



Schroders Emerging Markets Lens: Emerging Market Debt

Strategic Research Unit

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Marketing material for
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Summary

Emerging market (EM) bonds fell in August as upward pressure in developed market (DM) bond yields resumed. Weakness in China's economy weighed on sentiment more broadly towards EM bonds. A stronger US dollar was a drag for local debt. Despite recent performance, EM bonds remain positive YTD, led by local bonds (slide 4).

Hard currency emerging market debt (EMD):

- The hard EM bond index yield and spread are elevated relative to their long term history (slides 8-9)
- The above-median hard EMD spread is attributable to the high yield (HY) sovereign index. The spread on the investment grade (IG) sovereign market is below its historical average, and at a more than ten year low (slide 9)
- In corporate EMD, the IG and HY corporate spreads are slightly below their historical median (slide 14)

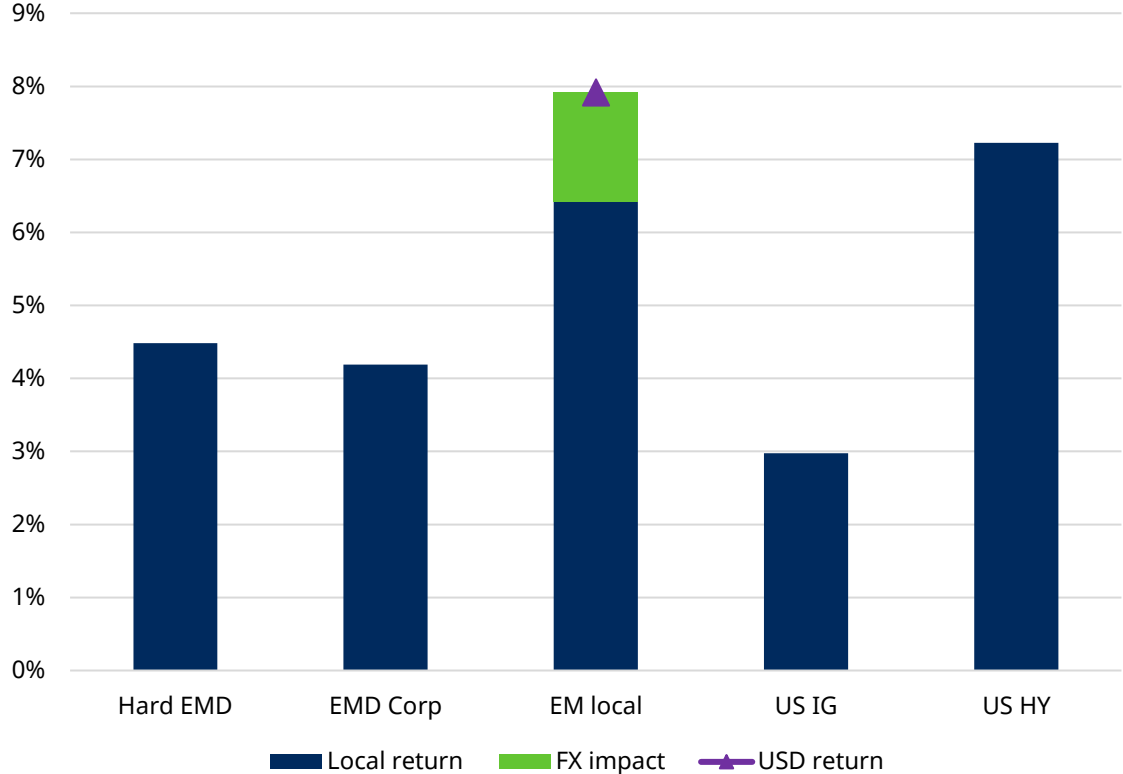
Local currency EMD:

- The real yield premium of EM over DM is close to the bottom-end of its post-GFC range (slide 30), but has started to pick up. This is primarily due to rising EM real yields over the past few months, as EM inflation has moderated.
- The average local EM yield curve is now close to flat (slide 29)
- There are undervalued **currencies** in all three EM regions (slide 35), but the degree of value varies significantly

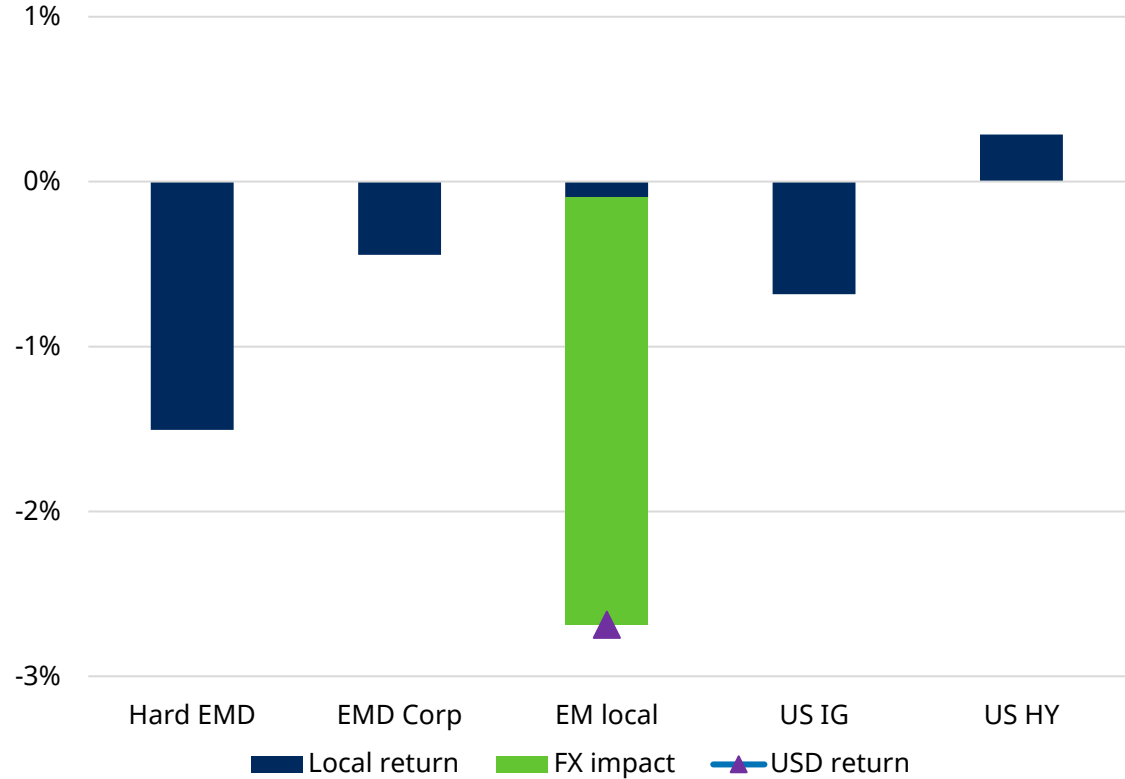
EMD came under pressure in August

Despite being the laggard in the past month, local EM bonds continue to lead YTD

Total return YTD



Total return August 2023

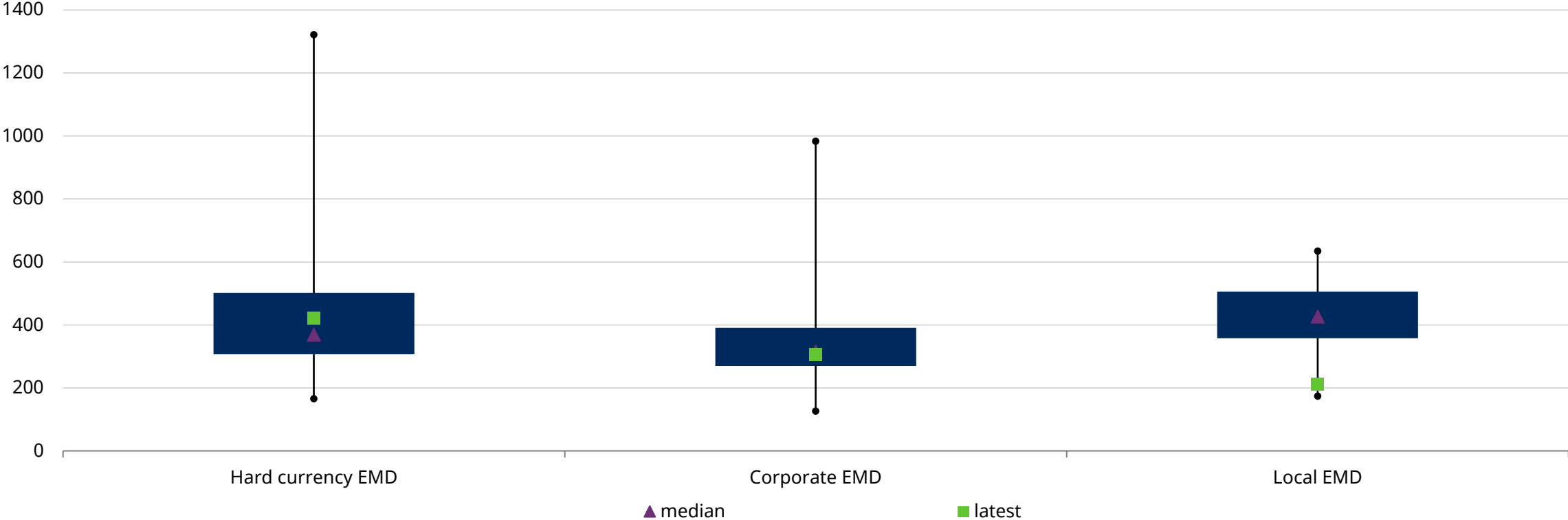


Note: Local currency = US dollar for all apart from local EMD which is in the relevant local EM currency.
 Source: Schroders, Refinitiv Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 31 August 2023.
 Please see relevant disclaimers on page 40.

EMD headline valuations

Spread percentiles

Spreads of key EMD indices (basis points)



Hard currency valuations remain cheapest versus history, but there is more to this than meets the eye...

See slides 10-11

Source: Schroders, Refinitiv Datastream, J.P. Morgan. Data as at 31 August 2023. Spreads are adjusted for changes in the distribution of credit ratings within each index over time. Percentiles shows where the current spread is relatively to the historical range of spreads, within a range of 0 to 100. The greater the percentile the higher the spread compared to history. Hard EMD =stripped spread, Local EMD =Spread to 5 year UST, Corporate EMD = spread to worst. Please see relevant disclaimers on page 40.



Emerging market debt:

Hard currency

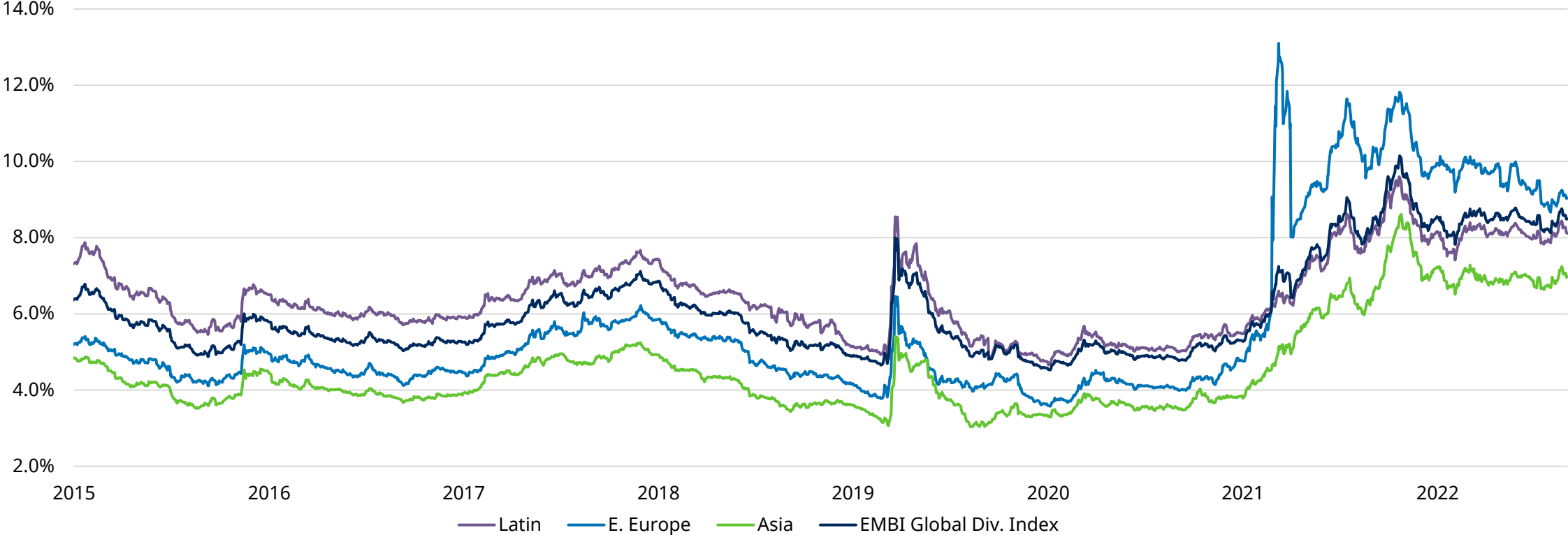
Summary: hard emerging market debt

- The hard sovereign EMD index yield is elevated relative to its long term history. In sovereign EMD, the spread dispersion between countries remains wide. Larger countries in general remain steady, but the picture is more challenging among smaller HY countries.
- The rise in US yields has raised the cost of debt for EM issuers, and the sovereign HY index spread remains at an elevated level. The IG spread is at a more than ten year low.
- In corporate EMD, both the IG spread, and to a lesser extent HY spread, have fallen below their historical median
- Credit quality has worsened since the pandemic. This was compounded by the 2022 challenges for issuers included in major sovereign and corporate EMD benchmarks.

