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Emerging market debt

April 2014

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Big Picture

- **Favour able debt dynamics**
  - Certainly relative to the bloated economies of the developed world
- **Powerful demographics**
  - Growing populations and economies
  - Improving creditworthiness
- **Generally on dis-inflationary trend**
  - Unlike developed markets which is exploiting quantitative easing etc. to avoid deflation/generate inflation
- **Genuine contrast creates opportunities for selection**
  - Chile is not Argentina

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Emerging Market is often a debt story, not an equity story

- **Where do corporate profits go?**
  - To the state (via. bloated state owned enterprise sectors eg. China, Brazil, Russia, India)
  - To the workforce (more socialist policies – note wage pressures in Brazil, South Africa, Chile, China, Turkey, Poland, South Korea).
  - These pressures have made emerging markets growth more sustainable by supporting higher domestic demand
- **Little left for equity holders**
  - favours external debt financing

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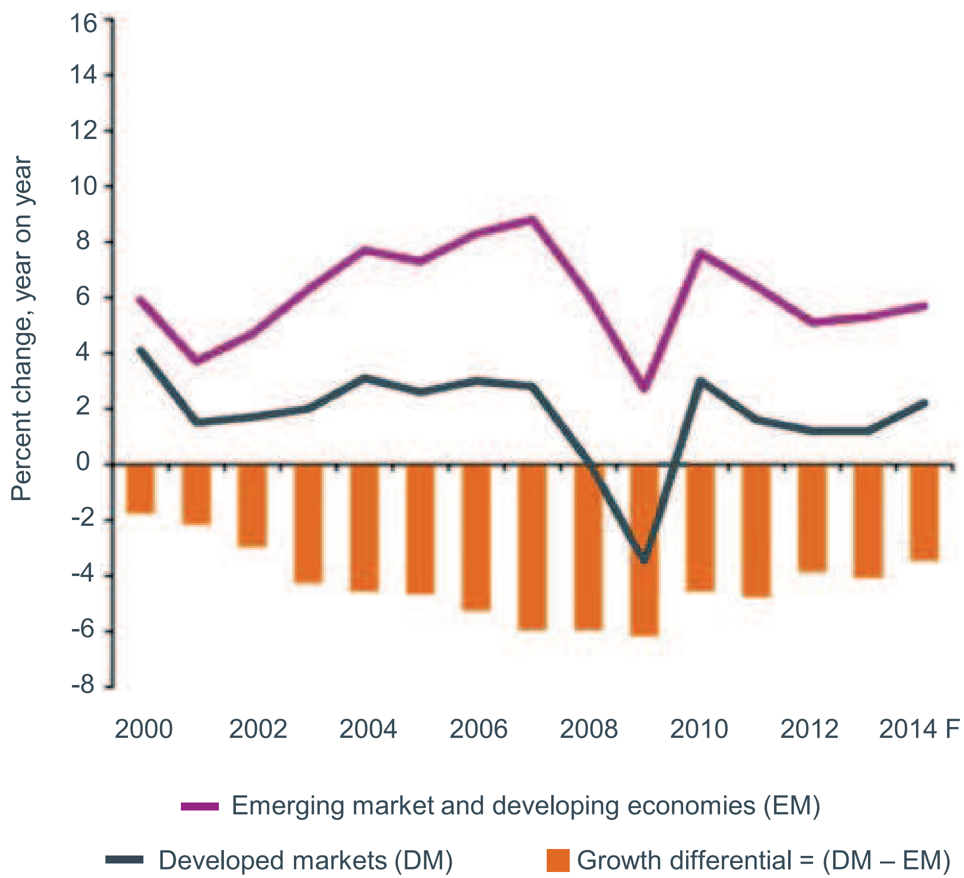
Favourable real economic growth



- **Growth differential remains high at 4%**
  - has 'moderated' to longer-term sustainable average
- **Despite various headline crises, emerging markets continue to pace world economic growth**

