August 2021

Revisiting EM Hard Currency Debt

The rising relevance of the asset class in institutional portfolios and the implications of a transformational decade

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About Ninety One

Ninety One is an independent, active global asset manager dedicated to delivering compelling outcomes for its clients, managing £139.0 billion in assets (as at 30.06.21). Established in South Africa in 1991, as Investec Asset Management, the firm started offering domestic investments in an emerging market. In 2020, almost three decades of organic growth later, the firm demerged from Investec Group and became Ninety One.

Today the firm offers distinctive active strategies across equities, fixed income, multi-asset and alternatives to institutions, advisors and individual investors around the world.

Investment involves risk; losses may be made.

The fast view

- Investors are increasingly reassessing their allocation to emerging market (EM) hard currency debt, one of the few remaining sources of yield in today's global fixed income markets. In addition to yield, the risk-adjusted return profile and diversification properties of the asset class explain why some institutional investors' capital market assumptions are pointing toward larger allocations.

- Although investors have flocked to developed market (DM) credit for yield pick-up, superior fundamentals for comparative credit quality mean EM hard currency debt may improve the yield and return potential of portfolios without introducing excessive risk. Over the past decade, EM fundamentals have strengthened, reinforcing this benefit.

- The remarkable evolution of the asset class over the past decade has seen the number of markets almost double (now 73) and its regional footprint diversify significantly. The increased importance of frontier markets has broadened the opportunity set, while introducing new challenges and complexities.

- The size, diversity and liquidity considerations in the investment universe today make a high-conviction, selective approach essential. At the same time, investors need to be careful to avoid a concentration of portfolio risk, given the potential for negative credit events to erode returns.

- In the COVID era, the importance of structural reforms in EM has risen; investors should look for managers with the depth and breadth of expertise to identify early those economies that are on the right path and, conversely, those where a structural deterioration is occurring and credit sustainability is under question.

- The 'G' in ESG has always been critical in EM. However, the 'E' and the 'S' are becoming increasingly important to integrate, introducing additional challenges given the inherent complexity of ESG analysis among EM.

- With the continued scarcity of yield in fixed income markets, we expect more investors to revisit their EM hard currency debt allocations. Other supportive tailwinds for the asset class include improving trade flows within EM, and we continue to see attractive valuations in high-yield markets where spreads are yet to fully recover.

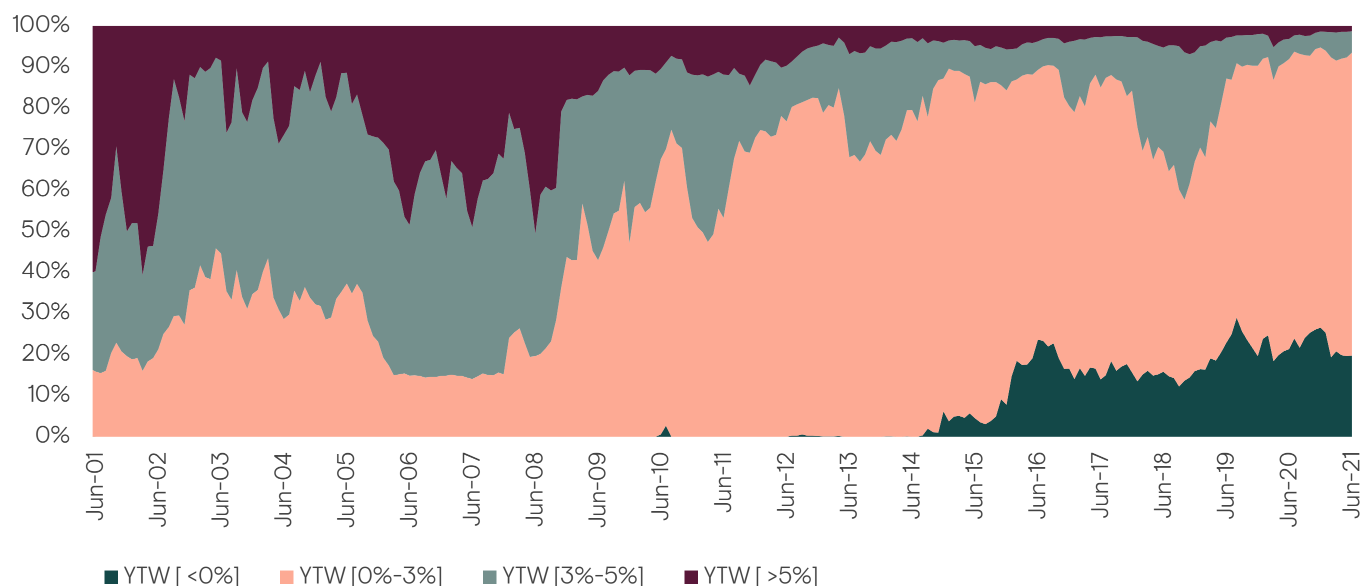
Why investors are revisiting the asset class