Hard EMD index yield ticked up to 8.5% in August

And remains elevated relative to history

Hard currency sovereign EMD regional index yield

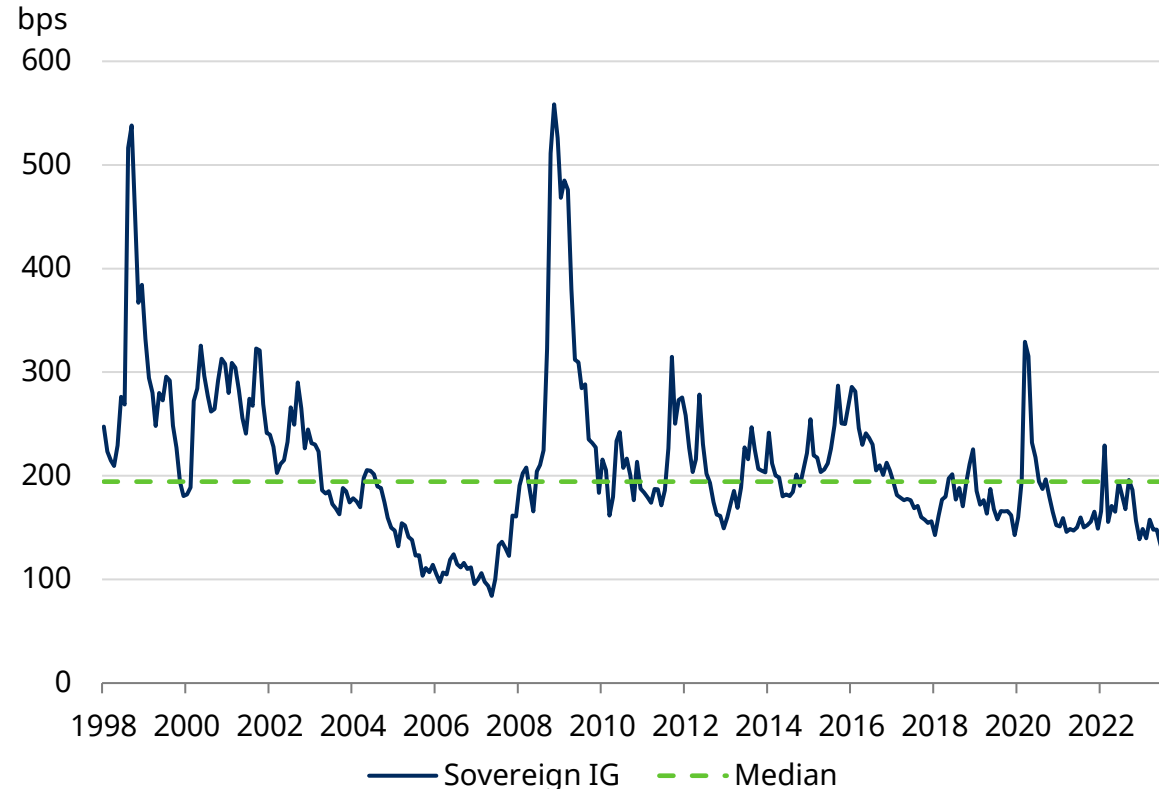


Russia was removed from all JP Morgan EMD indices from 31 March 2022.
Source: Schroders, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

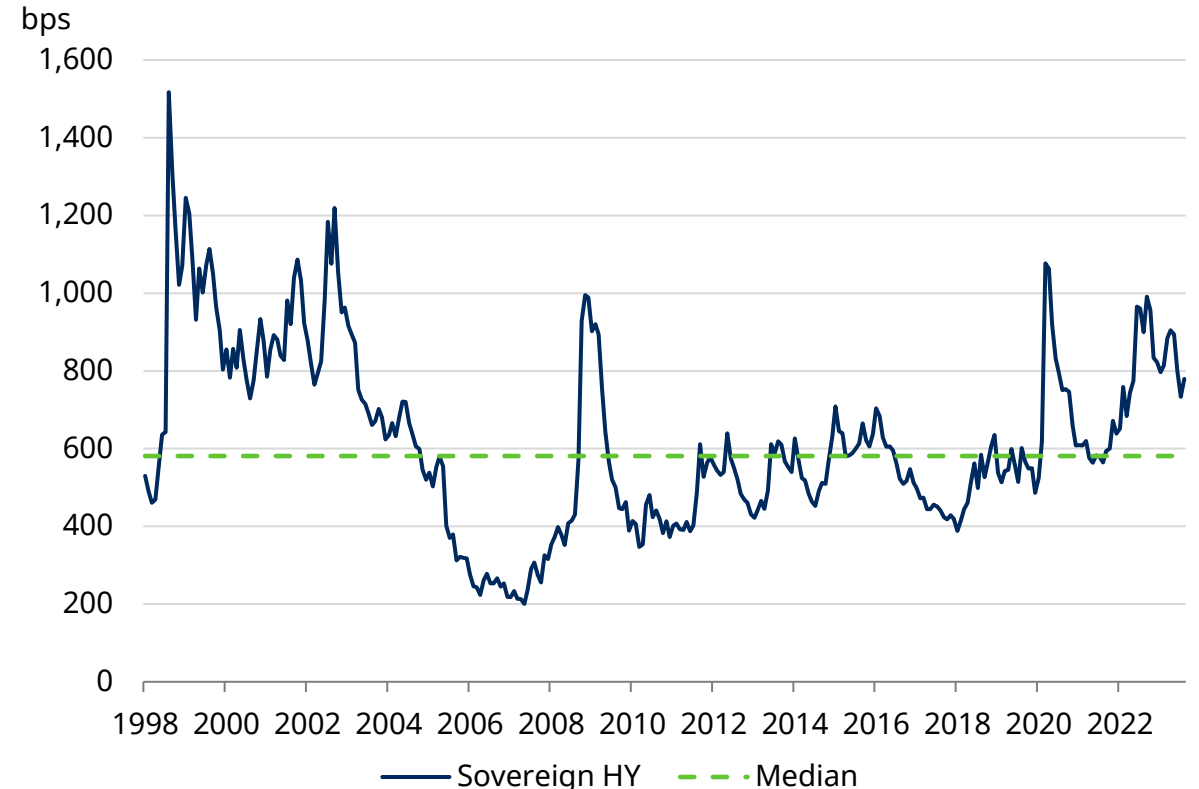
Valuation of hard currency sovereign EMD

IG spread remains at its tightest level since 2007

Hard currency sovereign EMD IG spread



Hard currency sovereign EMD HY spread



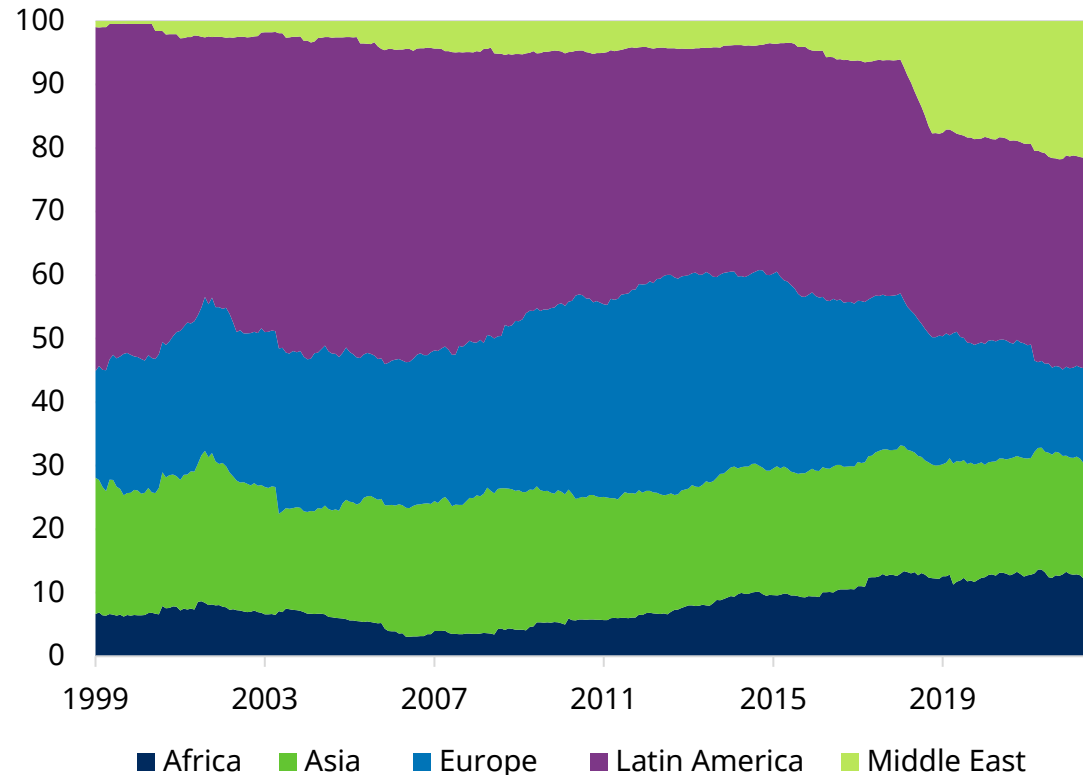
By contrast, the HY spread is well above its median

Source: Refinitiv Datastream, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

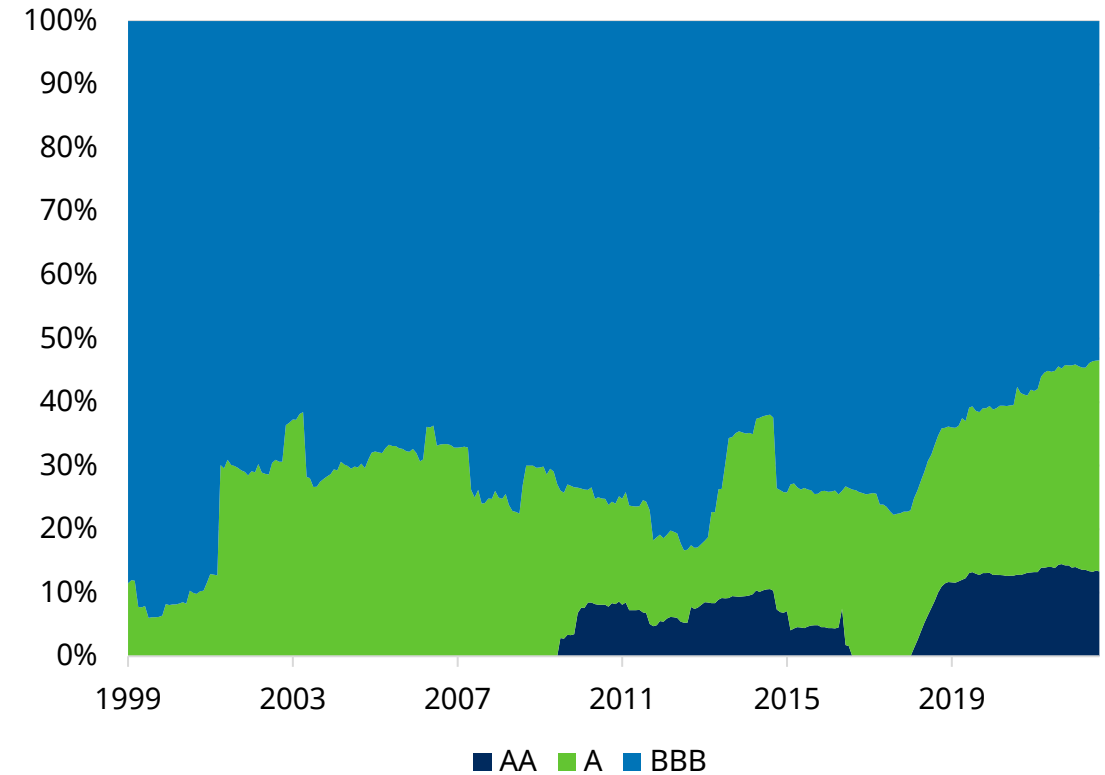
The rise of the Middle East and the impact on IG spreads

The Middle East region's index weight has quadrupled since early 2017

Sovereign EMD regional split



Sovereign EMD IG-sub index ratings split



The Middle East is mainly AA/A rated; consequently the average credit quality of the IG index has improved

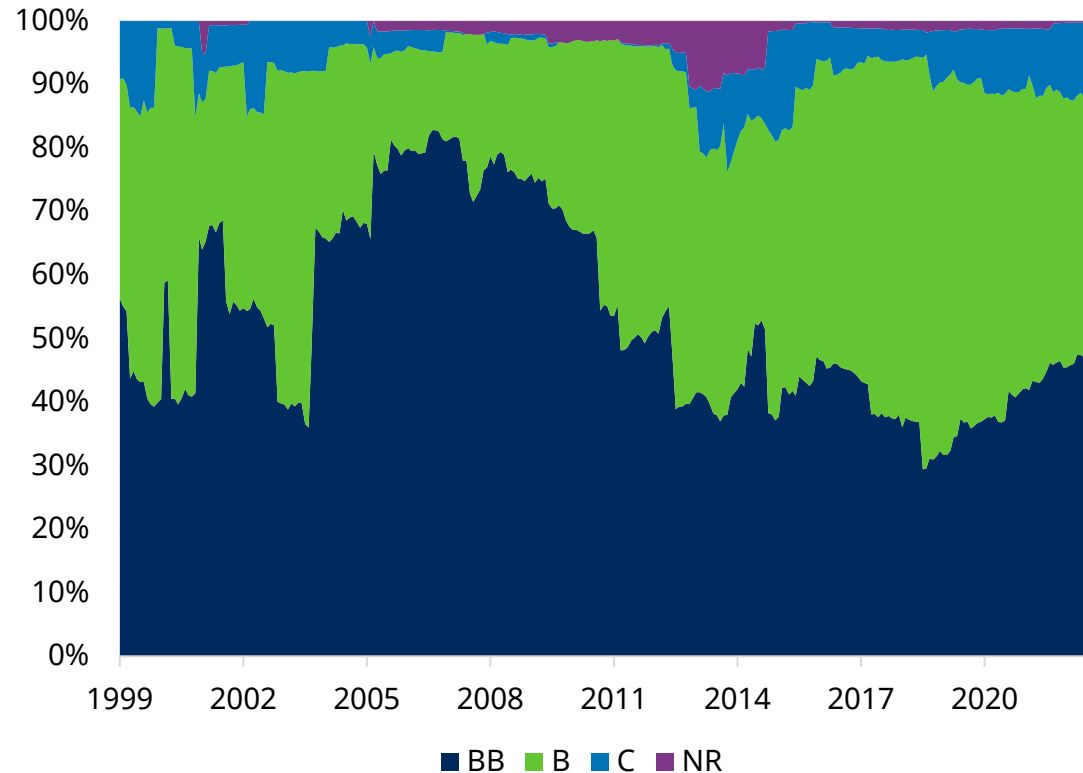
Source: Refinitiv Datastream, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

Source: Refinitiv Datastream, JP Morgan. Data as at 31 August 2023. IG sub-index is 51% of JP Morgan EMBIG Diversified Index. Please see relevant disclaimers on page 40.

The long term evolution of the HY index

A contrast between the long term and near term credit rating trends in the HY index

Sovereign EMD HY-sub index ratings split



- Average credit quality of the HY index has deteriorated over the medium-to-long term
- Recent trends have been more divergent, with an increase in the share of higher rated issues, but also an increase in the weakest
- Average credit quality has improved more recently, as the former has dominated the latter, but the latter will be leading to some tail risks.

