5 REASONS TO INVEST IN EMERGING MARKET DEBT NOW

MIRABAUD 1819
Asset Management

EMERGING MARKET DEBT IS STEADILY GROWING AS AN IMPORTANT ALLOCATION TOOL IN INVESTORS' PORTFOLIOS, ADDING DIVERSIFICATION OPPORTUNITY AND ACCESS TO DIFFERENT SOURCES OF INCOME. AGAINST THIS BACKDROP, WE BELIEVE THE CURRENT MACROECONOMIC ENVIRONMENT SUPPORTS A FAVOURABLE INVESTMENT OUTLOOK FOR EMERGING MARKET DEBT.

ROUND-UP WITH DANIEL MORENO, HEAD OF EMERGING MARKET DEBT

1 CAN EMERGING MARKETS, AS A REGION, CONTINUE TO DELIVER?

Emerging Markets delivered strong returns in 2017, with Sovereign hard currency debt returning over +10%* and local currency debt returning more than +15%*. Emerging Market corporate debt delivered returns of nearly +8%*. We believe this asset class continues to offer a structurally compelling story, with encouraging economic growth dynamics, attractive risk/return characteristics and positive fundamental long-term prospects. Trade and capital flows to Emerging Markets are also supportive of stable and stronger currencies. This ensures that Emerging Market debt has a high degree of longevity in regards to future income generation and capital appreciation. These features are particularly relevant in an environment in which developed market Fixed Income continues to suffer from extremely low yields and high duration risks.

2 HOW BIG IS EMERGING MARKET DEBT GLOBALLY AS A FIXED INCOME ASSET CLASS?

Emerging Market debt is a rapidly growing asset class. In 1989, it contributed around 1% of the total market capitalisation in global bonds. Today, it represents 18%. We believe this is still low in comparison to global Emerging Market economies' share of world GDP, which stands at 58%. As Emerging Market debt achieves greater prominence, the asset class has steadily grown as an allocation in global portfolios, driven by investor appetite for different sources of diversification and income.

3 IS EMERGING MARKET DEBT A RISKY ASSET CLASS?

The risks in this asset class have steadily diminished. There is a fundamental difference in Emerging Market debt today compared with the 1980s and 1990s. Today, there is less of a mismatch between liabilities and deposits, largely driven by much stronger local markets. This leads to stronger liquidity in the capital markets of Emerging Market countries, creating the potential for lower volatility.

4 HOW INFLUENTIAL IS THE LOCAL CURRENCY BOND MARKET?

There is a general misperception that local currency bonds across Emerging Market countries represent a small part of the overall market. Emerging Market bonds generally have experienced a significant period of growth and adjustment in the last twenty years. Whilst at the beginning of their growth phase, the only bonds available in emerging markets were those denominated in US dollars (hard currency bonds), the development of fixed income markets in these regions have led to significant growth in local currency bonds. Today, they represent around 95% of all Emerging Market bond issuance, and are thus very influential.

5 WHAT ARE THE RISKS OF HOLDING LOCAL CURRENCY BONDS?

Local currencies across Emerging Markets are less volatile today because they are more established and supported by economic growth. Any investor purchasing equity or fixed income portfolios that invest in underlying securities outside their home currency will be subject to some currency risk. In Emerging Markets, local currencies tend to exhibit more volatility than their developed market counterparts, resulting in potentially more exchange rate risk. However, such risks can be mitigated by carefully selecting currencies in those countries that have good fundamentals and attractive valuations, where local interest rates are higher. Over the long run, the additional return this generates (through the higher interest rates) more than compensates for the exchange rate risk.

**Source: Mirabaud Asset Management as at 31 December 2017*

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