a collapse in foreign investor flows) and the IMF may need to revive some of the support measures implemented post-COVID in tandem with countries also focussing on securing more multilateral support.

6. Does the IMF have enough dry powder to alleviate funding pressures in EM?

The IMF's 'dry powder' is extensive, but we do not see countries desperately calling. Of its US$1 trillion of capital, the IMF has currently only deployed around US$250 billion, leaving it with around US$746 billion available.

In terms of the Common Framework, the IMF has made a record amount of emergency funding available and a US$650 billion allocation of special drawing rights, or SDRs — US$21 billion of which has been allocated to be available directly to low-income countries. Last year's IMF SDR allocation was made to all countries, as it had to be, but with 60% of countries not needing the money, the intention is to transfer those allocations to countries needing assistance. The leaders of the G20 have committed to support low-income countries by 'onlending' US$100 billion of their SDRs to significantly magnify this impact.

7. Is there a brighter outlook for EM Debt?

While EM Debt has been caught up in the global fixed income bear market, we are encouraged by the fact that EM relative performance has been much stronger than in previous crises, as noted in Question 1. This speaks to the structural strength of emerging markets now compared to other sell-offs over the past 25 years: lower levels of dollar debt, free-floating exchange rates and proactive central banks. Given this structural improvement across EM, we see conditions slowly moving towards an environment that is constructive for EM Debt returns.

There are early signs of slowing inflation across the globe (see Question 2) which means central banks are likely later in their hiking cycles than the market is pricing, as outlined earlier.

Why is the point in the hiking cycle so important? We have analysed 79 hiking cycles across EM over the past 20 years and the results clearly show that EM fixed income markets underperform as we transition from the early to later parts of a hiking cycle as markets initially underestimate the peak in the cycle and then tend to overestimate it as the cycle progresses. Later in the hiking cycle bonds tend to outperform as the market realises that it is much later in the hiking cycle than they initially believed. This inflection point can be seen Figures 6 and 7 when the hiking cycle is 80-90% of the way through (Figure 7 shows fixed income returns moving from negative to positive late in the hiking cycle). We believe are now approaching, or at, that inflection point.

Figure 6. Market expectations vs actual rate-hiking cycle

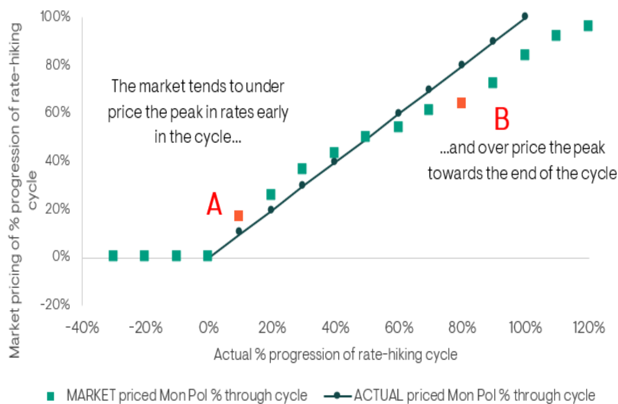
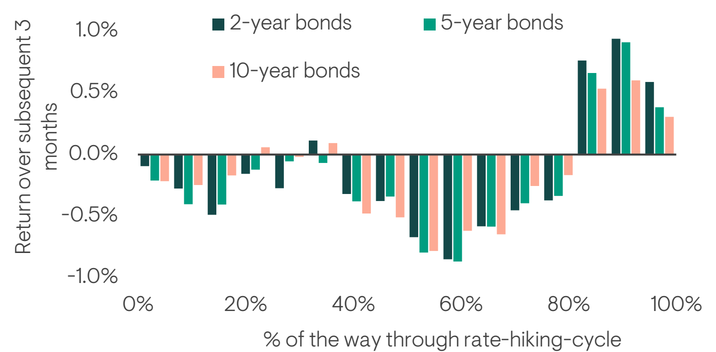