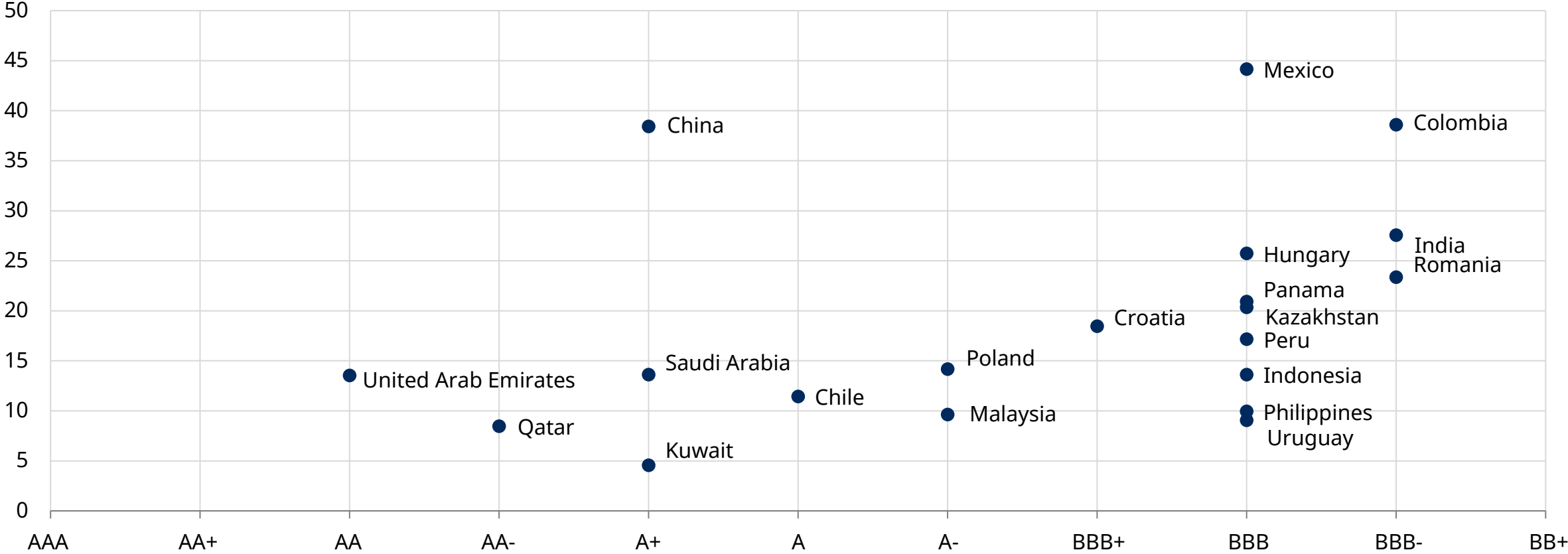
Source: Refinitiv Datastream, JP Morgan. Data as at 31 August 2023. HY sub-index is 49% of JP Morgan EMBIG Diversified Index.

NR = not rated

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Duration adjusted spreads of IG countries

Hard currency sovereign EMD IG: spread vs. duration vs. credit rating

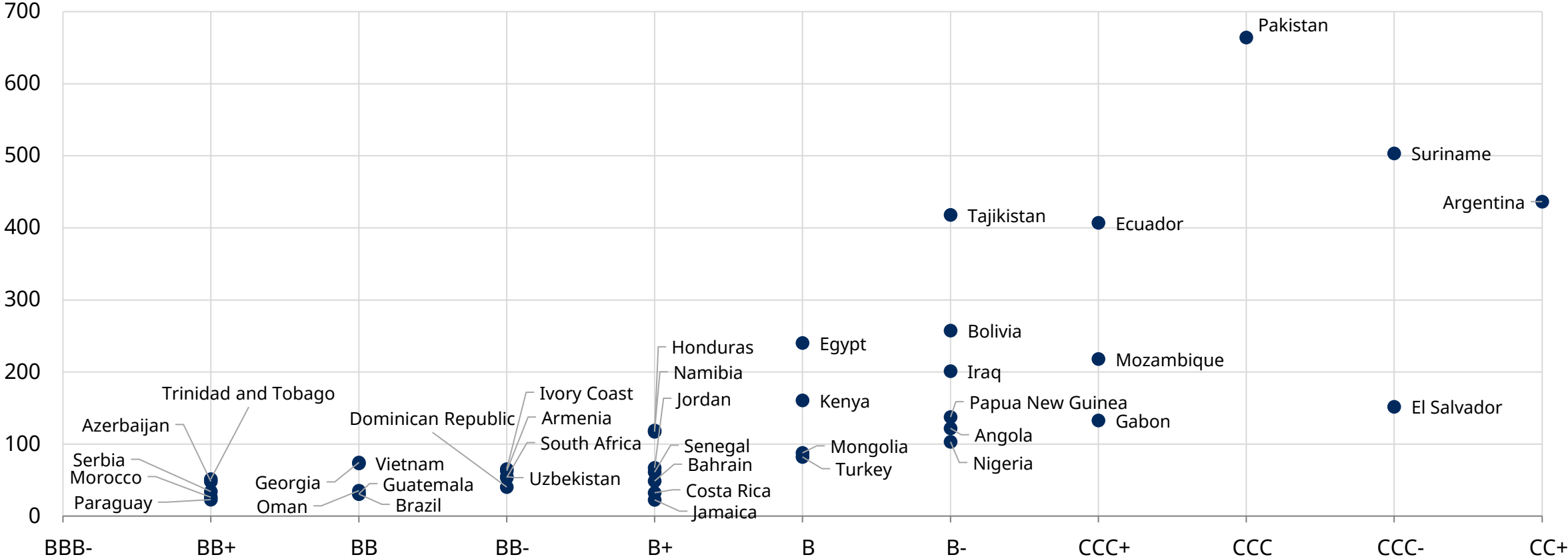


¹The JPMorgan EMBI Global Diversified Index includes both sovereign and quasi-sovereign bonds.
 The y-axis shows spread per unit of duration, in basis points.
 Source: Schroders, Refinitiv Datastream, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

Duration adjusted spreads of HY countries

Significant variability between the countries

Hard currency sovereign EMD HY: spread vs. duration vs. credit rating

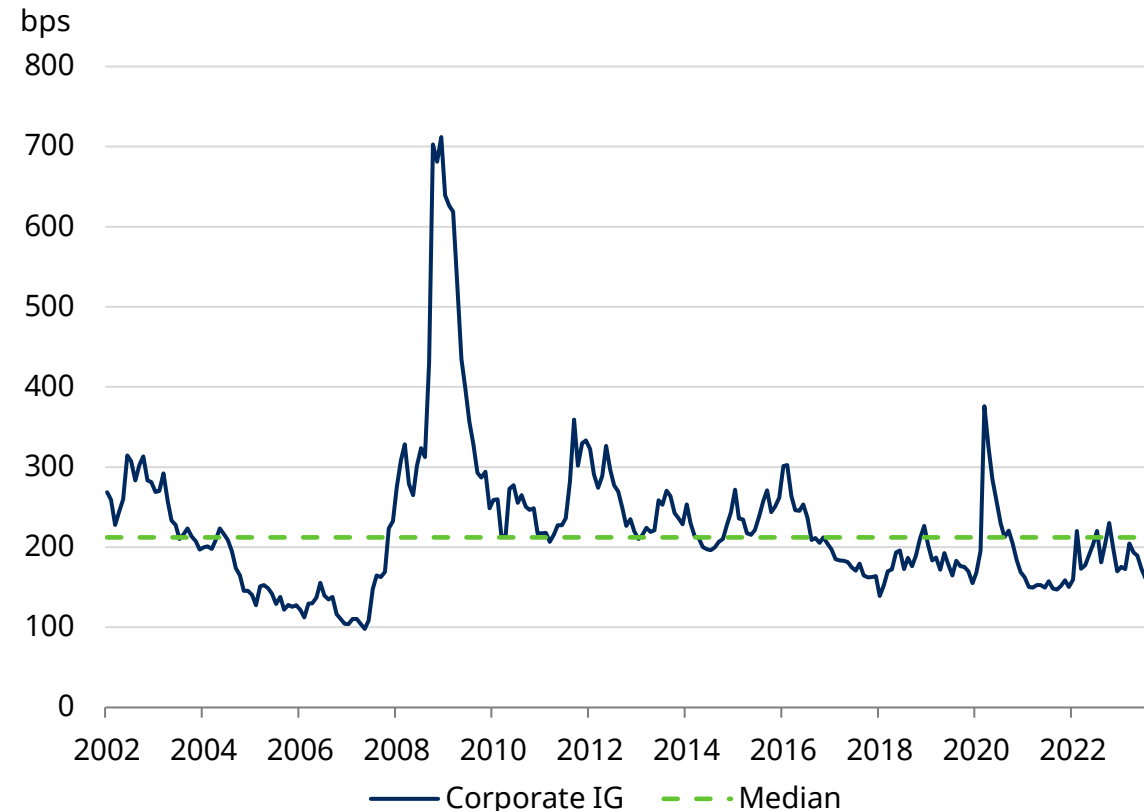


The y-axis shows spread per unit of duration, in basis points.
 Source: Schroders, Refinitiv Datastream, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

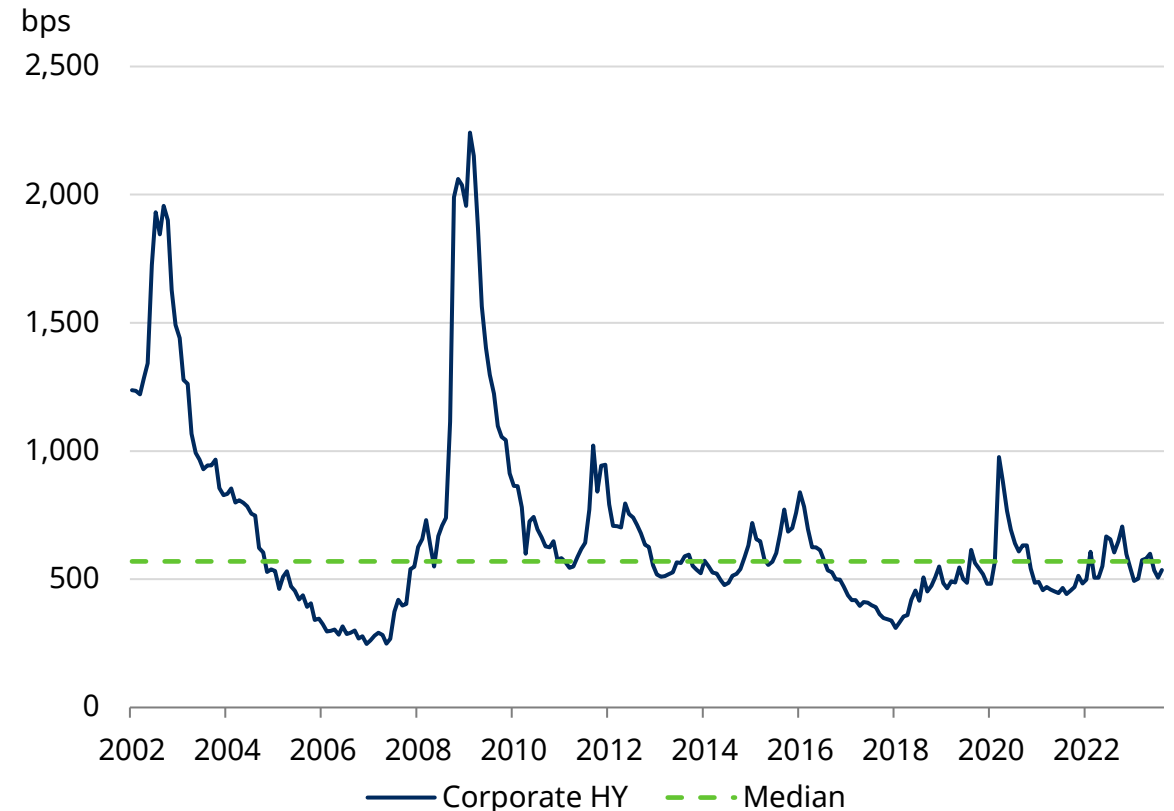
Valuation of hard currency corporate EMD

The IG and HY corporate spreads are slightly below their historical median

Hard currency corporate EMD IG spread



Hard currency corporate EMD HY spread

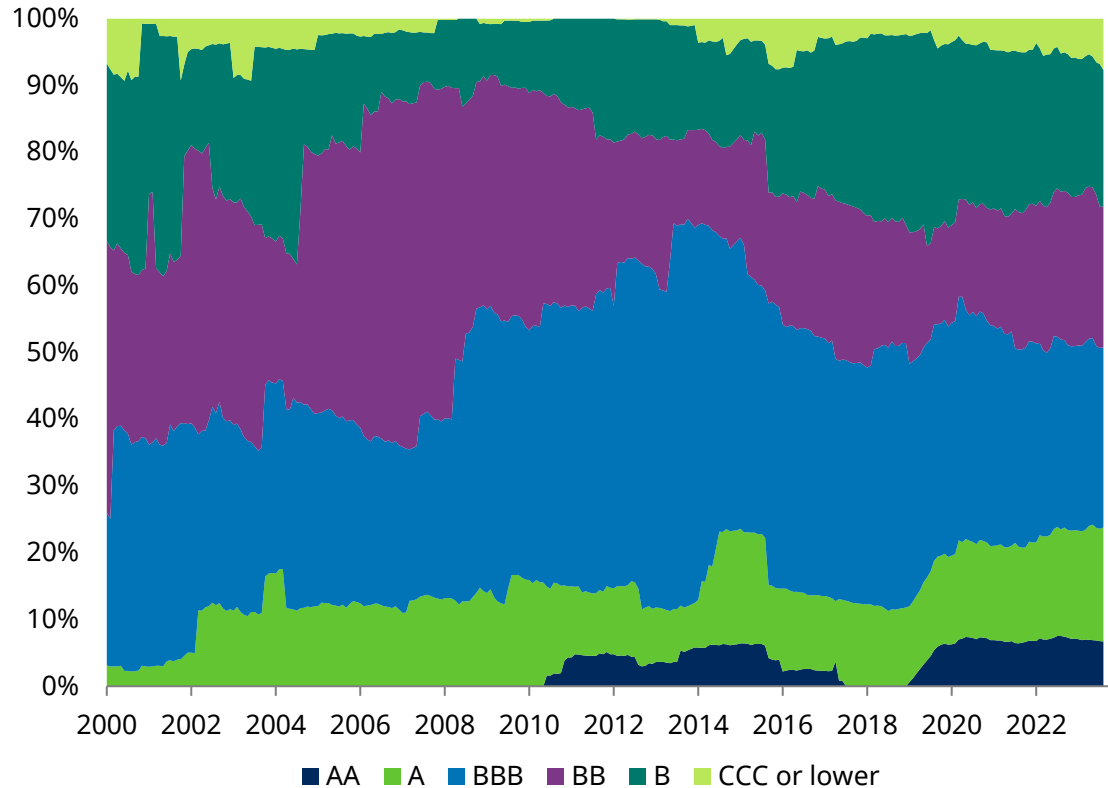


Source: Refinitiv Datastream, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