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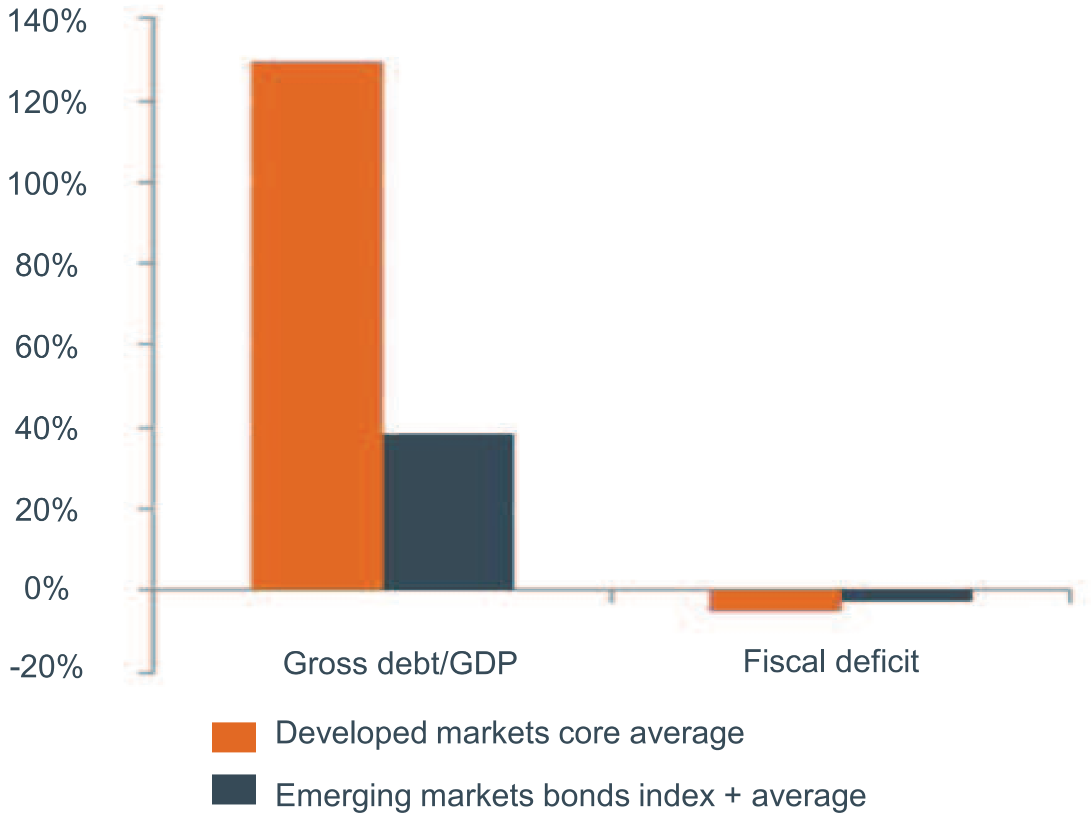
Source: IMF

Emerging markets debt dynamics are much healthier than developed markets



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A welter of indices (typically maintained by JP Morgan)

- **Diversified Investment Grade**
  - Hard currency; investment grade; sovereign and quasi-sovereign
- **Diversified**
  - Hard currency; investment grade and non-investment grade; sovereign and quasi-sovereign
- **Emerging Markets Bonds Index +** 42
  - Hard currency; sovereign, investment grade and non-investment grade
- **Corporate Emerging Markets Bonds Index (CEMBI) Broad Diversified**
  - Hard currency corporates; investment grade and non-investment grade
- **Government Bond Index- Emerging Markets Global Diversified (GBI-EM GD)**
  - Local currency; sovereign, investment grade and non-investment grade