For almost 30 years, hard currency sovereign debt has given investors valuable exposure to the improving fundamentals and credit dynamics in EM without introducing currency risk. The past 10 years have brought both a transformation of the asset class and a shift in the macro and market environment facing investors. The result is that some investors are now revisiting the asset class and the role it plays in their portfolios. In an institutional asset allocation, the yields, risk-adjusted return potential and diversification properties of the asset class today explain why capital market assumptions of a number of industry participants are pointing toward larger allocations.

A source of yield in a world where low yields are persisting

Over the past 10 years, we have seen the theme of low and negative yields in the world's bond markets persist, making it harder for investors to meet their objectives with traditional bond allocations. Of the US$65 trillion of global bonds outstanding, 57% yield less than 1% and only around 6.5% offers yields of 3% or more.[1] Yet it's typical to find yields in the region of 5% to 10% in the hard currency sovereign debt universe, making it a useful source of yield pick-up to complement investors' global sovereign and credit portfolios.

Figure 1. Yield distribution in global bond markets



Source: BofA Global Fixed Income Markets Index (GFIM), Ninety One data as at 30 June 2021. YTW: yield to worst (lowest possible yield of a bond that does not default and fulfils all its legal obligations, i.e. the smallest amount investors will receive in the event of either the bond being called early or maturing). For further information on indices, please see Important Information section.

Stronger fundamentals and higher yields than DM for comparable credit quality

The yield pick-up offered by EM hard currency debt is often accompanied by superior fundamentals for comparable credit quality as there is typically a lower level of analysis and understanding of the EM investment universe, where misconceptions are rife. This is particularly the case in smaller markets which, as we explain later, are an increasingly important part of the asset class. That means EM hard currency debt allocations may improve the yield and return potential of investors' portfolios without introducing excessive risk – an important consideration for investors today, many of whom have ramped up allocations to higher risk parts of the fixed income universe in search of yield.

> The yield pick-up offered by EM hard currency debt is often accompanied by superior fundamentals for comparable credit quality

[1] Source: BofA Global Fixed Income Markets Index (GFIM), Ninety One data as at 30 June 2021.

Diversification benefits

A further reason for increased attention from investors is the significant diversification benefits the asset class has brought to portfolios, making it a valuable and efficient allocation. The correlation data in Figure 2 illustrates this.

Figure 2. Asset class correlations

	EM Hard Currency	BBG Barclays US Agg	BBG Barclays US Credit	BBG Barclays US Treasury	EM Local Currency	JPM CEMBI Broad Div	MSCI EM Equity	S&P 500
EM Hard Currency	1.00							
BBG Barclays US Agg	0.47	1.00						
BBG Barclays US Credit	0.77	0.81	1.00					
BBG Barclays US Treasury	0.06	0.88	0.47	1.00				
EM Local Currency	0.81	0.29	0.54	-0.03	1.00			
JPM CEMBI Broad Div	0.93	0.36	0.75	-0.08	0.81	1.00		
MSCI EM Equity	0.69	0.09	0.46	-0.27	0.83	0.83	1.00	
S&P 500	0.69	-0.07	0.35	-0.41	0.54	0.54	0.74	1.00

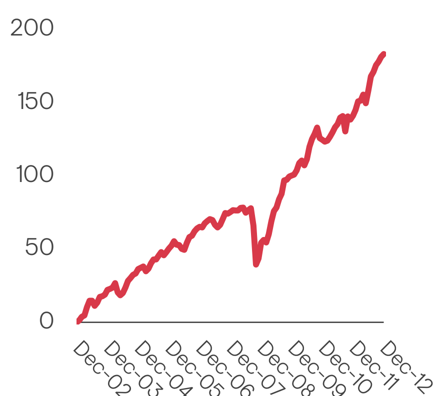
Source: Bloomberg data as at June 30, 2021. Pairwise correlations of monthly returns from June 30, 2011 to June 30, 2021. EM Hard Currency = JP Morgan JPEIDIVR Index - J.P. Morgan EMBI Global Diversified Composite; EM Local Currency = JP Morgan JGENVUUG Index - J.P. Morgan GBI-EM Global Diversified Composite Unhedged USD. For further information on indices, please see the important information section.