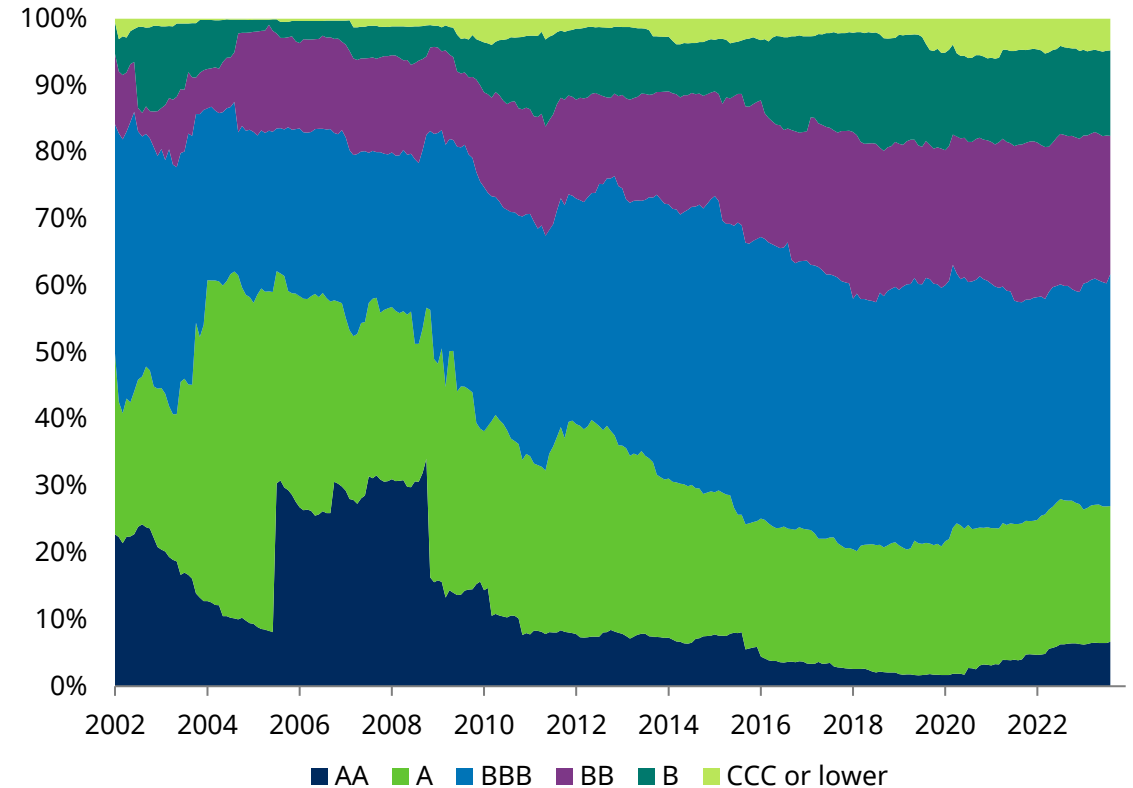
EMD historical ratings split

Share of IG bonds has fallen in the sovereign and corporate indices in the last 10 years

Sovereign EMD ratings split



Corporate EMD ratings split



Source: Schroders, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

Characteristics of EM hard currency issuers

Hard currency corporate issuers



■ Financials ■ Nonfinancials

Hard currency sovereign issuers



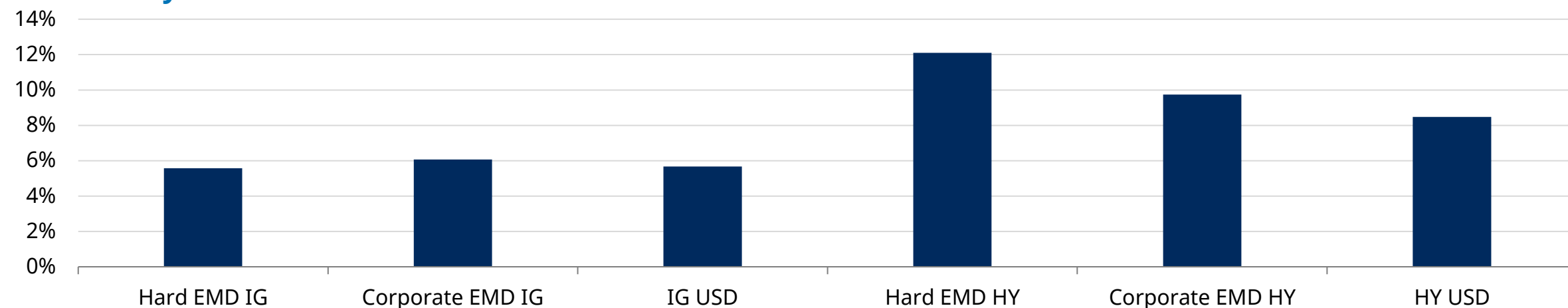
■ Sovereign ■ Quasi Sovereign

Source: Refinitiv Datastream, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

Hard and corporate EMD offer a spread pick-up over equivalent rated US corporate debt

	Hard EMD IG	Corporate EMD IG	IG USD	Hard EMD HY	Corporate EMD HY	HY USD
Yield	5.6%	6.1%	5.7%	12.1%	9.7%	8.5%
Spread (bps)	130	175	122	779	536	385
Duration	7.9	4.7	7.0	5.4	3.2	4.2
Rating	A3	A3	A3	B1	B1	B1
Percentage of EMD index	50.7%	59.4%	-	49.3%	40.6%	-

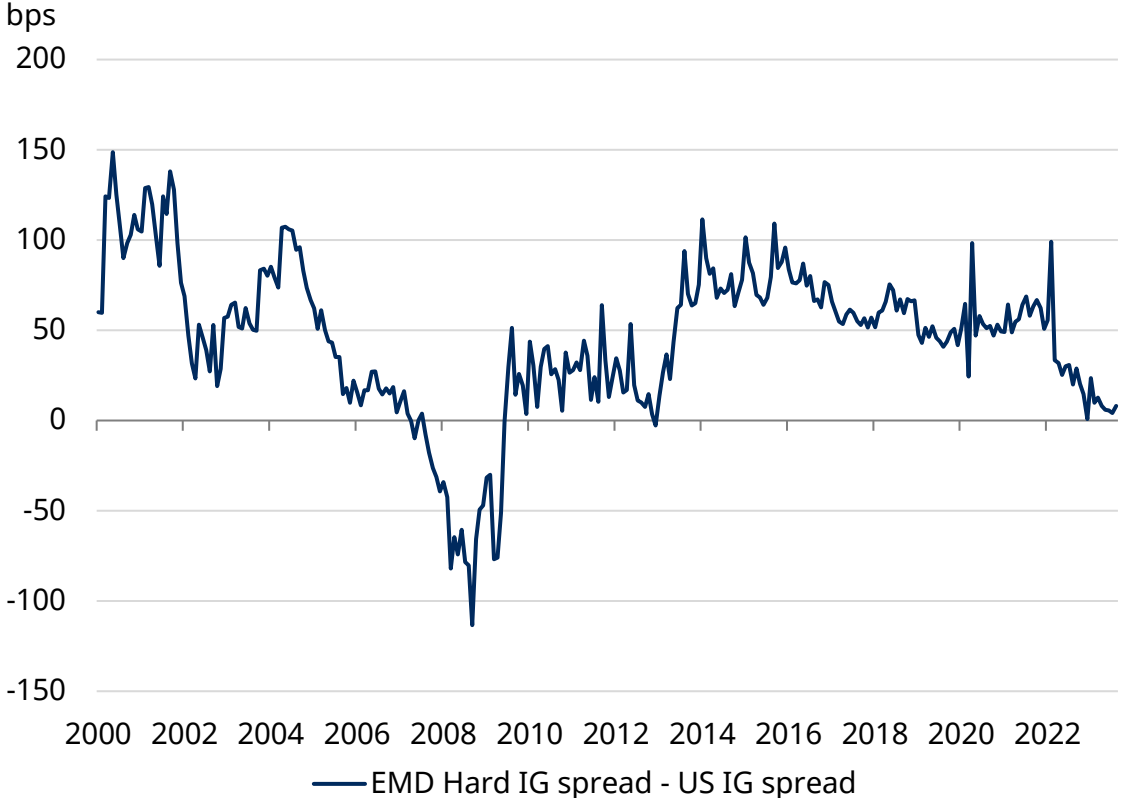
EM vs. DM yields



Source: Schroders, Refinitiv Datastream, ICE Data Indices, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

EM dollar debt: sovereign EMD vs. US corporates

Sovereign EMD IG spread minus US IG spread



Sovereign EMD HY spread minus US HY spread

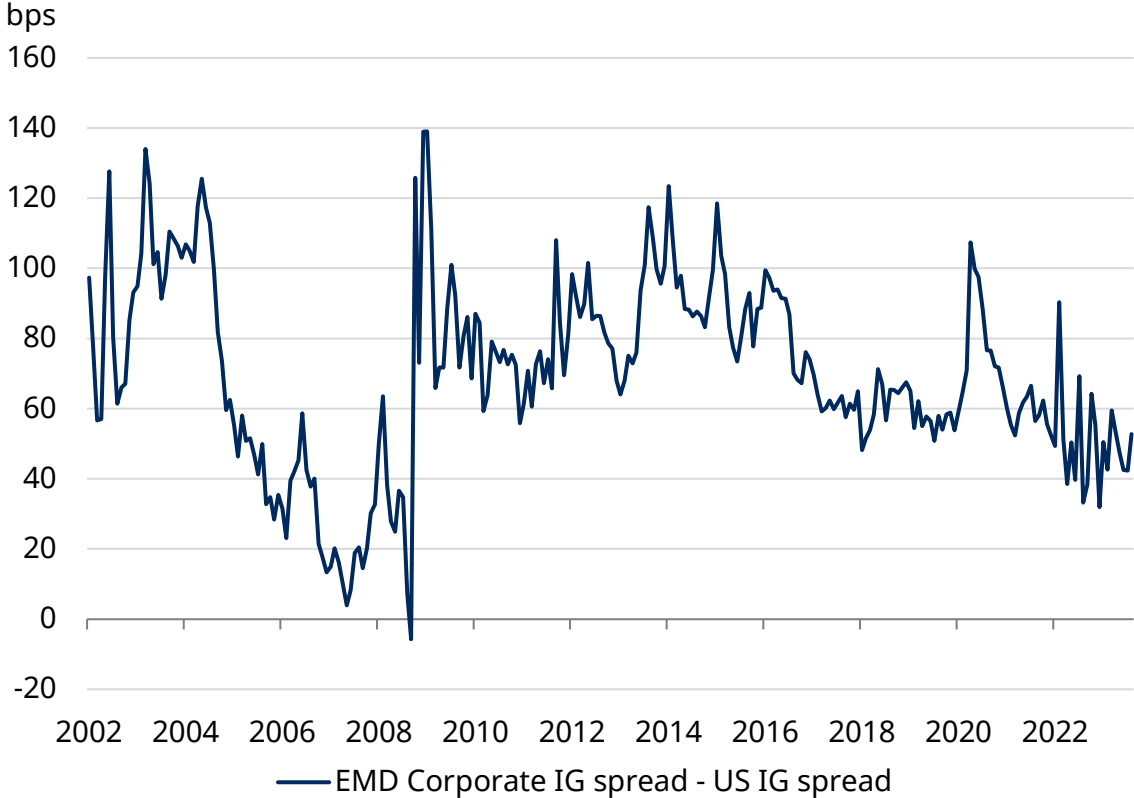


Sovereign IG spread premium to US IG is only marginally above zero

Source: Schroders, Refinitiv Datastream, ICE Data Indices, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

EM dollar debt: corporate EMD vs. US corporates

Corporate EMD IG spread minus US IG spread



Corporate EMD HY spread minus US HY spread



Source: Schroders, Refinitiv Datastream, ICE Data Indices, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.



Emerging market debt:

Local currency

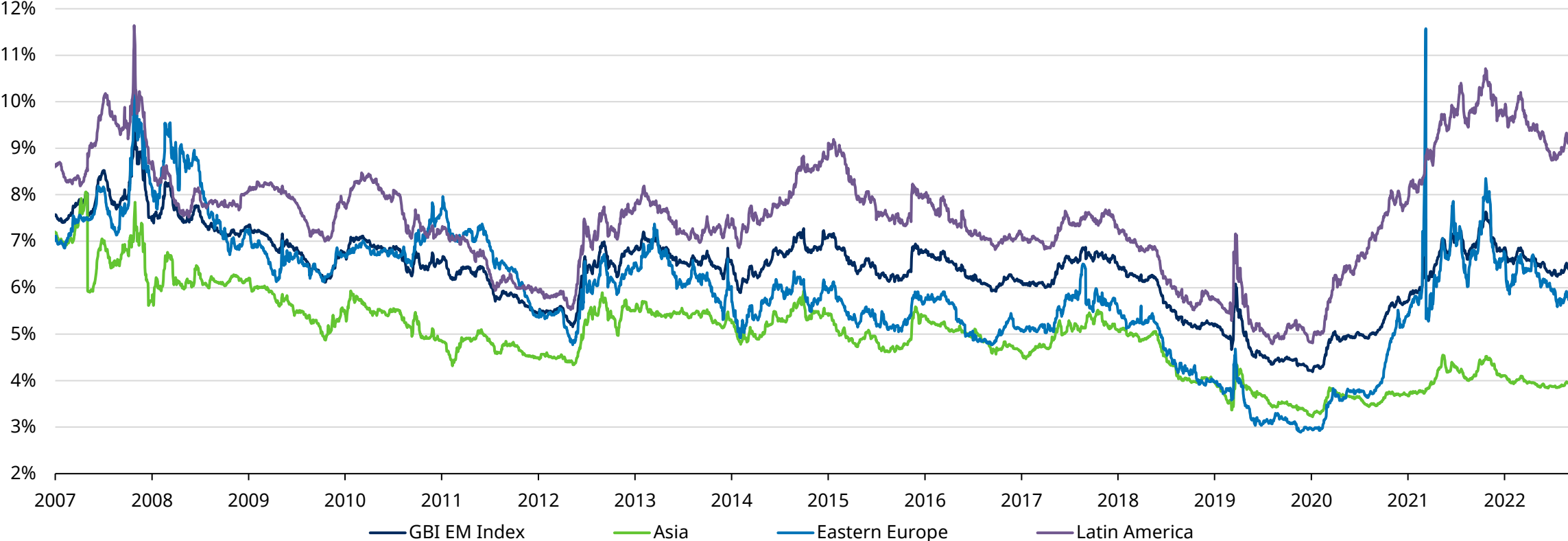
Summary: local currency emerging market debt

- The local EM index yield ticked up slightly in August. It remains a lot higher than in previous years, and there continues to be significant variation between regions.
- With the average EM policy rate at its highest level in around 20 years, and inflation falling, EM rate cuts are underway. Turkey is the notable exception, where a renewed vein of orthodoxy has led to sharp rate hikes.
- The average local EM yield curve is now close to flat
- The real yield premium of EM over DM is close to the bottom-end of its post-GFC range, but has started to pickup. This is primarily due to rising EM real yields over the past few months, as EM inflation has moderated.