Figure 7. Returns of bonds (2, 5 and 10 years to maturity) over the subsequent 3 months at different points in rate hiking cycle

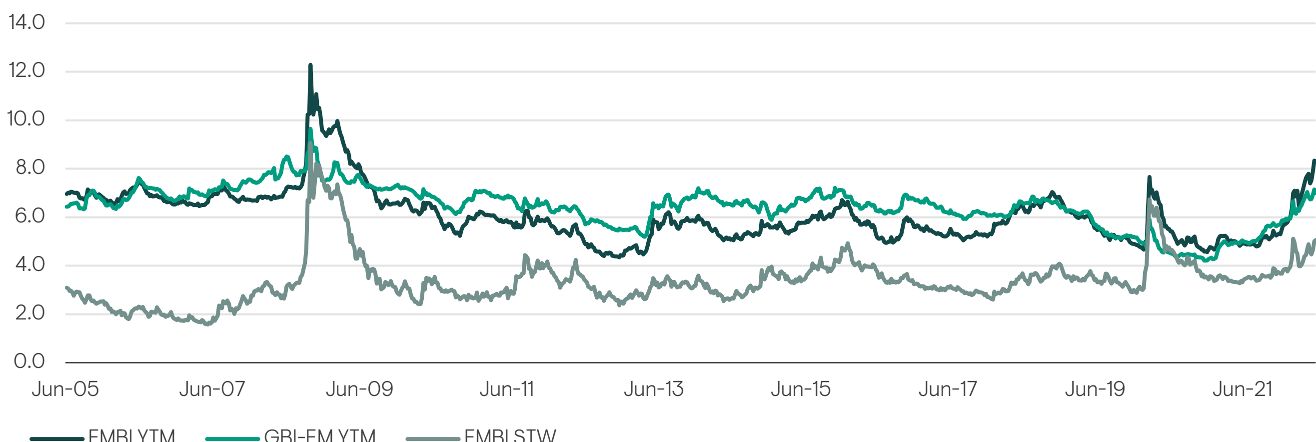


Source: Ninety One as at 8 July 2022. Dataset includes 79 hiking cycles in EM since 2003, 53 of those cycles >180 days and 28 of those cycles >=300bps. Medians are used. Bond returns are equal duration positions, hedged, i.e., 10% in a 2-year bond hedged with 10% FX forward.

Valuations

In further support of the outlook for EM Debt, we cannot ignore the historically high levels of yields and spreads we are seeing. At close to 8.5% at the time of writing, EM hard currency yields are at levels not seen since the GFC and provide a cushion against volatility.

Figure 8. Yield and spread of emerging market debt indices, %



Source: Bloomberg, JP Morgan, Ninety One, as at 30 June 2022. Yield to maturity and spread to worst for JP Morgan EMBI (hard currency) and JP Morgan GB-EM (local currency) indices. For important information on indices, please see Important information section.

Expected returns

As shown in the charts below, looking back at the return drivers of EM debt, it is yield that has made the largest contribution to return. This paints a strong picture for return prospects from the asset class in the coming three-five years.

Contributions to return

Fig. 9. Hard currency return breakdown (JP Morgan EMBI)