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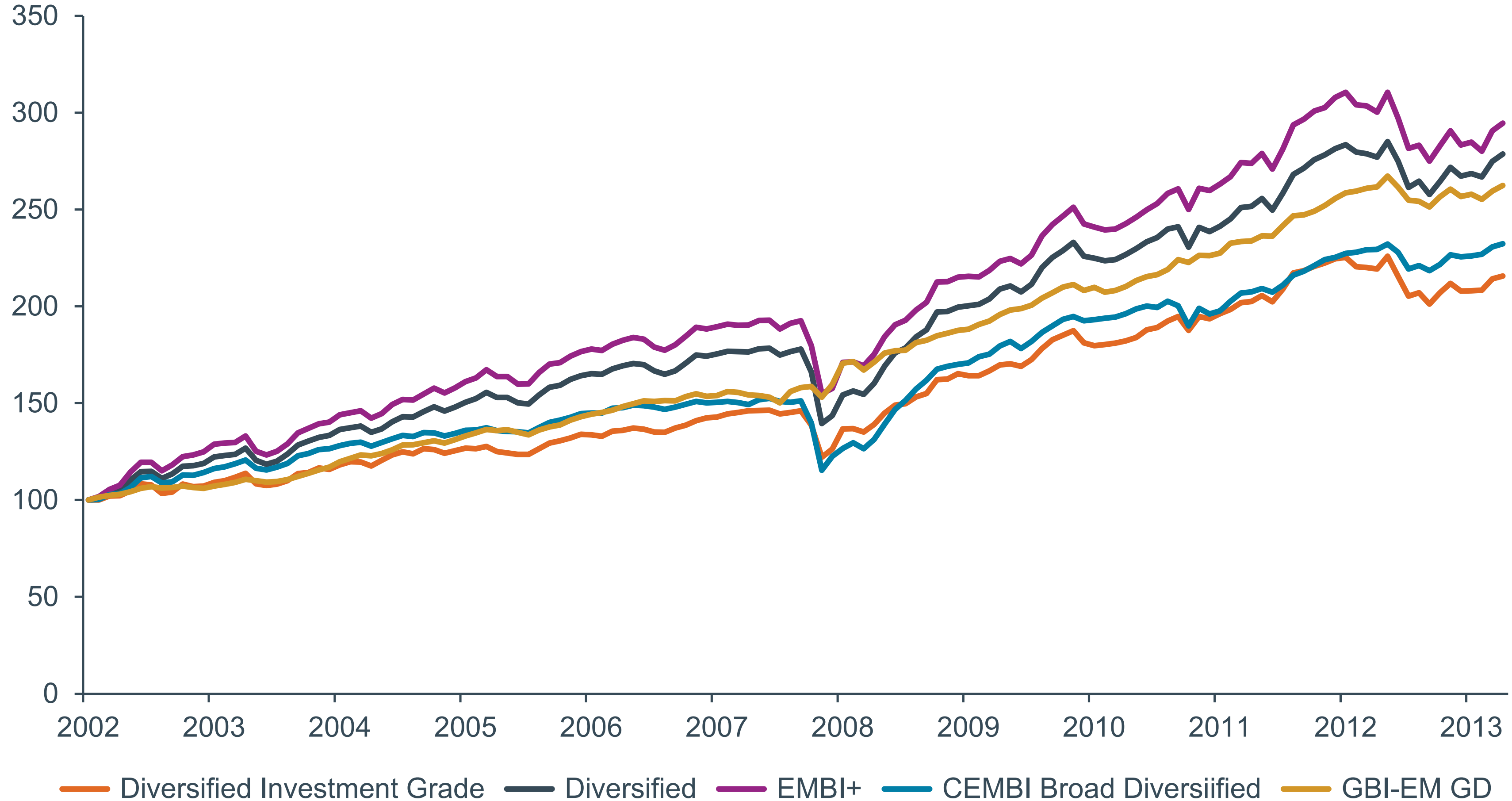

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Source: Bloomberg as at 31 March 2014