EM local currency index yield ticked up to 6.4% in August

Led higher by Latin America

Yields of EM regions



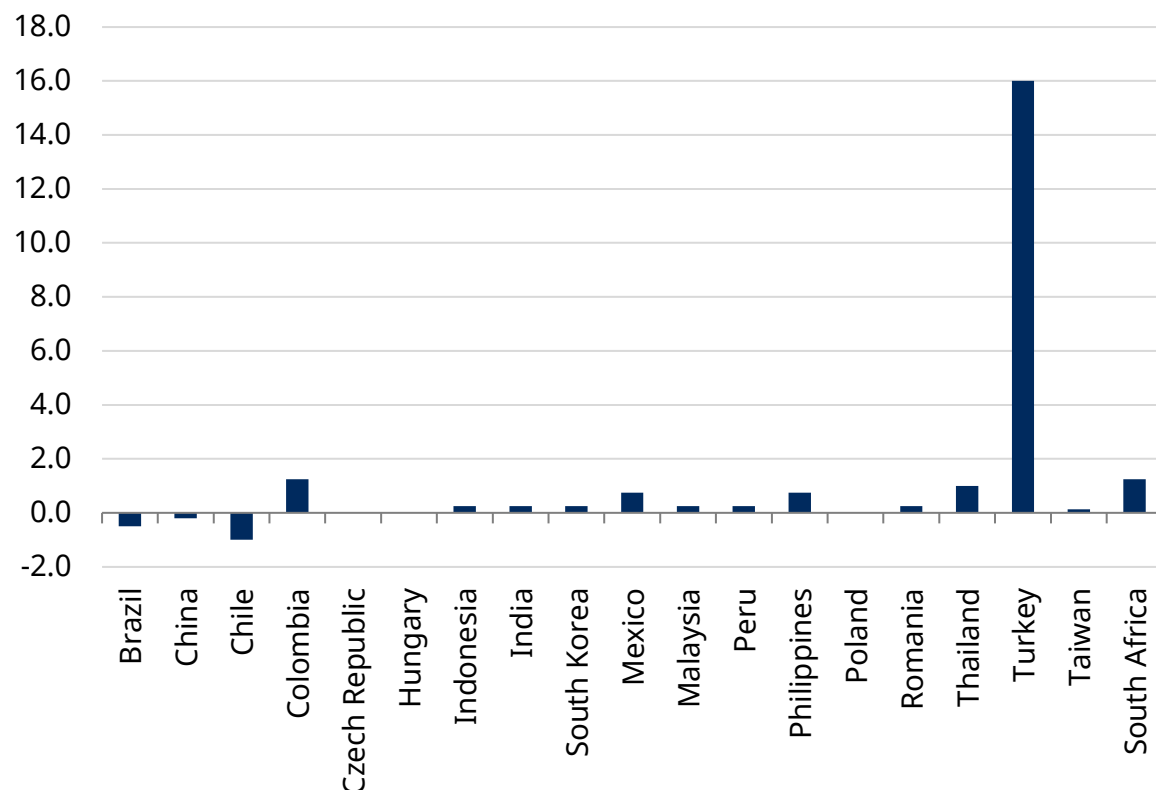
Yields vary significantly by region, and are notably higher in Latin America relative to the EM index

Source: Schroders, Refinitiv Datastream. Data as at 3 July 2023. Russia was removed from all JP Morgan EMD indices from 31 March 2022. Please see relevant disclaimers on page 40.

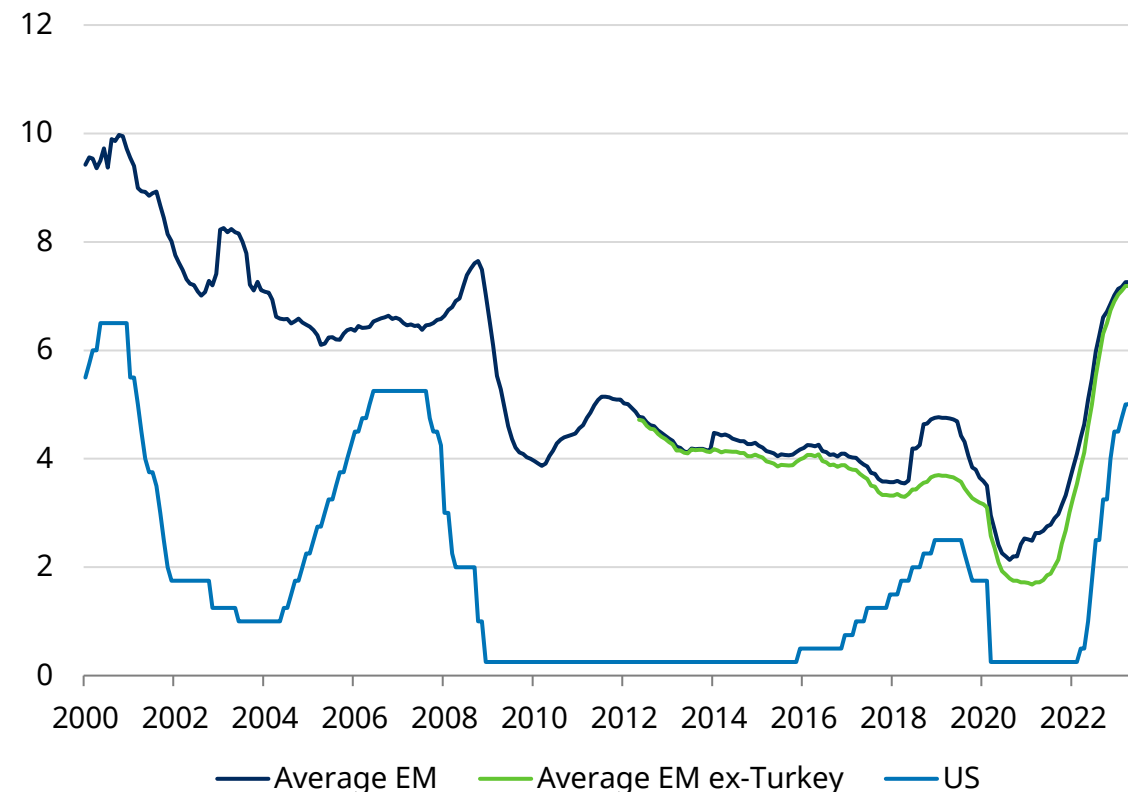
The average EM policy rate is close to a 20 year high

EM policy rates

Change in EM policy rates YTD (%)



Average EM policy rate¹ (%)



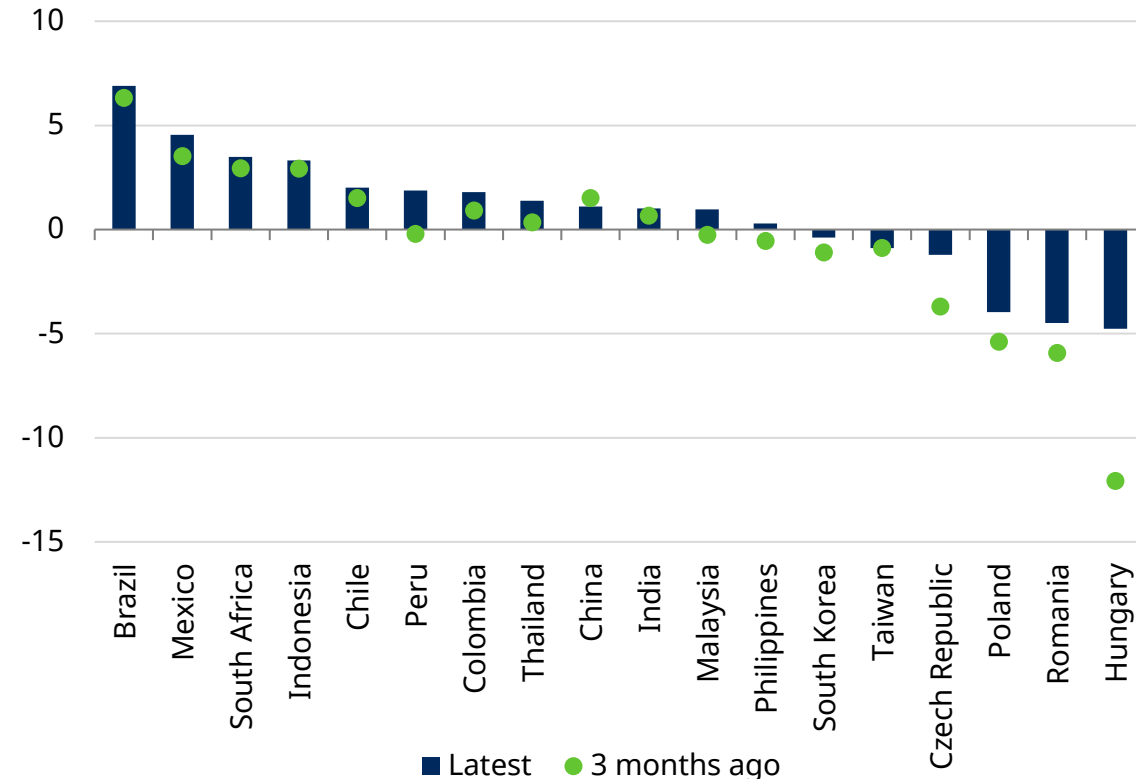
After changing course in June, Turkey's central bank has now hiked rates by over 16%

Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. ¹Based on 19 major EM countries. Please see relevant disclaimers on page 40.

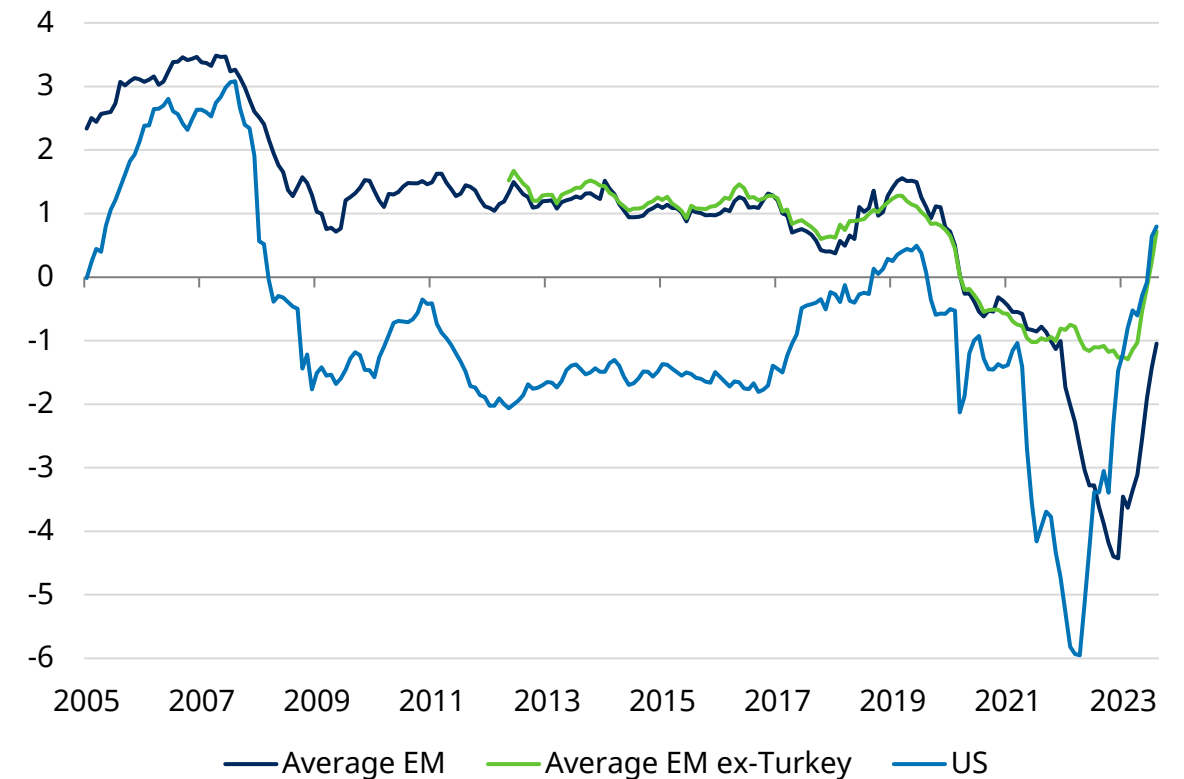
Various EM real policy rates are still negative

...especially in Eastern Europe

EM real policy rates (%)



Average EM real policy rate¹ (%)

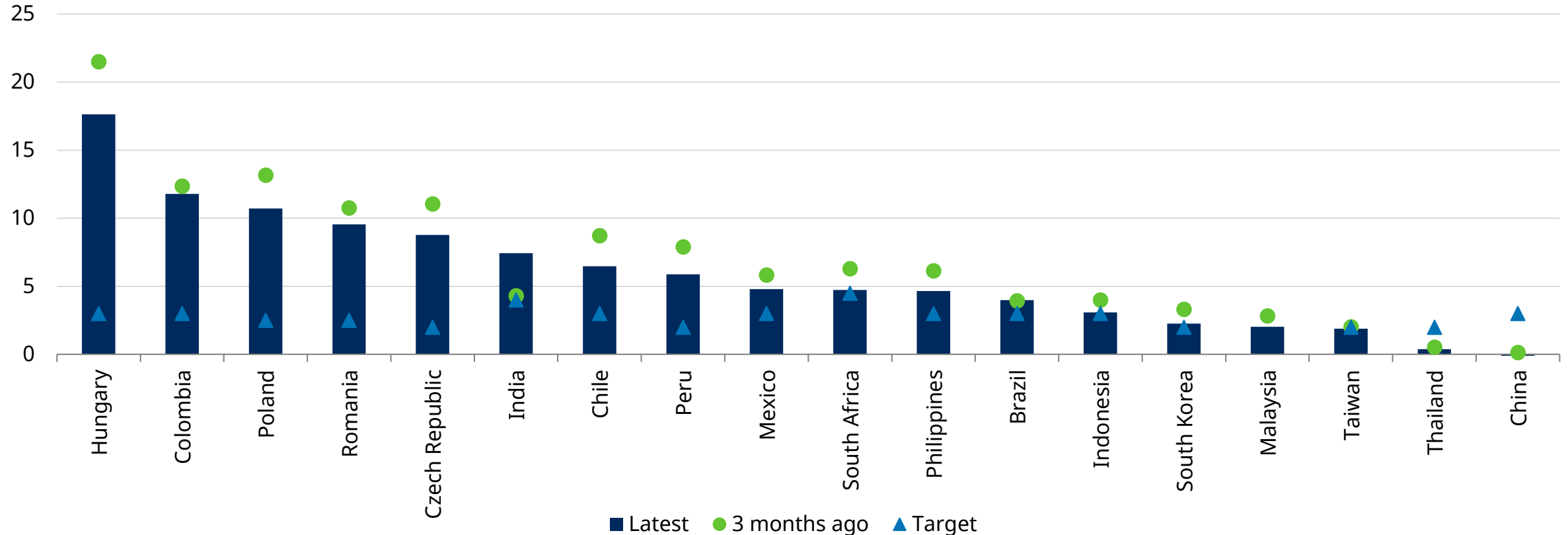


¹Based on 19 major EM countries. Turkey has very high inflation at the moment, with the annual core inflation at 65%. Despite large rate hikes recently, Turkey's policy rate is well below core inflation at 25%. Hence, Turkey's real policy rate is very negative at -40%, skewing the EM average.
 Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Nominal policy rate minus annual core inflation.
 Please see relevant disclaimers on page 40.