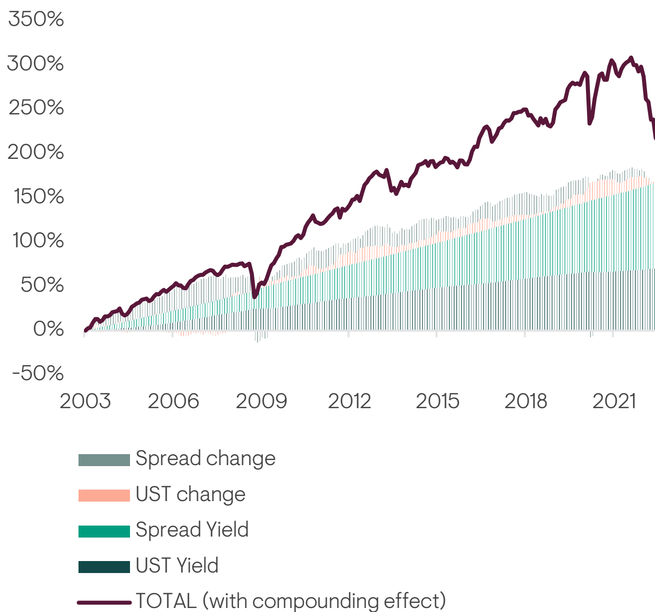
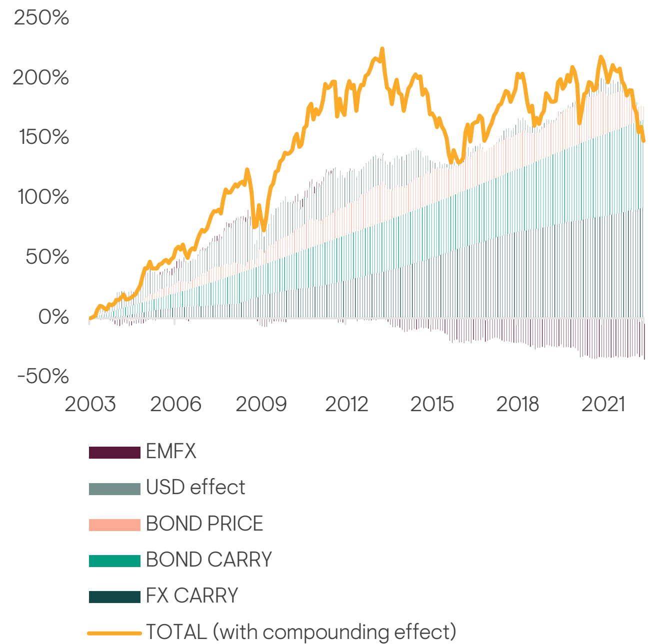


Fig 10. Local currency return breakdown (JP Morgan GBI-EM)



Source: Bloomberg, JP Morgan. As at August 2022. For important information on indices, please see Important information section.

We can extrapolate the above backward-looking breakdown of return drivers into what this might mean for future returns. In the charts below, we plot yields over time and for each point in time we show the return recorded over the subsequent three-year period. This shows that when yields spike (dark green line), the subsequent 3-year return (light green line) is strongly positive. This holds true for both local and hard currency returns.

Yields and subsequent 3-year performance

Fig 11. Hard currency return (JP Morgan EMBI)

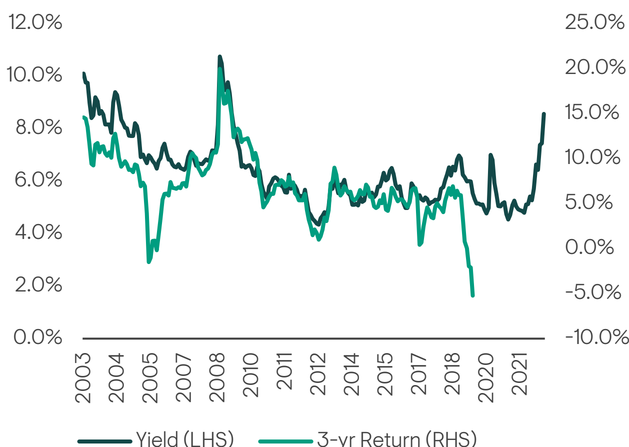
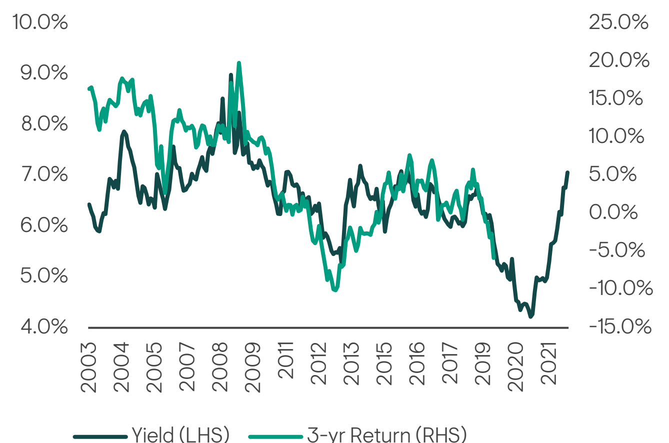


Fig 12. Local currency return breakdown (JP Morgan GBI-EM)



Source: Bloomberg, JP Morgan. As at August 2022. For important information on indices, please see Important information section.

