EM Sustainable Blended Debt

Market context

US Treasury yields fell significantly in February, with the 10-year yield ending the month at 4.2% after spiking to above 4.6% earlier in the month. Conflicting forces driving this volatility included a weakening of market sentiment and mixed macroeconomic signals: US inflation (CPI) data exceeded expectations and inflation forecasts rose, but weaker-than-expected services PMI data indicated a contraction in economic activity. US trade tariff uncertainty continued, with tariffs imposed on China, Mexico and Canada in early March. Federal Reserve Chair Powell suggested that tariffs could increase inflation, dampening expectations of rate cuts; as of the end of February, the market was pricing in c.70bps of cuts by December 2025.

Against a volatile global backdrop, the emerging market (EM) fixed income asset class delivered positive returns in February.

The local currency debt market (JP Morgan GBI-EM) gained 0.7%, driven by bonds – EM currencies were broadly flat on the month. Hard currency sovereign markets performed well, with the JP Morgan EMBI posting a 1.6% gain. This was led by investment-grade bonds (+2.3%), which benefited from the fall in US Treasury yields. The high-yield part of the market gained 0.9%, boosted by a rally in some more distressed markets.

For a more detailed global market background, please read our market review.

Performance

The Strategy outperformed its benchmark (50% JPMorgan GBI-EM Global Diversified; 50% JPM EMBI Global Diversified) over the month*, gross and net of fees.

The Chilean peso had a strong month, helping the portfolio's overweight position. The peso's sensitivity to the copper price, which rose over the month, helped the currency. In addition, Chile's central bank pivoted to a more hawkish stance, further strengthening the currency.

Exposure to hard currency bonds in Paraguay contributed to performance, with the rally in US Treasury yields helping bond prices.

The Thai baht depreciated over the month, driven by a weaker trade balance and rate cuts from the central bank. Underweight positioning helped the portfolio.

In contrast, the portfolio's underweight exposure in Mexican local bonds early in the month held back performance. Dovish messaging from the central bank continued, leading to a drop in yields. We have since closed the underweight.

Underweight positioning in Panama also detracted from relative performance. The market was helped by the fall in Treasury yields, and credit spreads tightened thanks to the government's progress on social security reforms.

*Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.
Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Past performance does not predict future returns; losses may be made.

Outlook

Attractive yields and proactive monetary policies are supportive for the emerging market (EM) debt asset class. However, global economic uncertainties - particularly related to US policy direction and trade tariff dynamics – in addition to volatility in global financial markets, call for measured optimism from investors.

The reaction of EM assets to rising US Treasury yields and a stronger US dollar since the US election has been relatively modest. US Treasuries sold off in the weeks following Trump's election win, based on expected policy changes and associated fears that the US deficit could rise and inflation could return. However, since the start of the year, US Treasuries have rallied back, with the market continuing to price in rate cuts this year.

Against this backdrop, the performance of EM assets reflects several factors: resilient global growth and robust fundamentals in EM economies, light market positioning and central banks focusing on risks to the growth outlook rather than inflation fears. That said, uncertainty around US policy and its potential impact on EM economies means short-term market volatility is likely to continue; this could present investment opportunities.

We maintain a positive view on the medium-term outlook for EM debt asset class returns. EM resilience is being supported by strong domestic reform agendas, especially in frontier markets where overall funding needs are manageable, and yields remain attractive. From a top-down risk perspective, we retain an overweight risk target. We continue to express our bottom-up investment views through active relative-value positioning across this increasingly diverse opportunity set.

While the Trump administration's policies may pose risks to the global inflation outlook, we remain constructive on the longer-term outlook for EM rates markets: a broad softening of inflation across EM economies means that real (inflation-adjusted) yields remain attractive, which is a key driver of long-term asset class returns. Across parts of EM, recent central bank rhetoric suggests a focus on addressing risks to economic growth, as noted above. The overall trajectory of US monetary policy gives us increased confidence that EM central banks will be able to continue cutting rates. We maintain a modest overweight in EM FX, supported by positioning and valuations.

In EM hard currency, our top-down target remains slightly overweight, with exposure leaning towards the higher-yielding portion of the market. Here, we remain constructive on markets supported by positive country-specific dynamics and sufficiently high yields to cushion against potential volatility. In addition, we have recently added to higher quality duration risk through new bond supply in the first quarter to take advantage of improved valuations in investment-grade issuers.

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. 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. 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.

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