Attractive risk-adjusted return profile

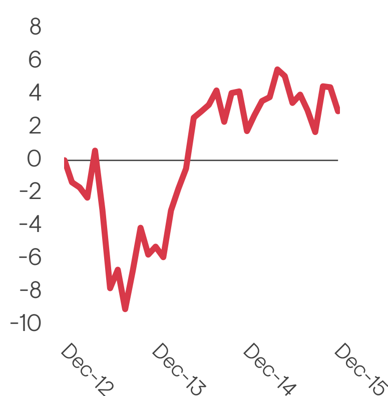
Over the past two decades we have seen three contrasting market backdrops and in each, EM hard currency debt has delivered what investors need from a return-seeking fixed income allocation, as shown in the figures below.

Figures 3, 4 and 5: Cumulative returns of EMBI in different market regimes, %

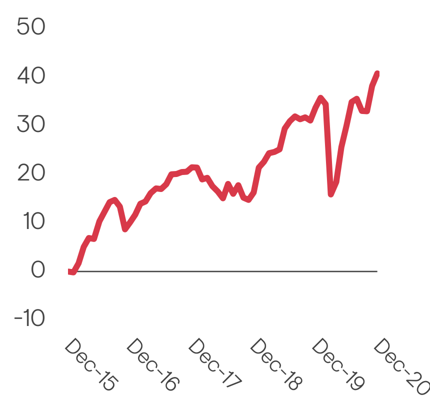
Rise of China and Commodity Super Cycle 2003 – 2012



Taper Tantrum and Commodity Crisis 2013 – 2015



Growth returns and COVID Impact 2016 – 2020



Annualised: 10.9% 1.5% 7.2%

Past performance is not a reliable indicator of future results, losses may be made.

Sources: Ninety One, JP Morgan, Bloomberg; as of December 31, 2020. Emerging Markets HC Sov Index = JPM EMBI Glo Div. Emerging Markets Local Sov Bond Index = JPM GBI-EM Global Diversified. Emerging Markets Corporate Index = JPM CEMBI Broad Diversified. For further information on indices, please see the important information section.

More generally, its return profile has often been similar to the more 'return seeking' fixed income during US equity sell-offs, which resulted in positive return in four of the nine equity drawdowns periods since April 2010[2]. On a risk-adjusted basis, the asset class's returns have also stacked up favourably, as shown below.

Figure 6: Statistics for 15 years to end of December 2020

	Returns	Standard deviation	Sharpe ratio	Correlation to BBG US Agg	Correlation to S&P 500
S&P 500	9.88	15.12	0.57	0.03	1.00
USHY	7.48	9.63	0.65	0.23	0.73
Bank Loans	4.60	7.73	0.44	0.02	0.62
EMD Mix (50% HC Sov / 50% LC Sov)	6.09	10.16	0.48	0.46	0.63
EM HC Sovereign	6.93	8.87	0.64	0.54	0.59
EM Corporate	6.49	7.98	0.66	0.47	0.58
EM Local Sovereign	5.10	12.51	0.31	0.36	0.61
50% USHY / 50% EMD Mix	6.85	9.24	0.61	0.37	0.73
1/3 HY / 1/3 Loans / 1/3 EMD Mix	6.14	8.29	0.59	0.28	0.73

Sources: Bloomberg, Ninety One, as at December 31, 2020. For further information on indices, please see the important information section.

A decade of evolution

The evolution of the asset class over the past decade has been quite astounding. While on the one hand this has created a broader opportunity set; on the other it has increased the complexities around investing in it.

Where it all started

The asset class was born in 1989, with the creation of 'Brady bonds' by then US Treasury Secretary Nicholas Brady. The debt-reduction plan enabled commercial banks to exchange their claims on developing market governments (mainly from Latin America) and convert them to more tradeable and liquid Brady bonds after many of those countries defaulted on their debt. Much has changed since then. Hard currency markets have become an increasingly important source of financing for EMs and remain the main entry point for most markets when making their first foray into global fixed income markets.

A strengthening of EM fundamentals

EM debt fundamentals have evolved significantly over the past decade; while the picture is far from uniform, in aggregate it is a story of strengthening fiscals, more orthodox monetary policy and lower inflation.