The tables below show expected returns for hard currency debt, local currency debt and a 50/50 blend of the two under various US Treasury yield and EM Debt spread assumptions. This analysis assumes a 5% default rate (much higher than the 1.5% average annual default rate seen over the last 20 years).[1] We also stress tested this model to see what it would take to generate negative returns over a five-year period: yields to rise to above 11%, EMFX to sell off 4% per year and a cumulative 25% credit loss through defaults (which implies around a 40% index default rate). While any scenario is possible, this seems to be a very unlikely outcome.

Figure 13. Historically high yields provide a meaningful buffer

EMBI (Dollar Sovereign Debt) RETURNS - 5 yr Forecast

	10-year UST Yield in 5 years' time						
EMBI Spread	2.25%	2.50%	2.75%	**3.00%**	3.25%	3.50%	3.75%
150	15.9%	15.4%	14.9%	14.4%	13.9%	13.4%	12.9%
200	14.9%	14.4%	13.9%	13.4%	12.9%	12.4%	11.9%
250	13.9%	13.4%	12.9%	12.4%	11.9%	11.5%	11.0%
300	12.9%	12.4%	11.9%	11.5%	11.0%	10.6%	10.1%
350	11.9%	11.5%	11.0%	10.6%	10.1%	9.6%	9.2%
400	11.0%	10.6%	10.1%	9.6%	9.2%	8.8%	8.3%
450	10.1%	9.6%	9.2%	8.8%	8.3%	7.9%	7.5%
500	9.2%	8.8%	8.3%	7.9%	7.5%	7.0%	6.6%
550	8.3%	7.9%	7.5%	7.0%	6.6%	6.2%	5.8%

- Currently the EMBI has a spread of 550bps.
- The 10-year average spread is 350bps.
- In the central scenario we assume US Treasury yields remain around 3%, spreads return to average and 5% of the index defaults each year.

GBI-EM (Local Currency Sovereign Debt) RETURNS - 5 yr Forecast

	Local Currency Bond Yield in 5 years' time						
Annualised Crncy Apprec.	4.50%	5.00%	5.50%	**6.00%**	6.50%	7.00%	7.50%
4.0%	14.4%	13.9%	13.4%	12.9%	12.4%	11.9%	11.5%
3.0%	13.4%	12.9%	12.4%	11.9%	11.4%	10.9%	10.5%
2.0%	12.4%	11.9%	11.4%	10.9%	10.4%	9.9%	9.5%
1.0%	11.4%	10.9%	10.4%	9.9%	9.4%	8.9%	8.5%
0.0%	10.4%	9.9%	9.4%	8.9%	8.4%	7.9%	7.5%
-1.0%	9.4%	8.9%	8.4%	7.9%	7.4%	6.9%	6.5%
-2.0%	8.4%	7.9%	7.4%	6.9%	6.4%	5.9%	5.5%
-3.0%	7.4%	6.9%	6.4%	5.9%	5.4%	4.9%	4.5%
-4.0%	6.4%	5.9%	5.4%	4.9%	4.4%	3.9%	3.5%

- Currently the GBI-EM is yielding 7.0%.
- The 10-year average yield is 6.0%.
- In the central scenario we assume the GBI-EM yield returns to 6% and currencies remain stable versus the US dollar.