EM inflation

Headline inflation is above target in most EM ex. China

Headline inflation (%)



But there are signs of disinflation almost across the board

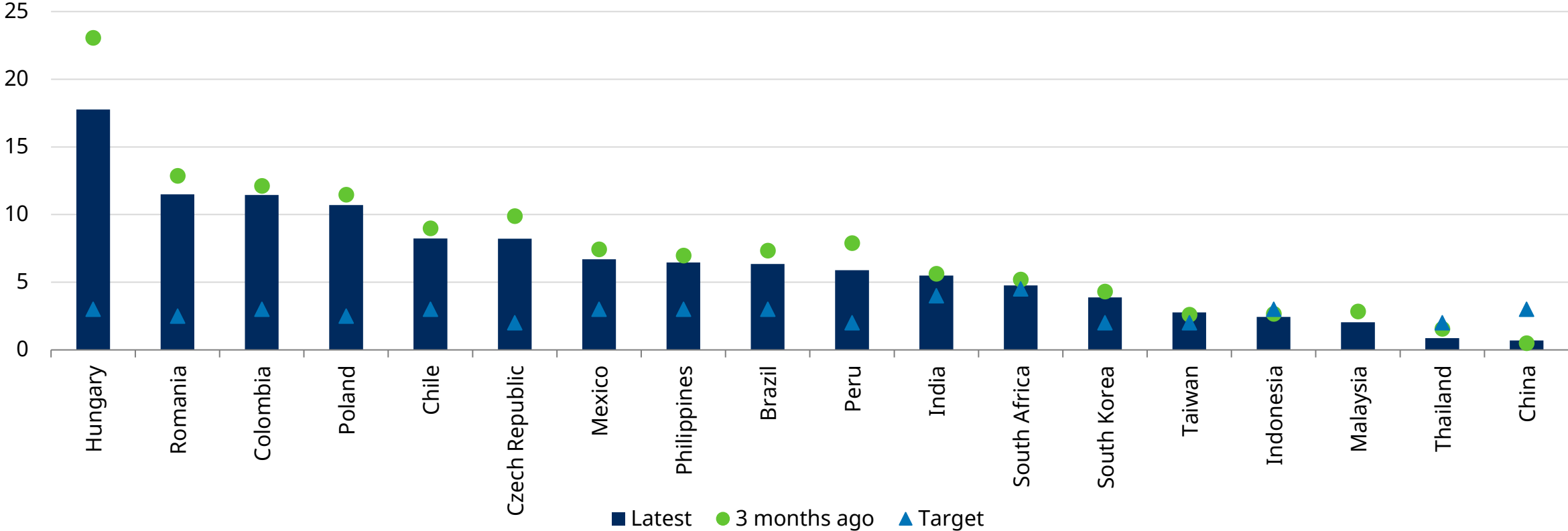
Turkey's annual headline inflation (59%) omitted from the figure.

Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

EM core inflation

Core inflation is also above target in EM ex. China, Thailand, and Indonesia

Core inflation (%)

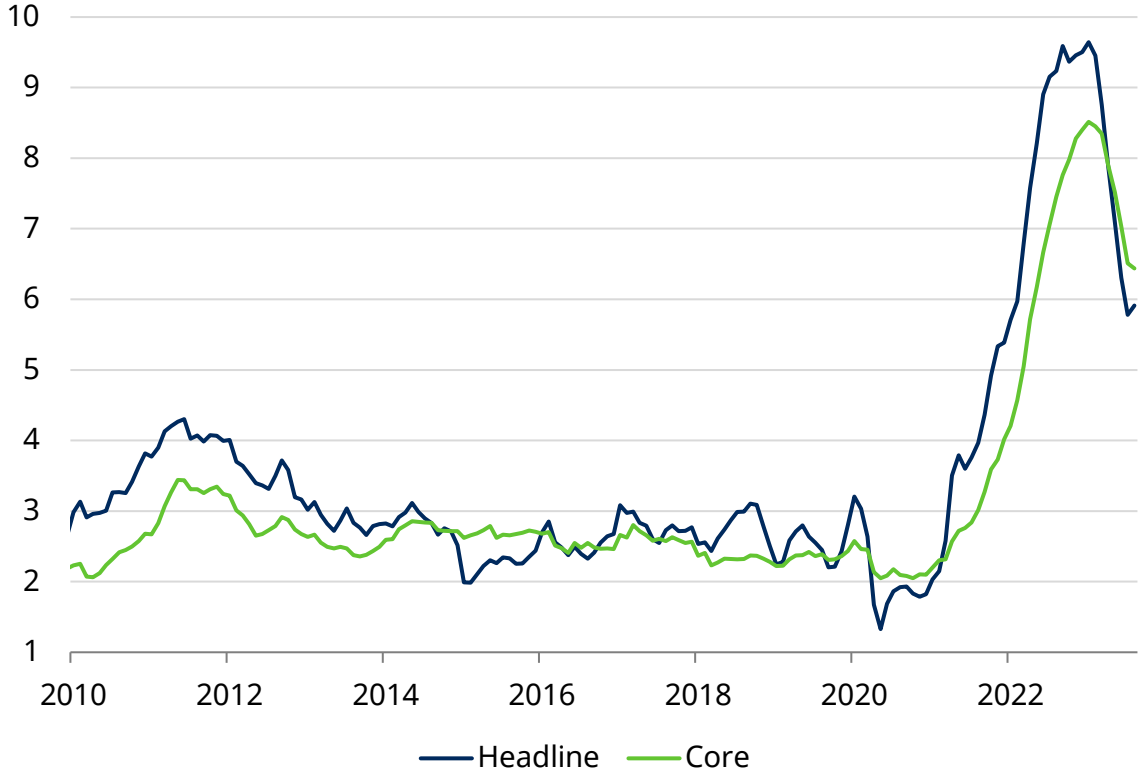


Turkey's annual core inflation (65%) omitted from the figure.
Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

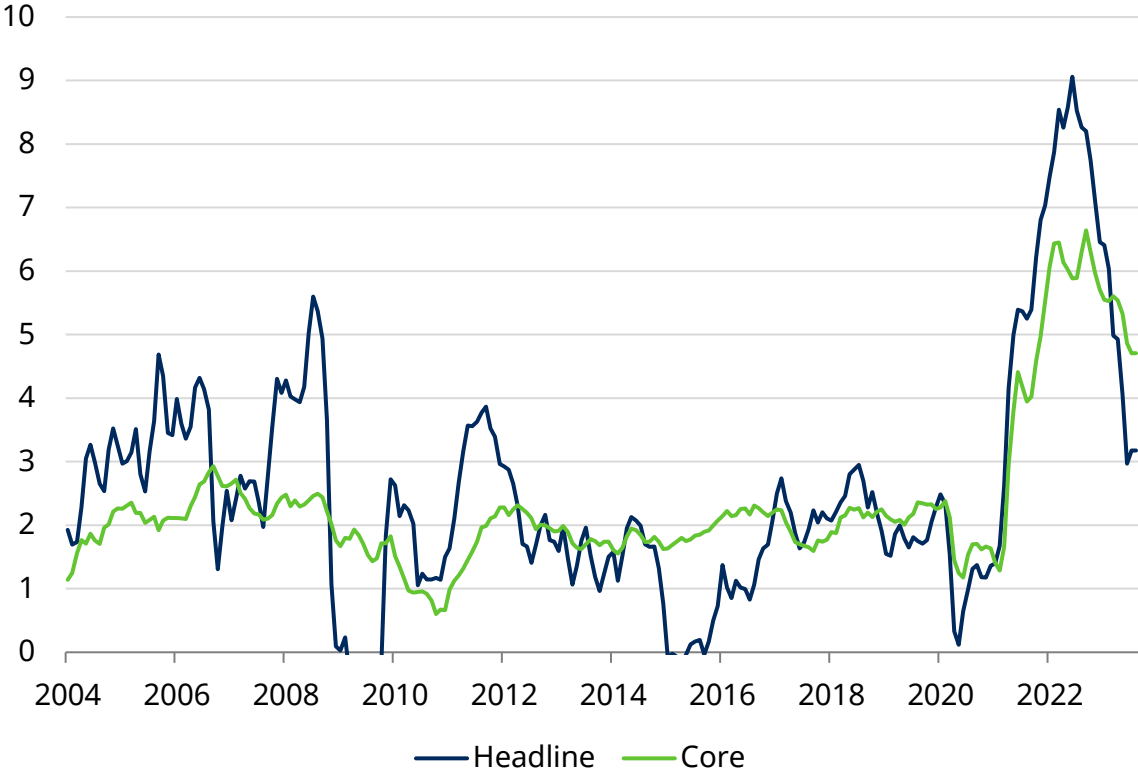
Headline EM inflation has fallen significantly

...and core is also coming down

Average EM inflation ex Turkey¹ (%)



US inflation (%)

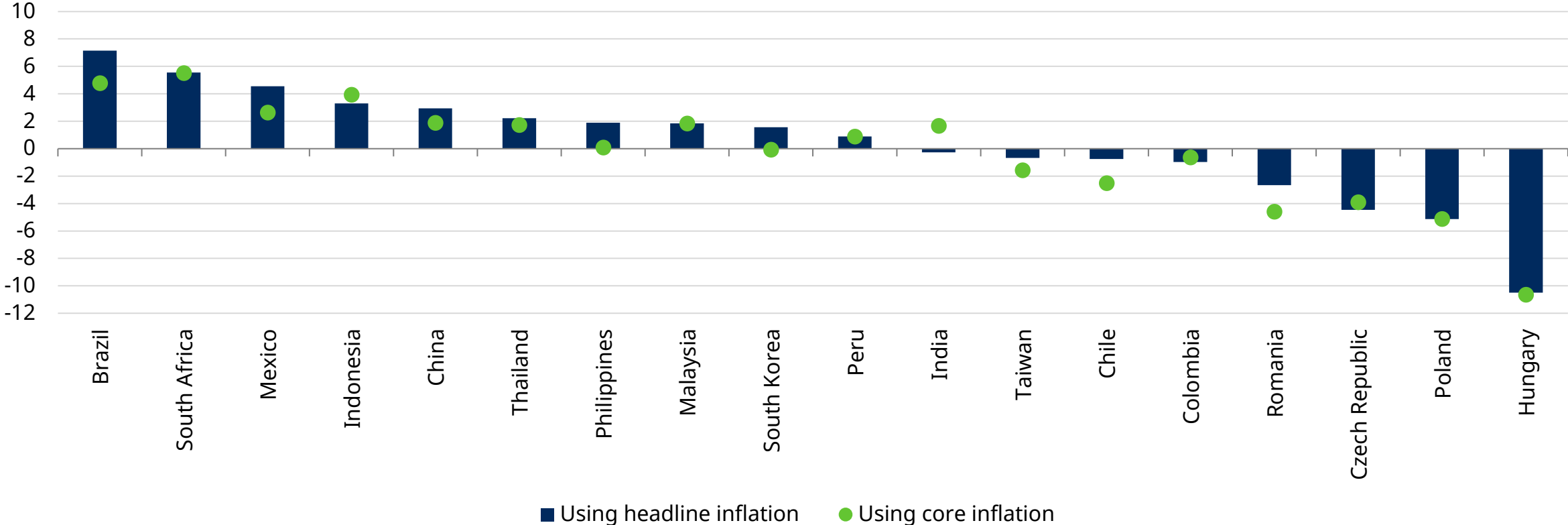


¹Based on 19 major EM countries. Turkey excluded because of significantly higher inflation in the country compared to the rest of the EM. Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

