

# EMD leads the way

BY EMMA DU HANEY, FIXED INCOME PRODUCT MANAGER, ABSOLUTE INSIGHT EMERGING MARKET DEBT FUND

Interest in emerging market debt has grown as developed bond markets endure a swathe of government bond issuance and doubts about the security of their AAA ratings.

The credit crisis at first dealt a serious blow to emerging debt markets, but as the dust settled, sentiment rebounded strongly as investors realised that emerging economies were not going to be pulled down with their developed counterparts.

The Absolute Insight Emerging Market Debt Fund (Ucits III-compliant) performed very well over the crisis and in the months that followed. The Fund's absolute return approach, targeting best ideas in emerging markets proved to be very effective in displaying less downside than the market during the crisis and similar upside after the storm (see chart).

### Reasons for success

This performance was due primarily to two factors: our ability to pick good risk-adjusted opportunities within the asset class and an exceptionally tough risk framework based on dynamic risk contribution measures, stop losses and, importantly a common sense approach.

Taking the first element of the fund's success, it is important to appreciate that the fund is not locked into replicating the constituents of a typical emerging market index. Its performance

is measured against a cash benchmark (three month GBP LIBID) rather than an index benchmark. There are a couple of reasons for this.

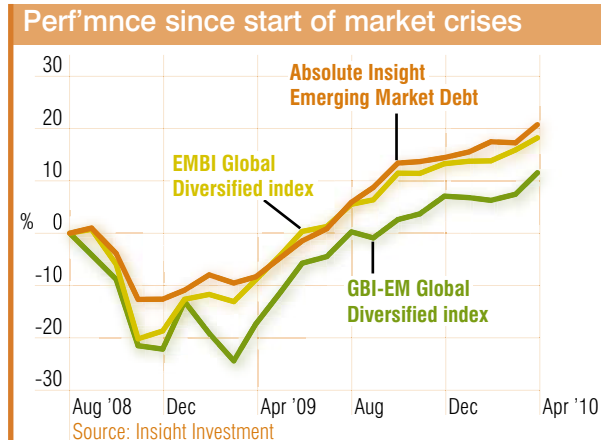
The first reason is that despite the value of emerging market debt totalling almost \$8trn, existing indices cover less than \$1trn. Therefore most of the market is off limits to index-related investors, particularly those with tracking error constraints.

Looking at emerging market debt from an unconstrained perspective means we can focus on the areas of the market where we feel value can be added, rather than invest according to market indices. It thus allows risk to be allocated away from areas that look less likely to reward the risk taken.

It is also important to remember that emerging market debt is not one homogenous asset class, but actually consists of several sub-asset classes, each with its own risk/reward pay-off.

So the fund can, and does, invest across the whole emerging market debt spectrum: not just external and local government and corporate bonds on a global basis, but currencies and derivatives too.

This enables us to diversify the portfolio not only by geography, but by instrument as well. The



use of derivatives allows exposures to be hedged or for outright short positions to be created in order to achieve the fund's absolute return goal.

### Alleviating concerns

A long/short fund structure can alleviate investor concerns about market timing, as the fund can position for both positive and negative outcomes.

This is particularly helpful when faced with the current situation where there is great uncertainty over the direction of interest rates and creditworthiness across global bond markets.

Given the volatility in market indices, there are clear advantages to an end investor for taking an absolute return approach to emerging market debt. Last year, despite hedges sometimes accounting for

40% of the fund and cash often in excess of 10%, our active approach produced returns broadly in line with market indices while producing far lower volatility (see table). So when the market is rallying, even defensive strategies can improve the fund's volatility profile.

At Insight, we have been managing funds on an absolute return basis for more than ten years and the Absolute Insight Emerging Market Debt Fund, which offers daily liquidity, is part of the Absolute Insight range of dedicated absolute return funds.

We expect the rest of 2010 to continue to be a year of diverse performance across the emerging regions, and it will be ever more important for returns to be generated from both positive and negative views, as well as the flexibility to hedge out market risk.



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Emma Du Haney, fixed income product manager, Absolute Insight Emerging Market Debt Fund

### Attractive returns with low volatility

	YTD 2010 (%)	2009 (%)	1 year volatility (%)	1 year Sharpe ratio (%)
Absolute Insight Emg Mkt Debt	6.3	29.89	3.31	8.44
EMBI Global Diversified Index	5.1	29.82	4.28	5.57
GBI-EM Global Diversified Index	7.1	21.98	9.41	2.91

Source: Insight Investment