EM Blended Debt RETURNS - 5 yr Forecast

EMFX Change (p.a.)	Bond Yield Level						
Local	4.50%	5.00%	5.50%	**6.00%**	6.50%	7.00%	7.50%
Hard	4.25%	5.00%	5.75%	**6.50%**	7.25%	8.00%	8.75%
4.0%	14.7%	13.6%	12.5%	**11.5%**	10.5%	9.5%	8.6%
3.0%	14.3%	13.2%	12.1%	**11.1%**	10.1%	9.1%	8.2%
2.0%	13.9%	12.8%	11.7%	**10.7%**	9.7%	8.7%	7.8%
1.0%	13.5%	12.4%	11.3%	**10.3%**	9.3%	8.3%	7.4%
0.0%	**13.1%**	**12.0%**	**10.9%**	**9.9%**	**8.9%**	**7.9%**	**7.0%**
-1.0%	12.7%	11.6%	10.5%	**9.5%**	8.5%	7.5%	6.6%
-2.0%	12.3%	11.2%	10.1%	**9.1%**	8.1%	7.1%	6.2%
-3.0%	11.9%	10.8%	9.7%	**8.7%**	7.7%	6.7%	5.8%
-4.0%	11.5%	10.4%	9.3%	**8.3%**	7.3%	6.3%	5.4%

- A 50/50 weighting of the EMBI and GBI would return 10% in the central scenario.
- To generate negative returns over 5-years would require yields to rise to above 11%, EMFX to sell off 4% per year and a cumulative 25% credit loss through defaults.

Source: Ninety One July 2022. For illustrative purposes only. Forecasts are inherently limited and are not a reliable indicator of future results.

[1] JPMorgan calculation of default rates annually in the EMBI Global index from 2001 to 2020.

Ninety One Multi-Asset Team - Capital Market Assumptions

At Ninety One, the Multi-Asset team and process operates independently of our Fixed Income Team. The output from our Multi-Asset team colleagues' process to the end of June 2022 (updated every six months) is supportive of a positive outlook for EM Debt over the coming 10 years. We include the latest output from their Multi-Asset Teams CMA tool below.

The equity CMA forecasts have risen over the year but remain well below levels seen during the COVID-19 sell-off. However, the bond market CMAs are now well above the levels reached in March 2020. Return forecasts for EM local currency bond markets are higher due to both higher yields and Real Effective Exchange Rates, which are below long-run averages.