Constituents of Emerging market diversified index

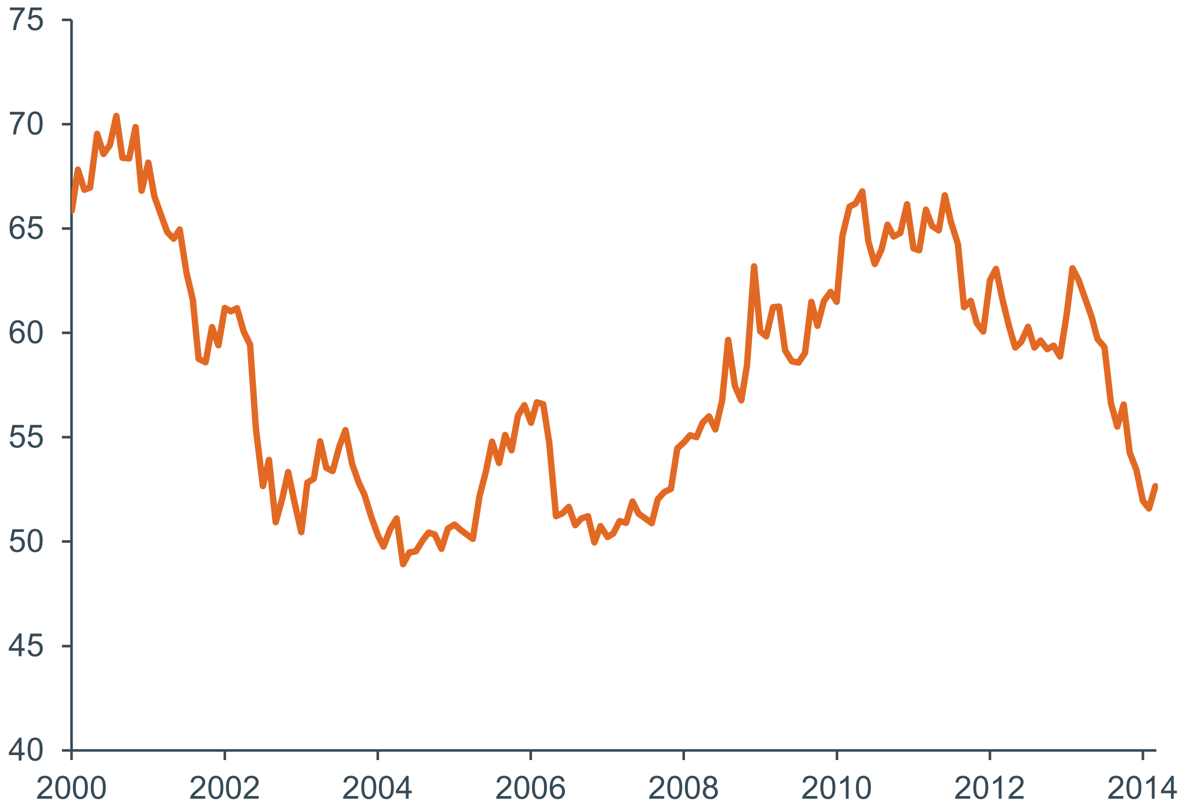
	Weight	Average duration (yrs)	Rating	Yield (%)
Philippines	7.4	8.7	BBB-	3.9
Brazil	7.4	7.6	BBB	4.9
Mexico	7.1	9.4	BBB+	4.8
Turkey	7.1	7.6	BBB-	5.3
Indonesia	6.9	7.9	BB+	5.0
Russia	6.8	5.6	BBB	4.7
Colombia	5.9	8.8	BBB-	3.9
Poland	5.4	5.5	A-	3.4
China	5.2	7.2	A+	4.3
South Africa	5.0	6.6	BBB	5.2
Chile	4.8	8.3	A+	3.7
Peru	4.7	9.8	BBB+	4.6
Kazakhstan	4.5	6.9	BBB-	5.0
Panama	3.5	9.8	BBB	4.4
Malaysia	3.2	4.6	A	2.8
Lithuania	2.9	5.3	BBB-	5.0
Uruguay	2.9	10.2	BBB-	4.6
Romania	2.7	8.3	A-	3.4
Costa Rica	1.9	7.5	BBB-	3.9
Latvia	1.3	4.5	BBB-	5.0
Trinidad and Tobago	1.0	5.1	BBB	5.2
Morocco	1.0	9.4	BBB+	4.8
Slovak Republic	0.7	6.9	BBB	4.7
India	0.5	5.6	A+	4.1
Namibia	0.2	6.2	BBB+	4.8

Source: Bloomberg as at 31 March 2014

- **Wide range of countries to select from**
  - Most managers will avoid the minor weights
- **Weighted average yield of 4.5%**
  - c.f. US (2.7%), UK (2.7%), 44
- **Spain**
  - Yield of 3.2%
  - Credit rating BBB-
- **Portugal**
  - Yield of 3.8%
  - Credit rating BB-

The currency dimension

Emerging market foreign exchange vs GBP



- **The main currency reference point is US$**
  - Hard currency debt usually raised in US$
- **Emerging market foreign exchange has been hit hard of late**
  - Everything cycles

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Source: Bloomberg as at 31 March 2014

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