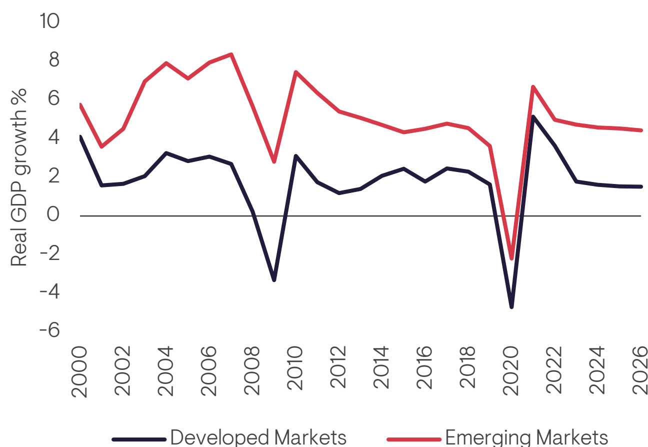
The cycle that began in 2013 (labelled Taper Tantrum and Commodity Crisis in Figures 3 to 5 above) was particularly challenging for EM economies but it sparked some positive developments, with sluggish growth and crises in several countries reinvigorating governments' commitment to structural reform. By 2018, fiscal and current account balances had improved significantly as a result of these painful but necessary steps.

From a policy perspective, prudence and orthodoxy also improved over those difficult years, with central bank independence in most markets driving inflation structurally lower. Furthermore, while some large developed economies retreated from globalisation, most EMs continued to look outward, seeking to deepen integration through regional trade agreements.

While COVID-19 caused an unprecedented demand shock to the global economy, as vaccinations gradually control the pandemic there is still a case for a continuing rebound in EM in the second half of 2021. We discuss growth dynamics in more detail in the following section. As the figures below show, the EM/DM growth differential remains intact and the average level of indebtedness in EM remains much lower than in DM.

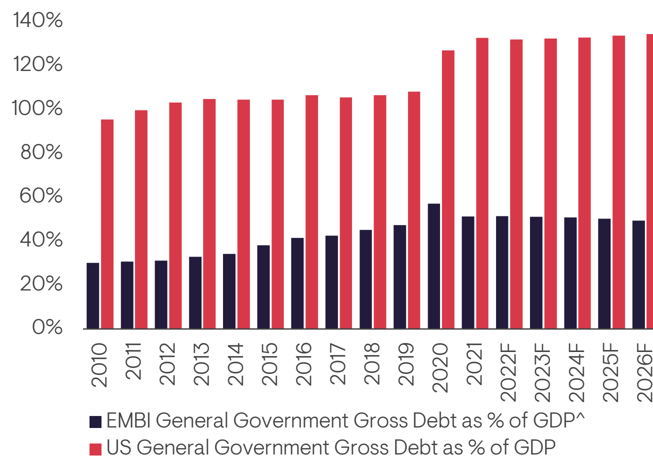
[2] Based on Bloomberg and JP Morgan data for the S&P 500 and EMBI index returns for the following periods: 2 months ending Jun 30, 2010; 2 to3 quarters ending Sept 30, 2011; 2 months ending May 31, 2012; 2 quarters ending Sept 30, 2015; quarter ending Feb 29, 2016; 2 months ending Mar 31, 2018; Quarter ending Dec 31, 2018; Month ending May 31, 2019; quarter ending Mar 31, 2020.

Figure 7. IMF global growth outlook – real GDP growth, %



Source: IMF, World Economic Outlook, April 2021.

Figure 8. EM vs DM debt/GDP



Source: Haver, World Economic Outlook (WEO) April 2021. ^JP Morgan EMBI Global Diversified Benchmark weighted general government gross debt excluding Macedonia and Barbados.

A bigger and broader range of countries

Over the past 10 years, we have seen a diverse array of countries join the flagship EM hard currency debt index JP Morgan EMBI, almost doubling the total number from 38 to 73. Now spanning oil exporters & importers, regional manufacturing hubs and services-driven economies, the analysis of the investment universe has become more challenging.

Smaller and more globally dispersed markets

A key feature of the EMBI's growth has been the increasing number of frontier markets, including countries in central Asia, Sub-Saharan Africa and the Middle East. These markets are typically under-researched by the mainstream investment community, bringing greater potential for alpha capture for those willing and able to do the necessary analysis.

Once focused in Latin America, the investment universe now spans the globe. While this is among factors explaining its diversification properties, it also brings additional complexity to investors who need to keep abreast of global geopolitical trends in addition to a highly diverse set of market-specific drivers.