Real bond yields remain negative in certain EM

EM Europe real bond yields are negative relative to core inflation

Real 10 year yield

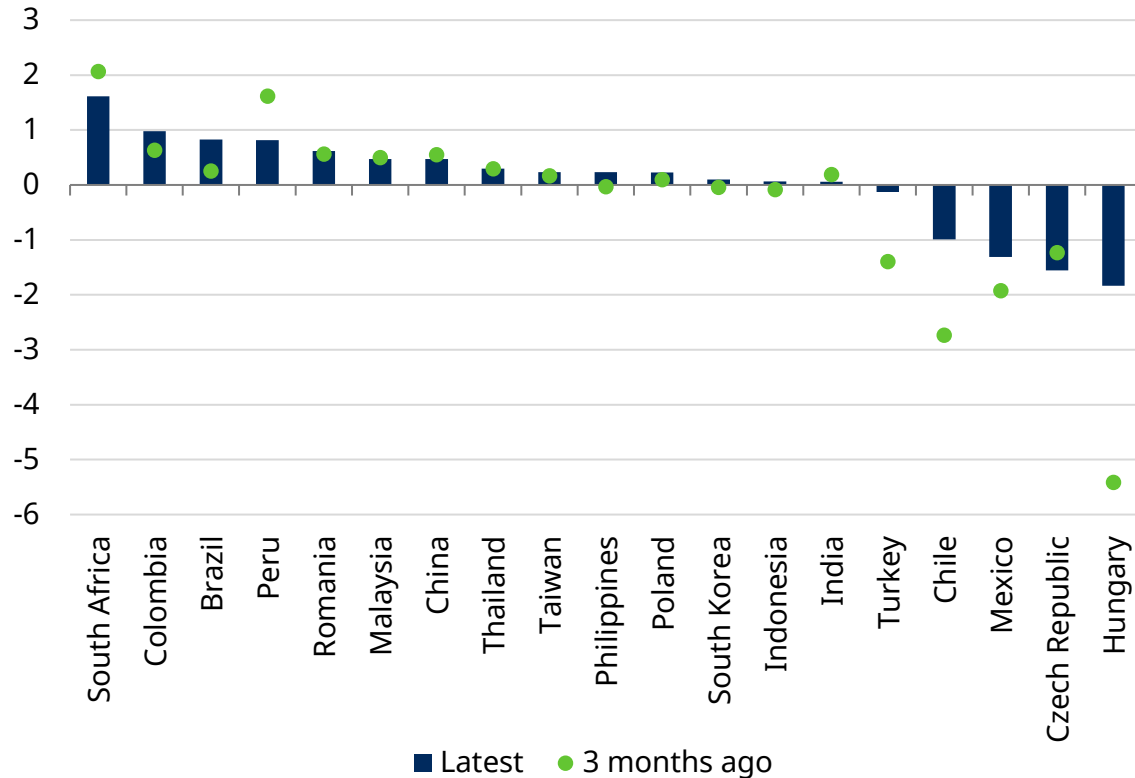


Real bond yields are positive in Brazil and South Africa in particular

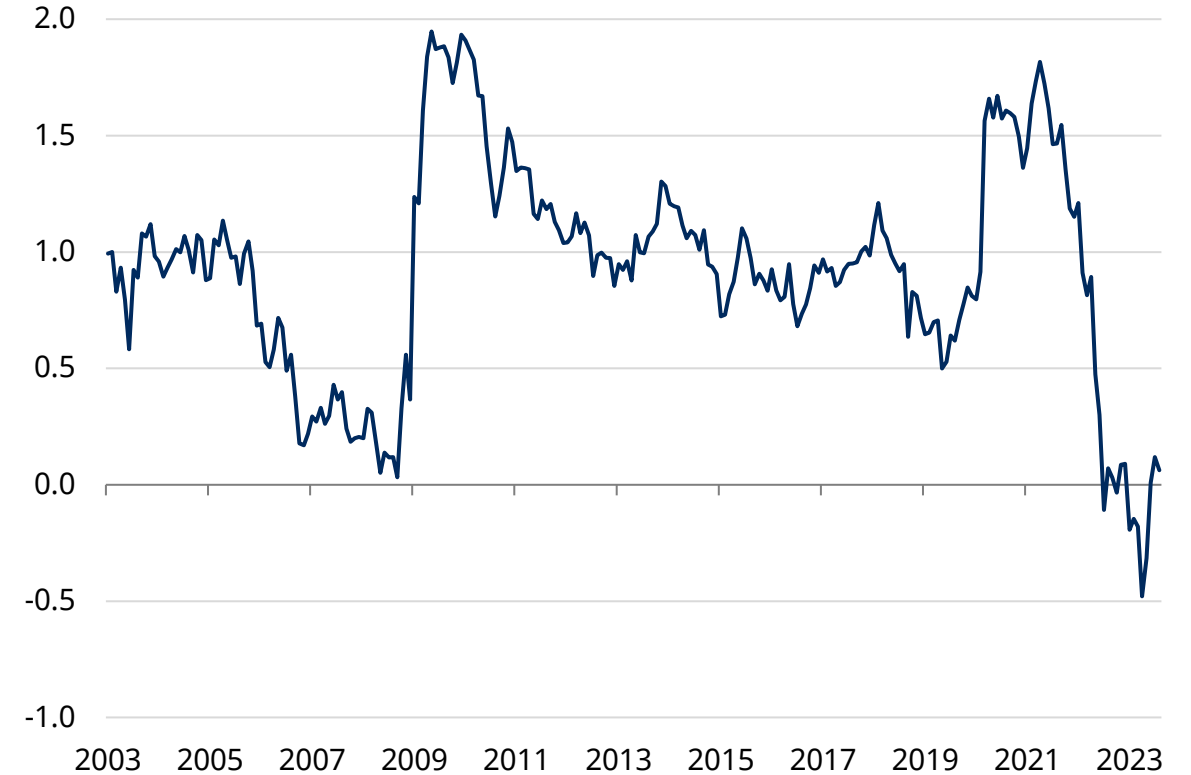
Nominal 10 year yield minus annual headline or core inflation.
Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

EM yield curve shape

Yield curve steepness (10y yield – 2y yield)



Average EM yield curve steepness (10y yield – 2y yield)¹



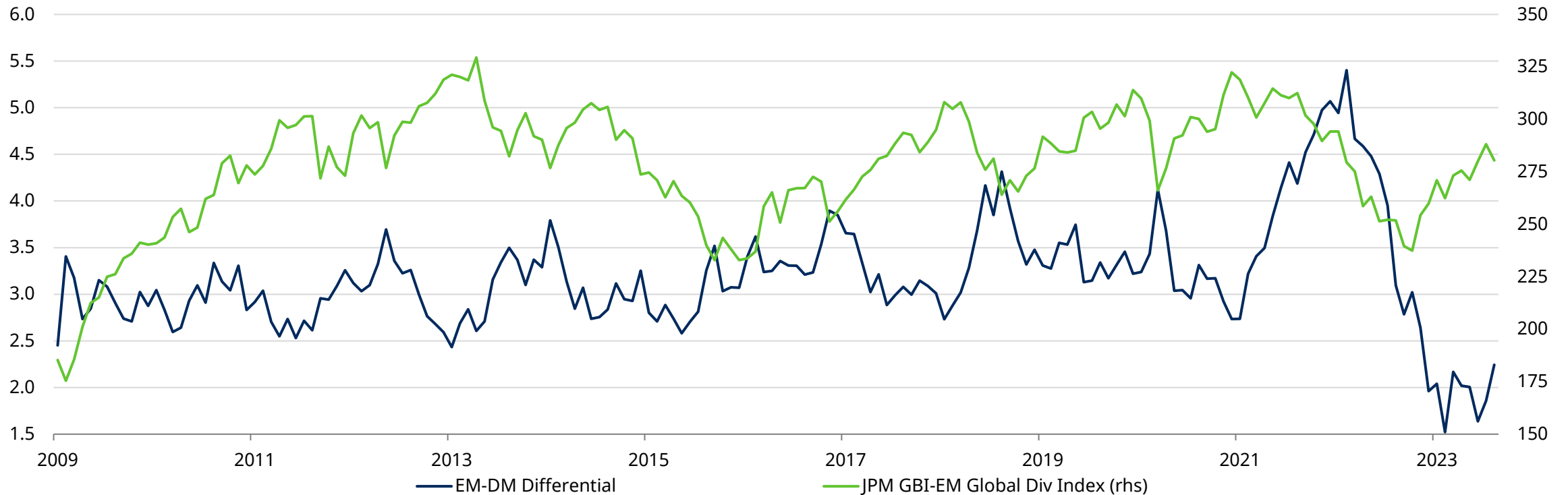
The average local EM yield curve is close to flat

¹Based on 19 major EM countries.
Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

EM/DM real yield differential

EM local currency bond valuation

EM-DM real yield differential (%)



Real yield differential remains close to a post-GFC low

Past performance is not a guide to future performance and may not be repeated.

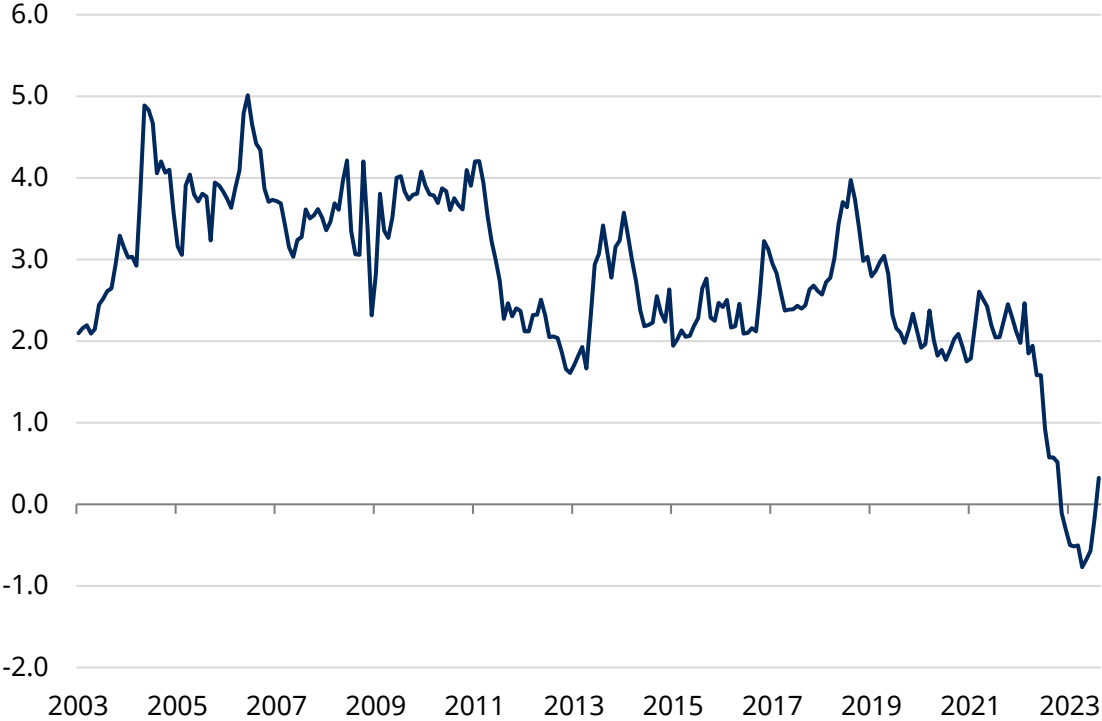
EM real yield is weighted average of individual JPM GBI-EM index nominal yields deflated by core inflation. DM real yield is 5Y government bond yields of US, UK, Euro zone, Japan deflated by core inflation, weighted by the size of individual government bond market.

Source: Schroders, Refinitiv Datastream, ICE Data Indices, JP Morgan. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

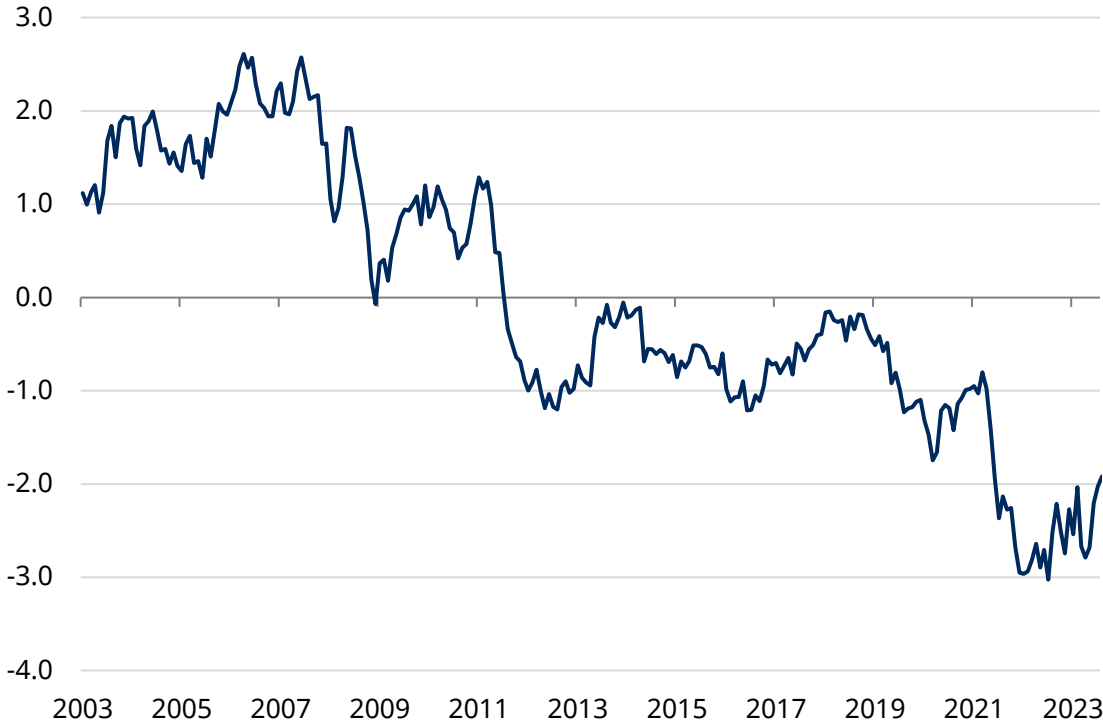
EM and DM real yields

Individual drivers of the real yield differential

EM real yield (%)



DM real yield (%)



EM and DM real yields have picked up recently; EM turned positive in August

Source: Schroders, Refinitiv Datastream, ICE Data Indices, JP Morgan. Data as at 31 August 2023. EM real yield is weighted average of individual JPM GBI-EM index nominal yields deflated by core inflation. DM real yield is 5Y government bond yields of US, UK, eurozone, Japan deflated by core inflation, weighted by the GDP PPP of each country. Please see relevant disclaimers on page 40.