Figure 14. Equity 10-year Local Currency Return Forecast

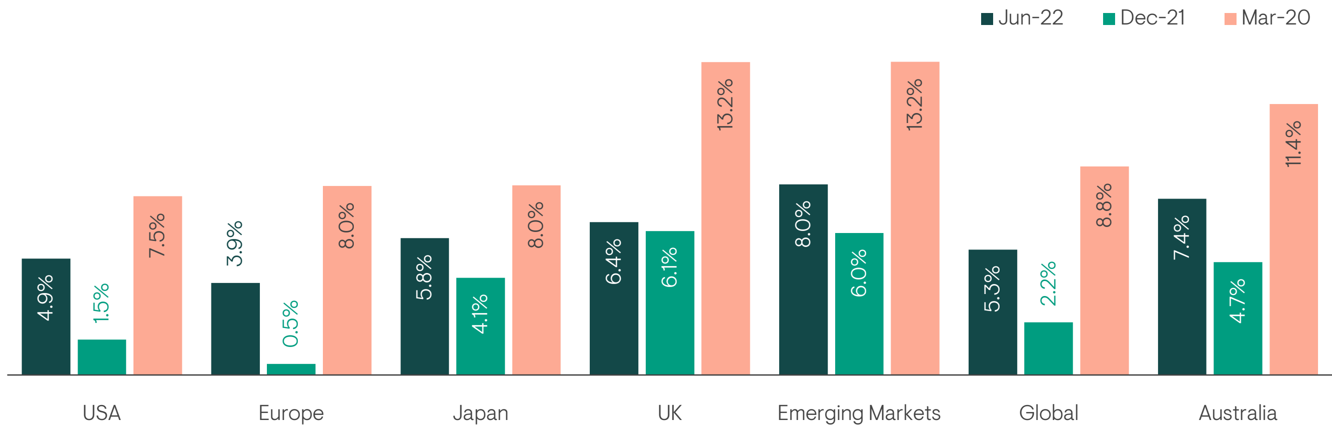


Figure 15. Fixed Income 10-year Local Currency Return Forecast

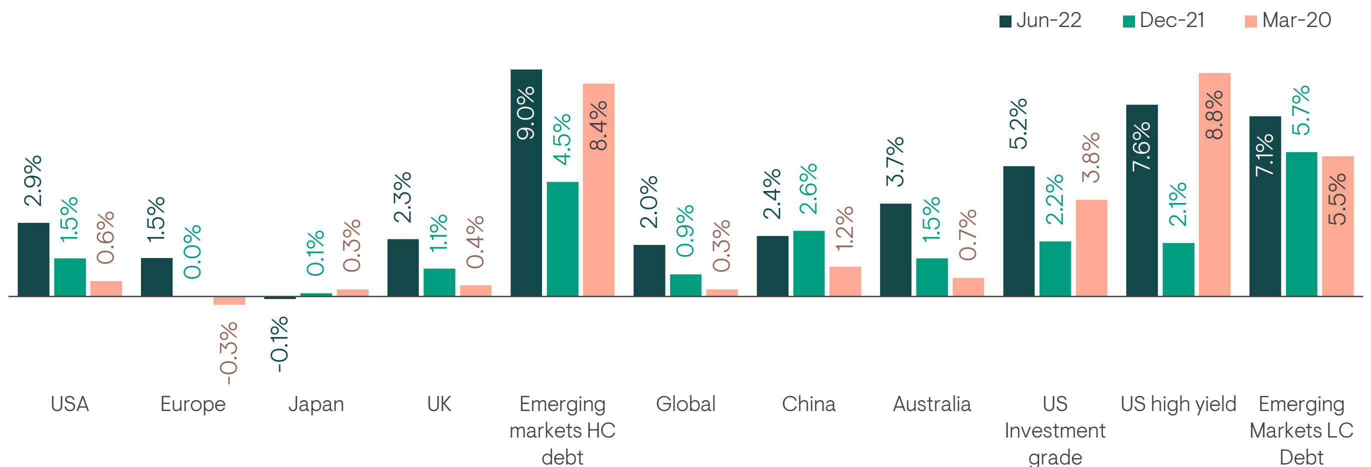


Figure 16. 10-year EM Local Currency Return Forecast

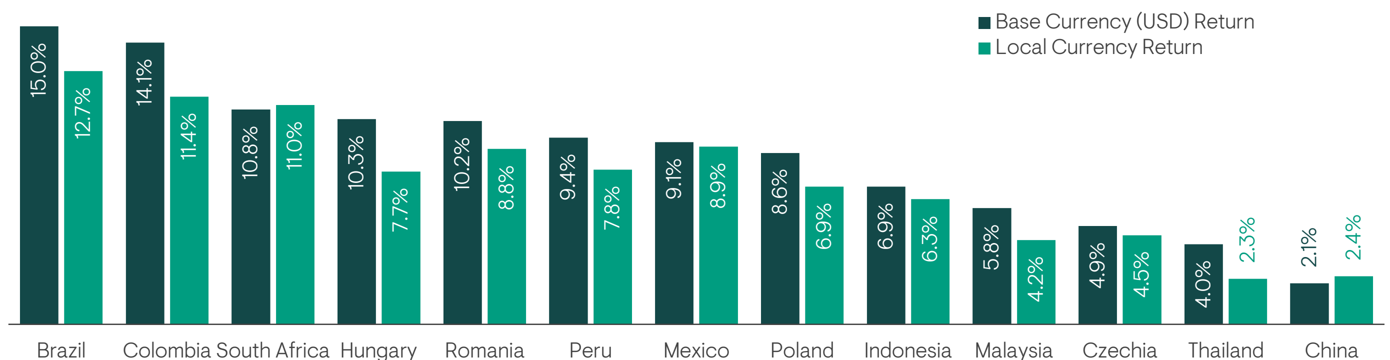
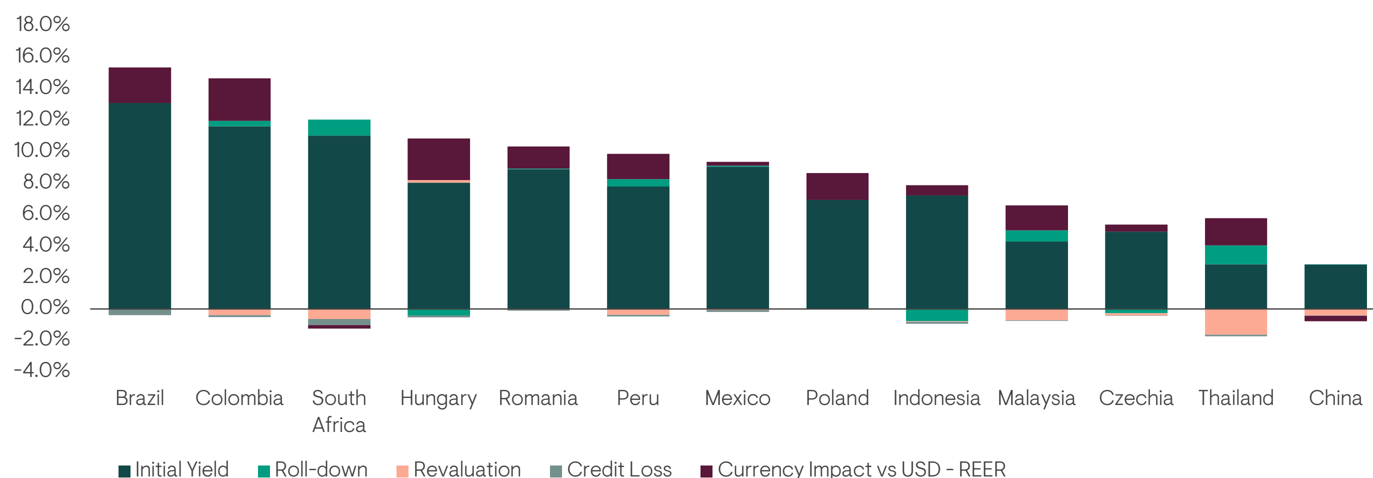


Figure 17. 10-year EM local Currency Return Forecast (USD)



Source: Ninety One, June 2022. Forecasts are inherently limited and are not a reliable indicator of future results.

In summary

While, like wider fixed income asset classes, EM Debt has been caught up in the global bear market year-to-date, we are encouraged by the fact that EMs' relative performance has been much stronger than in previous crises. This speaks to the relative structural strength of emerging markets now compared to other sell-offs over the past 25 years: lower levels of dollar debt, free-floating exchange rates and proactive central banks. Given this structural improvement across EM, combined with attractive valuations and signs that inflation is slowing and many central banks in EM are near the end of their hiking cycle – representing an attractive entry point for debt investors – we believe the backdrop is shifting to a much more constructive phase for EM debt investors.

General risks: The value of investments, and any income generated from them, can fall as well as rise. Where charges are taken from capital, this may constrain future growth. Past performance is not a reliable indicator of future results. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Investment objectives and performance targets are subject to change and may not necessarily be achieved, losses may be made. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

Specific risks: Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. **Default:** There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss. **Derivatives:** The use of derivatives may increase overall risk by magnifying the effect of both gains and losses leading to large changes in value and potentially large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. **Emerging market (inc. China):** These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. **Interest rate:** The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise. **Government securities exposure:** The Fund may invest more than 35% of its assets in securities issued or guaranteed by a permitted sovereign entity, as defined in the definitions section of the Fund's prospectus.

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