A greater proportion of high-yield markets

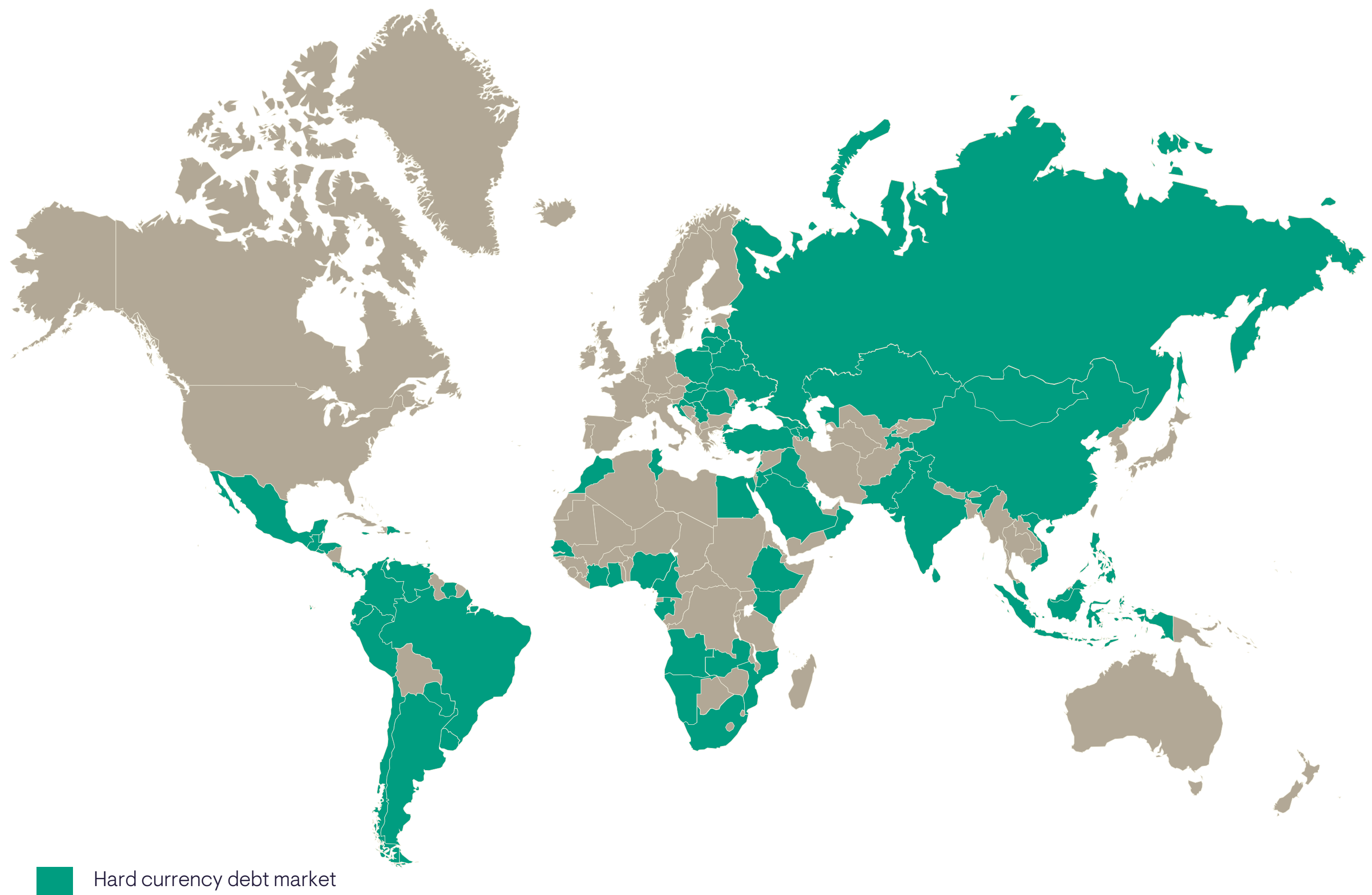
All of the above has resulted in a rise in importance of high-yield markets within the EMBI – markets that often rank low on the liquidity scale. The result is a greater dispersion of potential return outcomes, especially relating to the potential for negative credit events.

Corporate credit market evolution

In parallel with the developments above, the corporate credit market, also predominantly denominated in US dollars, has seen a total transformation. Over the past decade, China has risen from a 6% weighting in the CEMBI to 25%; more broadly Asian issuance has increased from one-third of the total annual supply to two-thirds. This geographic shift eastwards has been accompanied by an adjustment in composition. Once the preserve of quasi-sovereigns, the CEMBI universe now includes companies in the real economy, for example by the addition of Chinese tech companies or Indonesian telecommunications businesses.

The increasing depth and breadth of the EM corporates debt universe is among reasons why a growing cohort of investors is exploring the asset class. Another key attraction is the attractive yields – like sovereign debt, these are typically higher than developed market peers for the same credit quality. EM corporates benefit from the 'post-code premium', whereby very healthy and strong companies pay out more interest in EM than their DM peers purely because of the country they are domiciled in. With the growth of Asia in the investment universe (predominantly investment-grade markets), the asset class' overall credit quality has also increased and investors have wide opportunity set to select from, spanning the credit rating spectrum.