Emerging market currencies

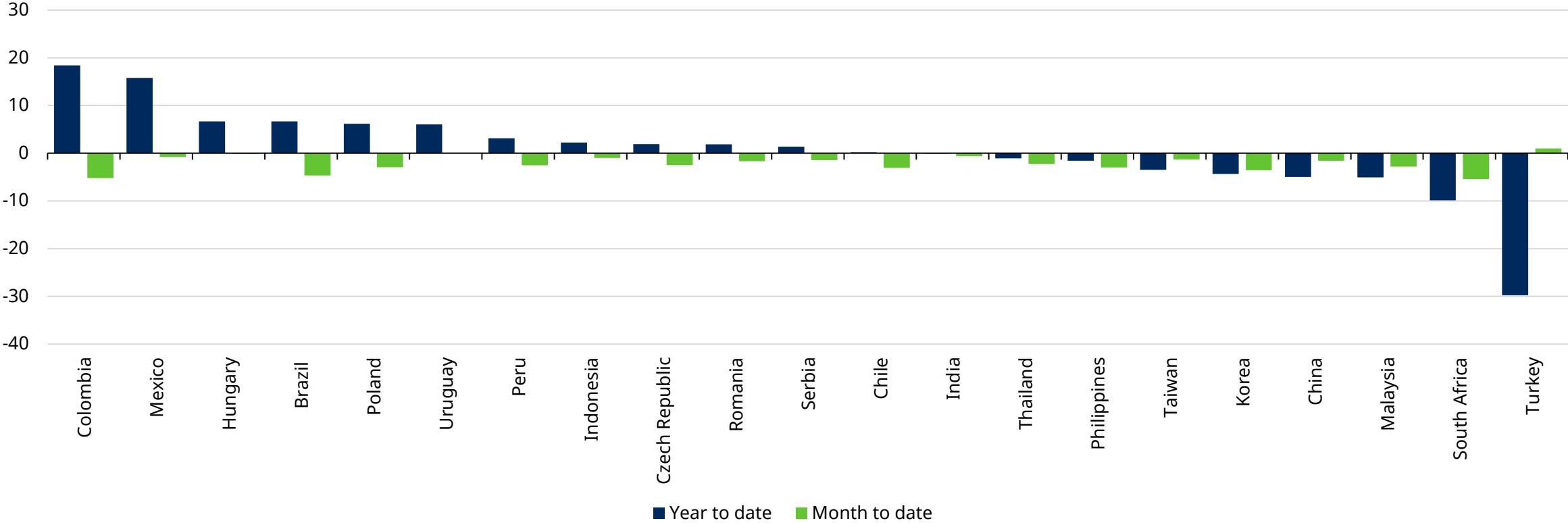
Summary: emerging market currencies

- EM currency performance versus the US dollar has been mixed YTD
- There are undervalued currencies in all three EM regions, though the degree of value in EM currencies varies significantly
- The Czech koruna is notably above its long term and five-year averages. Currencies in Uruguay, and to a lesser extent in Romania and India are also expensive versus history. Turkey, Serbia, and South Africa are among the cheapest EM currencies relative to the long term average
- EM FX carry, the strategy of buying higher-yielding EM currencies against lower-yielding currencies to earn the interest rate differential, made a comeback because of EM rate hikes but has faded

EM currency performance vs. US dollar

EM currency performance has been more mixed YTD

EM currency returns (%)



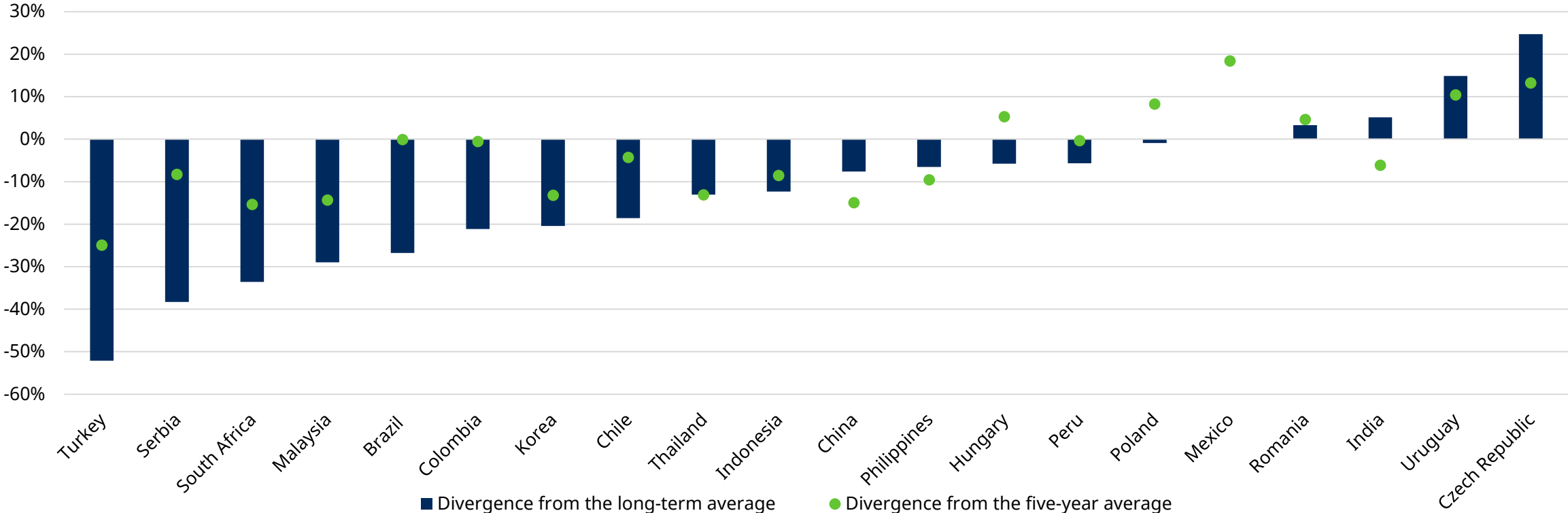
Latin currencies have seen the most appreciation so far this year

Past performance is not a guide to future performance and may not be repeated.
 Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

EM currency value

Some currencies are significantly undervalued

Real exchange rate: deviation from average



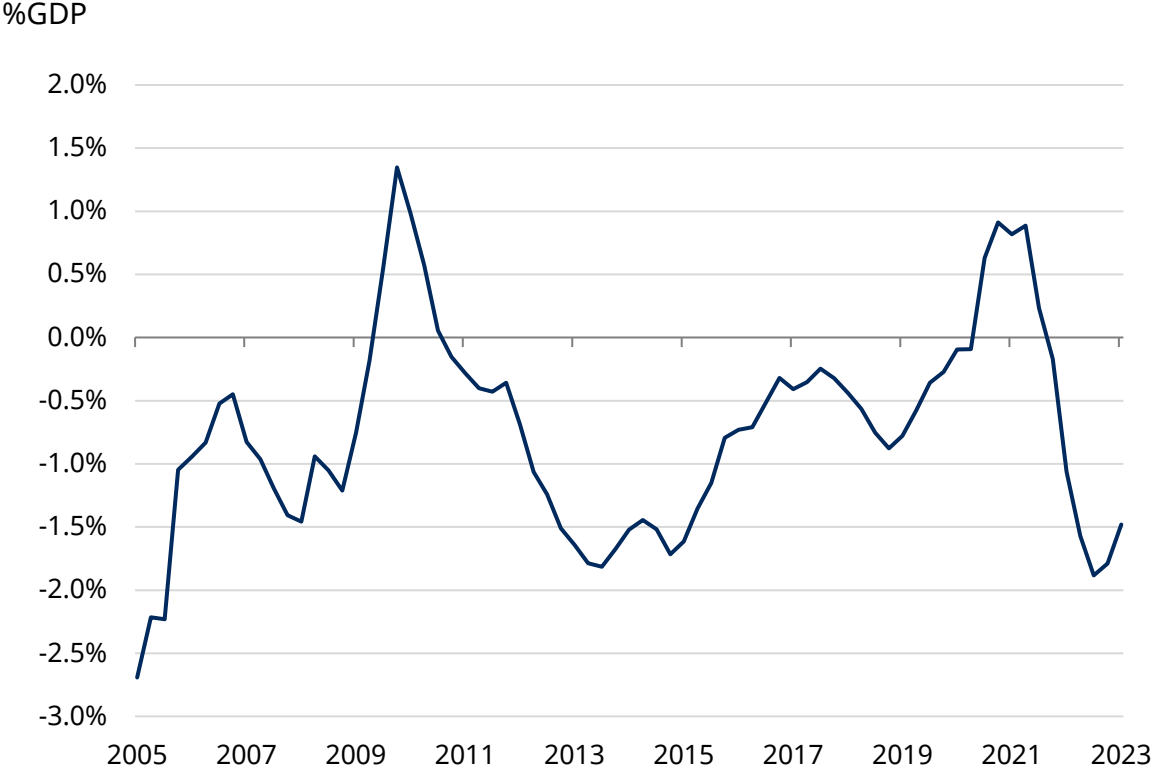
Czech Republic and Uruguay have real exchange rates well above the long term average

Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Real exchange rate is the nominal dollar exchange rate deflated by the consumer price index (CPI) of each EM country vs. US. Long-term average is since January 1995. Please see relevant disclaimers on page 40.

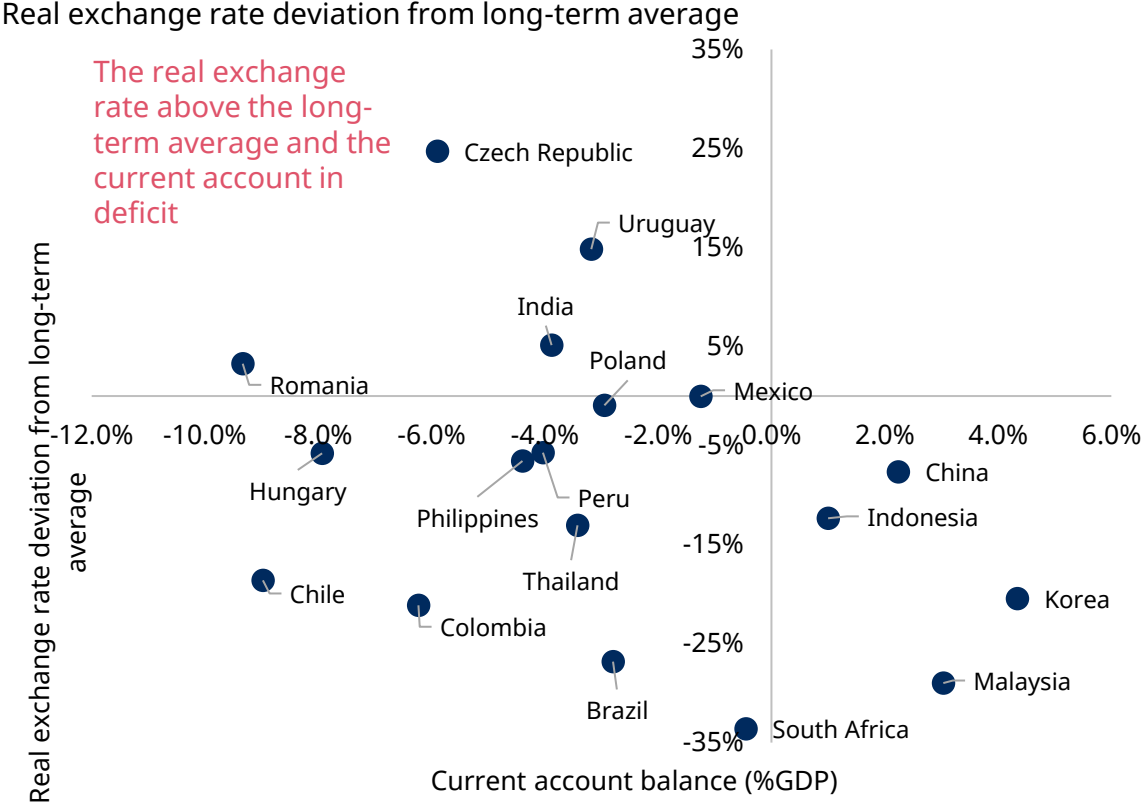
EM fundamentals: current account vs. currency valuation

Czechia, Uruguay and Romania are among the most vulnerable to currency weakness

Average EM current account balance¹



EM currency value² vs. current account balance



¹Based on the historical country weights of the JPM GBI-EM Global Diversified Index. ²Currency value is the deviation of the real exchange rate from the long-term average since 1995. Source: Schroders, Refinitiv Datastream. Current account data as at Q1 2023, currency value data as at 31 August 2023. Please see relevant disclaimers on page 40.

The EM FX carry trade made a comeback on the back of EM rate hikes but has faded

Average EM carry¹

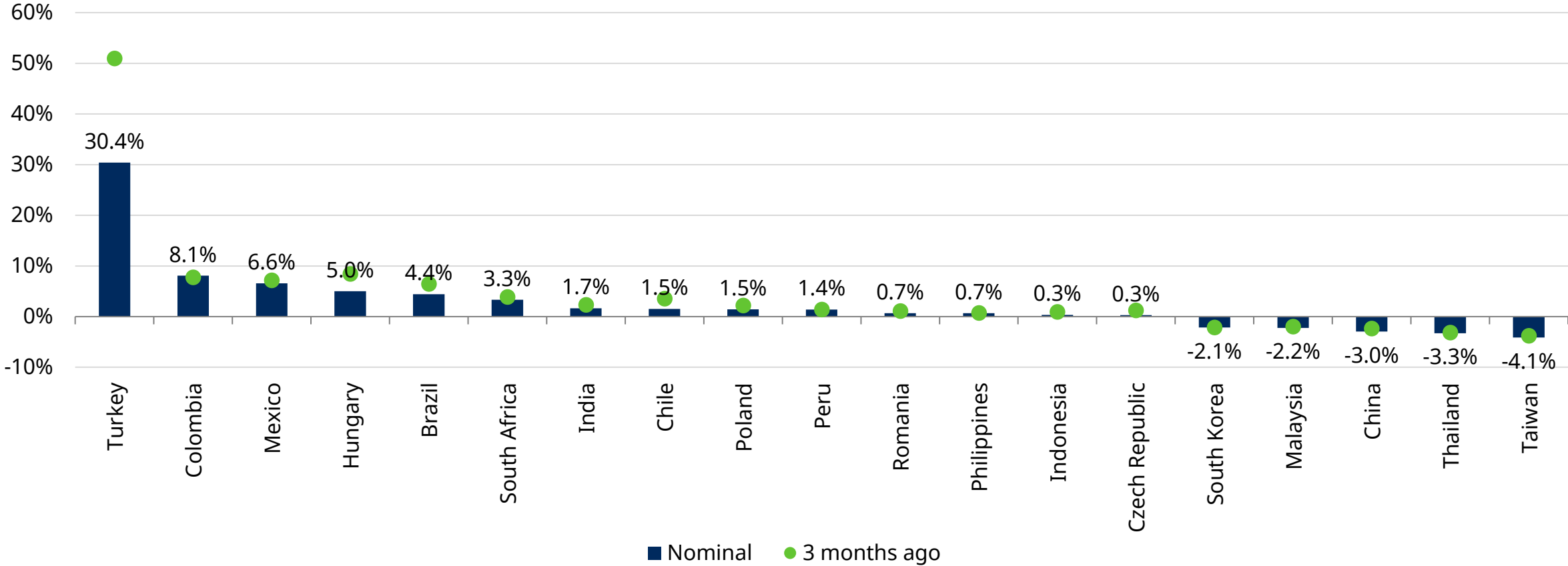


¹The return of holding 1-year FX forward vs. US dollar to maturity. Based on 19 major EM countries.
Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

FX Carry varies significantly between the countries

FX carry trade in Turkey has fallen significantly in the past three months

EM FX carry¹



¹The return of holding 1-year FX forward vs. US dollar to maturity.
 Source: Schroders, Refinitiv Datastream. Data as at 31 August 2023. Please see relevant disclaimers on page 40.

List of indices

- **Sovereign EMD** – The JPM EMBI Global Diversified Composite Index
- **Corporate EMD** – The JPM CEMBI Broad Diversified Index
- **Local EMD** – The JPM GBI-EM Global Diversified Index
- **US IG** - ICE BofA US High Yield Index
- **US HY** - ICE BofA US Corporate Index

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