Emerging Markets Corporate Debt

Market background

Emerging market (EM) fixed income posted negative returns in the third quarter, as a global bond sell-off weighed on markets, with the 10-year US Treasury yield closing at its highest level since 2007. Renewed tensions in the US-Iran conflict, including attacks on Saudi energy infrastructure, drove Brent crude oil prices above US$100 a barrel and reignited stagflation fears. The US Federal Reserve turned increasingly hawkish over the quarter and delivered its first rate hike since 2023 in September, signalling another increase before year-end. Fiscal concerns weighed on longer-dated bonds, while growth remained resilient throughout the quarter, further fuelling expectations of a rate hike. The European Central Bank and Bank of Japan also raised rates, while European sovereign bonds sold off sharply. The US dollar had a volatile quarter, drifting lower before rebounding in September following the rate decision.

The EM corporate debt market (JPMorgan CEMBI BD) fell 1.8%, with the investment-grade and high-yield segments declining 2.3% and 1.1%, respectively. As in the sovereign market, the rise in US Treasury yields was the driver of negative returns, with the higher-duration investment-grade market most affected, while the contribution from spreads was positive at the index level.

Performance

The Strategy produced a negative total return and underperformed its benchmark (JPMorgan Corporate EM Bond Index Broad Diversified) over the quarter*, gross and net of fees.

Positioning in Latin America detracted the most from relative performance, with gains in Brazilian oil and gas issuers only partly offsetting weakness elsewhere. Exposure to a Brazilian refiner added as it reported record quarterly earnings on wider refining margins and received a rating upgrade. A Brazilian mining company also helped performance. The bonds were supported by the Moody's upgrade to B1 and steady operating results. Against this, Mexican real estate weighed on performance, led by exposure to a commercial real estate investment trust. In addition, a Mexican silver producer detracted from performance, largely reflecting the higher duration of the long-dated bonds owned in the portfolio.

Holdings in the Middle East also detracted. United Arab Emirates real estate came under pressure as the sector continues to be one of the most impacted by the ongoing conflict, while longer-dated positioning in sectors such as oil & gas and utilities which was weighed on by the move in government bond yields.

Positioning in Asia was a more modest net detractor, with weakness in China real estate partly offset by gains elsewhere. China real estate weighed on performance as developers reported sharply weaker first-half results and the sector's financial difficulties continued. Elsewhere, a broad underweight to Asian financial issuers also detracted as these more defensive, short duration bonds were more insulated in the broader sell-off. Positioning in Indian utilities and financials added to performance, as did a broad underweight to higher-quality Taiwanese industrial issuers.

Portfolio activity

Portfolio activity was high over Q3 2026, concentrated in new issue participation and relative-value switches, with a view to reduce tail risk while preserving the yield on the portfolio.

Within Latin America, we added a Mexican REIT ahead of an expected investment grade upgrade as its build-out cycle completes,

*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.

funded by trimming a Mexican energy infrastructure trust and a Colombian bank. We participated in the new issue of an Argentine oil company which came cheap to its existing bonds, having previously switched our exposure into a cheaper, higher-rated Argentine oil company. We rotated our holdings in a Brazilian food production company and a downstream energy company into a new issue of another Brazilian beef producer company on relative value, following better results. We exited an illiquid Chilean mining company to fund opportunities elsewhere.

In Asia, we added an Indonesian oil & gas company, replacing our position in a Mexican petrochemical company to reduce tail risk. We also participated in an Indian renewable energy company's new issue on a solid underlying credit story, and an Indian financial company's new issue at an attractive valuation ahead of an expected rating upgrade. We switched our holdings in the capital structure of a Malaysian company to cut refinancing tail risk. We reduced both an Indian renewable energy company and an Indonesian geothermal company, with the latter funding purchases elsewhere.

In Europe, we added a Turkish consumer company which offers high-quality fundamentals.

In the Middle East, we were active as the regional conflict created opportunities for relative value: we consolidated a Saudi Arabian bank's Additional Tier 1 bonds into a new, better-value Tier 2 issue, and rebuilt exposure in the UAE via a short-dated instrument of a conglomerate on solid management and a history of early bond calls (repaying the bonds before maturity). We also participated in a new senior issue from a UAE bank which was priced attractively, rotating out of our position in an Omani bank which reached our target. Finally, we reduced our Saudi National Bank position and fully exited our National Bank of Kuwait position as these were no longer offering value versus peers.

In Africa, we added a South African technology company's tender-linked new issue, and exited our position in a Nigerian tower company which reached our target. We also added to an Angolan oil company, with very low break even, and we participated in a new issue from a South African PGM miner.

Outlook and strategy

Despite a more challenging market environment over September, emerging market debt has demonstrated notable resilience so far in 2026 against a notably volatile backdrop. EM inflation has remained broadly well-behaved, with fundamentals sound. That said, geopolitical tensions in the Middle East remain unresolved and elevated oil prices are a key risk to the market backdrop, alongside the durability of the geopolitical risk premium in refined product markets. In addition, rising global bond supply and fiscal issuance-driven pressure on the long end of yield curves, as well as a hawkishly tilted Fed and other central banks, present another headwind for markets.

In the context of ongoing macroeconomic and geopolitical uncertainty, EM corporate fundamentals remain healthy as companies' balance-sheet strength remains intact. In recognition of robust fundamentals, net changes in credit ratings for EM corporate issuers have generally remained on a positive trajectory. We expect this trend to continue and default rates to remain contained. However, we expect differentiation to remain high across the asset class as the corporate competitive landscape evolves - investors should take a selective approach.

Some areas of this increasingly mature asset class look expensive after a strong recovery in spreads, but a bottom-up perspective reveals plenty of opportunities across the globe. Additionally, credit spreads continue to offer value relative to other asset classes, particularly credit in developed markets. In addition, although a stabilisation in flows represents an improvement in sentiment towards the asset class, it remains under-owned. This clean technical picture has prevented outflows driven by the Middle East conflict.

We see a healthy and well-balanced supply picture in EM corporate credit. The strong pace of issuance that we saw at the beginning of the year resumed in Q2 after pausing in March and has continued over the summer. However, companies are issuing into supportive demand, while net issuance remains fairly neutral. Importantly, many EM corporates retain ready access to deep and liquid local markets. EM companies are increasingly tapping into this source of funding, which can boost the resilience of their balance sheets and diversify their funding channels.

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. Liquidity: There may be insufficient buyers or sellers of particular investments giving rise to delays in trading and being able to make settlements, and/or large fluctuations in value. This may lead to larger financial losses than might be anticipated. 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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