Figure 9. Hard currency debt markets today



Source: Bloomberg. JP Morgan EMBI universe as at March 31, 2021.

Navigating today's investment universe

Investors must carefully consider structural drivers

Following the COVID-19 impact on GDP, the latest World Economic Outlook from the IMF suggests that growth in many EM economies should return to pre-pandemic rates by 2022. However, it is vital for investors to recognise the significant diversity within these markets when considering the structural growth outlook.

One distinction that has become more important in recent years is between oil exporters and importers. Exporters' reliance on oil prices has come under the spotlight in recent years and while countries such as Saudi Arabia are taking steps to reduce their dependence on oil, others may face significant structural headwinds in years to come.

Many EM economies saw a muted deterioration of their fiscal balances in 2020 relative to many of their developed market peers, and the overall growth trajectory should help their debt balances to stabilise and fall significantly in 2022. But while not responsible for the debt sustainability issues facing weaker countries, COVID-19 has acted as an accelerant for a number of underlying problems and emphasises the importance of selection. In terms of debt sustainability, we think there will be a clear divergence between the winners and losers. Countries able to tackle their large primary deficits, such as Egypt and the Dominican Republic, are in a much stronger position than South Africa or Brazil, in our view.

Furthermore, fiscal balances and debt/GDP only tells half the story for many of these markets. Key for investors in the current environment are markets' fiscal balances, specifically the ratio of debt interest costs to revenues. Some frontier markets in particular have challenges to overcome as they develop and reach their potential:

1. Low savings rates often mean government attempts to stimulate the economy "crowds out" private sector investment.
2. High levels of informality and inefficient tax collection regimes result in relatively low levels of government revenue.
3. Despite debt levels similar to EM peers and lower than DM peers, smaller markets face substantially higher debt interest costs.

The key to these markets' success is how they tackle these three challenges. Over the past decade, we have witnessed success stories in the form of countries taking significant steps to both grow their domestic pensions and savings markets and improve the functioning of these markets – each of which should reduce the country's real interest rates. Examples include Ghana's creation of a defined contribution scheme. Meanwhile, countries taking significant steps – often with IMF support – to ramp up domestic revenues by expanding the tax base include Uganda, Ghana, El Salvador and Kenya. These dynamics are among the factors that investors should consider carefully when seeking to differentiate between markets with vulnerable finances and those on more solid ground/forging a clear path to sustainable finances. The ability to spot unrecognised fundamental improvements and catch an upgrade cycle early can create a significant advantage in this inefficient universe.

Case study 1: Egypt

We believe Egypt is a good example of a structurally strengthening market. In 2016, Egypt's twin deficit – its fiscal and current account deficit combined – totalled over 18% of GDP. Since then the country has undergone a significant structural shift. A currency devaluation restored competitiveness, and a strong reform agenda – underpinned by an IMF program – contributed to accelerated growth. After the pandemic hit, significant fiscal reform provided the space for Egypt to withstand this external shock and we continued to see an overarching narrative of fiscal discipline even in the face of COVID pressure. Egypt has shown a strong fiscal performance through its primary balance which came in above 1%, even during the COVID crisis. External balances have remained steady at around 4.5% of GDP, as weaker tourism receipts have been offset by stronger remittances.

Case study 2: Lebanon

Despite Lebanon being an EMBI constituent, in over 10 years of managing hard currency debt strategies, Lebanon's debt has not been attractive to us at any price, as we believed the country's political/economic system was fundamentally flawed and the risks were simply too high. Over recent years, significant and persistent fiscal and current account deficits financed through the banking sector led to a colossal level of debt/GDP, and to an oversized banking sector which was exposed almost entirely to the sovereign and aggravated vulnerabilities. These macroeconomic imbalances have been accompanied by political stagnation. Given the country's sectarian divisions and the fragility of its post-civil war institutions, the political elite has stalled on reforms and overseen an ineffective state riven with corruption. In 2019, against a backdrop of political paralysis and worrying signs that the country's increasingly fraught funding model was running out of steam, a proposed social media tax acted as a catalyst for widespread protests. This was the final straw for confidence which led to a run on the banks. The ensuing informal capital controls, US dollar shortages and spike in the unofficial exchange rate led to a collapse in bond values in the third quarter of 2019 as the market started to price in an ever-increasing probability of debt restructuring, with the bonds trading at highly distressed levels since then.

ESG: integration of E, S as well as G has become increasingly important

Structural reforms such as those mentioned above will have even higher importance in the post-COVID era and investors in these markets can play a very important role in engaging with these countries. The G of ESG is a key part of this and remains a crucial consideration for investors in the asset class. However, environmental and social matters have become increasingly important drivers of prosperity and therefore debt sustainability.

Biden's decision to re-join the Paris Agreement just hours after his inauguration signalled an intent to insert climate change into the architecture of global diplomacy and this is expected to have positive secondary effects throughout EMs. The EM investment universe contains many countries at risk from the climate crisis such as droughts and floods, much more so than DMs. Yet it also offers expertise in a number of areas (batteries, solar technology), likely to benefit as the US invests in greener infrastructure investments. Either way, it is clear that EM governments will need to play a key role in the planet's transition towards a sustainable future.

A forward-looking approach to ESG integration in EM debt investing is vital – where a country is heading is of more relevance than its past – and the toolkit required for effective integration of ESG into EM debt is a lot more complex than that required for DM. Investors cannot rely solely on third-party inputs, which are often sparse or flawed. Novel approaches are needed; with environmental factors becoming much more relevant for EM investors, we have partnered with the WWF to explore the use of satellite imagery as a new method to gauge countries' environmental trends and performance, adding a powerful tool to our toolbox when it comes to identifying risks and opportunities and for engaging with sovereign debt issuers.

In the post-COVID world, ESG will play a key role in terms of new (more targeted) funding vehicles for smaller countries. A global conversation is taking place involving policymakers, the IMF and the World Bank over how to lower interest costs facing these countries while allowing investors to invest into the projects and parts of the economy that really matter. COVID has highlighted the size of funding required in this space and has brought the two sides together: countries are looking to put frameworks in place; investors are encouraging countries to move in this direction; and multilaterals are looking to facilitate it all. Investors will need the appropriate tools to be able to assess how their capital is being used.

Investors must balance conviction with diversification

Given the diversity in the investment universe today, careful analysis is needed if investors hope to achieve attractive and durable risk-adjusted returns in this field. This not just about picking the winners from the full opportunity set, but also having the conviction to stay away from those markets where the risks are excessive and not sufficiently rewarded, even when others rush in. Furthermore, considering that over the past five years all of the top 10 performing markets, and eight of the bottom 10 markets, in the JP Morgan EMBI were frontier markets, it is clear that both a selective, conviction-based approach and a deep understanding of the intricacies of these more complex and typically less liquid markets have become vital.

The evolution of the hard currency market means that today it is a particularly rich hunting ground for active managers to explore relative-value alpha opportunities, given the information asymmetry arising from the inherent complexities in analysing many of these markets. From an information ratio perspective, we believe bottom up selection has greater potential in this investment universe than top-down calls, and investors need to be able to identify the attractive issuers while avoiding negative credit events. To do so, it is crucial that investors consider carefully forward-looking measures of liquidity, volatility and the general risk profile of every market. The increased diversity of the investment universe coupled with pressures relating to COVID recovery are among many other factors making this a more complex and nuanced feat.

Furthermore, portfolio construction approaches need to have careful risk budgeting embedded to ensure diversification is not compromised and concentration risks are managed; investors should beware of investment strategies that depend on just one or two countries or a single theme to drive performance. Diversification of return sources combined with careful controls to manage idiosyncratic risk are key to targeting sustainable risk-adjusted returns in this investment universe.

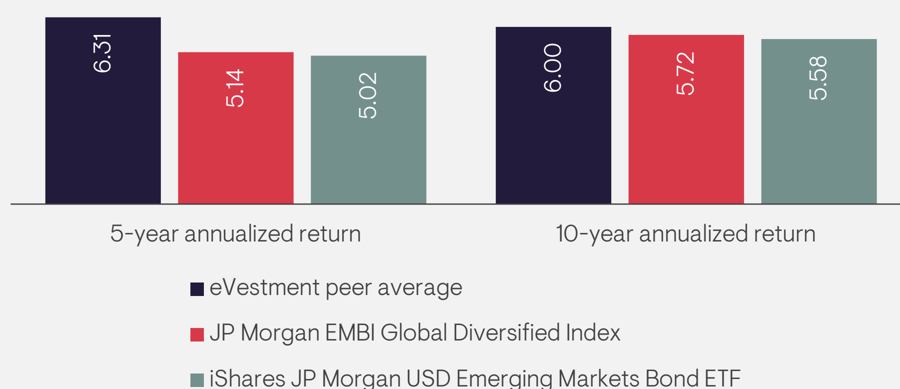
> A forward-looking approach to ESG integration in EM debt investing is vital – where a country is heading is of more relevance than its past

An inefficient market that is best suited for active management

Sophisticated investors are increasingly recognising the importance of a high-conviction/high active-share approach in EM debt allocations – similar to the trend we are observing in equity markets. A comparison of index, ETF and average active manager returns explains this.

In the EM hard currency universe, Figure 10 compares the annualised returns of the EMBI, the leading ETF and the average hard currency debt manager over the past 10 years. Furthermore, this just relates to the average manager; many investors aim to apply their manager selection skills to pick top quartile managers, where the results can be even more positive. Clearly, investors will need to take into account the impact of any fees when considering investment return potential.

Figure 10. EM hard currency debt, annualised returns, gross of fees, %



Past performance is not a reliable indicator of future results, losses may be made.

Source: eVestment, as at April 2021. Peer average based on strategies using the JP Morgan EMBI Global Diversified Index as a reference index. Performance is gross of fees (returns will be reduced by management fees and other expenses incurred). The periodic deduction of fees and expenses will have a compounding effect on performance. Example effect of management fees taken monthly over 10yrs on the value of a client's portfolio: Initial value = $100m, assumed return = 10% p.a., grows to $259m (no fees), grows to $243m (0.65% p.a. net fees). The annualised returns over 10yrs are 10% (gross of fees) and 9.29% (net of fees). For further information on indices, please see the Important information section.

Outlook for the asset class in the post-COVID world

We expect the EM economic rebound to be faster than the IMF forecasts mentioned earlier, as EM growth is supported by favourable structural dynamics and across both hard and soft commodities we are already seeing a significant boost to net exports in EM.

A revival in the manufacturing sector is currently boosting EM; demand is being supported by the US$1.9 trillion stimulus and the way that governments, businesses and society are getting better at dealing with COVID. While we are currently seeing some weakness across EMs from further lockdowns, as vaccinations are rolled out and restrictions broadly start to ease the subsequent recovery in activity should spark a return to near normality later this year.

Inflation concerns are acting to an extent as a dampener on optimism relating to the robust economic recovery taking hold in many parts of the world. Despite various data prints pointing to rising headline inflation, we are still largely inclined to view this as a temporary phenomenon. By not looking through the temporary effects of higher inflation, investors risk ignoring the broader cyclical picture, which remains attractive across EM. Yes, there will be supply bottlenecks as economies recover, with accompanying surges in inflation, but these should prove transitory. The reinflationary pressure over the past few months needs to be set against the much longer disinflationary trend of the last 25 years, and the tapering that will need to occur before the Fed will consider raising rates.

We believe central banks across the world generally remain supportive of economic growth and that the risk of an abrupt shift away from loose monetary policy remains low. The US administration under President Biden is also expected to be supportive for EMs, as it is likely to introduce more predictable foreign and trade policy. We think these macro and geopolitical adjustments are likely to be accompanied by a high degree of divergence for sovereign debt, reflecting factors such as countries' vulnerabilities at the beginning of the crisis (which may have been exacerbated by the pandemic), how well governments have been handling the crisis, and crucially how they will finance their deficits.

With a significant proportion of DM sovereign debt currently in negative real yield, we expect more investors to consider EM debt, given its yield and relative value attractions remain intact. Supportive tailwinds include the allure of relatively attractive yields and improving trade flows within EM regions. In particular, we continue to see value in high-yield markets as spreads have not fully recovered to pre-COVID levels.

Conclusion

The yield pick-up offered by EM hard currency debt for comparable credit quality, combined with its risk-adjusted returns and diversification characteristics are prompting a reappraisal of the asset class, with some institutional investors' capital market assumptions currently pointing toward larger allocations.

Investors revisiting the asset class may struggle to recognise it, such has been the transformation over the past decade. Now spanning oil exporters & importers, regional manufacturing hubs and services-driven economies, the analysis of the investment universe has become more challenging and requires a much broader analytical tool-kit.

In aggregate, fundamentals are stronger, but the increased prevalence of frontier markets brings additional risk and complexity. The evolution of the hard currency market means that today it is a particularly rich hunting ground for active managers with the right expertise to explore relative-value alpha opportunities, given the information asymmetry arising from the inherent complexities in analysing many of these markets. Investors need to be able to identify the attractive issuers while avoiding negative credit events and to do so they must consider carefully forward-looking measures of liquidity, volatility and the general risk profile of each market.

Conviction as well as a portfolio construction approach that aims to diversify return sources and carefully manage idiosyncratic risk are key to targeting sustainable risk-adjusted returns in this investment universe. With the rising importance of ESG integration, novel proprietary tools are also becoming essential.

With many EM economies already reaping the benefits of the post-COVID recovery and spreads in some high-yield EM bond markets yet to recover fully to pre-COVID levels, we believe now is a good time to revisit the asset class.

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.

Specific risks: 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. Interest rate: The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise. 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.

Important information

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