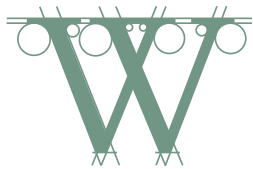


# Emerging market debt: a \$9 trillion investment opportunity



July 2010



While investors have become more wary of sovereign risk in relation to developed markets, emerging market debt (EMD) is starting to look like a safer haven. In emerging markets, the level of debt compared to GDP is 46%, less than half that of the developed world.

Developed countries on average have a debt-to-GDP level of 102%, meaning they owe more than they produce<sup>1</sup>. Moreover, with high projected rates of economic growth and entrenched policies of fiscal prudence, the debt dynamics of emerging markets are set to improve further. Indeed, emerging markets no longer languish in sub-investment territory. Today their improvements have been recognised by the credit rating agencies, and now it is a predominantly investment grade universe.

Along with the improved and improving creditworthiness, the yields available relative to the developed world increase the investment appeal of EMD. Currently, debt issued by emerging market governments in foreign currencies such as the US dollar (known as external debt) yields around 6.85%. Local debt, ie. debt issued in the local currency, on average offers a yield of 7.10%<sup>2</sup>. By contrast, 10-year US treasuries offer less than 3%.

While many investors are happy to accept the economic and valuation arguments in favour of EMD, concerns remain around the liquidity and depth of the market. While this is still a growing

Chart 1: Global EM Debt outstanding (ex Korea/ China local)



Source: Merrill Lynch, Insight Investment 2010.

market, the overall market capitalisation is already \$9 trillion<sup>3</sup>, making it a material part of the global bond universe.

One of the biggest changes in the past few years has been the growth of domestic investors. In the past, investors in emerging market debt were predominantly from developed markets, hence the issuance of bonds in US dollars and euros. But today domestic investors vastly outnumber foreign investors, and this has ensured greater stability for local markets. The total universe for tradable emerging market debt now exceeds

\$9 trillion<sup>3</sup>, a record high. Local currency debt now makes up 85% of this total, of which the majority is government debt (see chart 1). And this is in a market where local currency debt only started being issued in any significance from 2003.

On average, total debt outstanding in emerging markets has grown 18% per annum since 2002. So far this year emerging markets have issued around \$120 billion<sup>4</sup> of bonds. The improving trend in economic growth and enhanced governance has also increased investor appetite for corporate bonds (see chart 2).

<sup>1</sup>Source: Deutsche Bank.

<sup>2</sup>Source: Bloomberg.

<sup>3</sup>Sources: Bank for International Settlements, Bank of America Merrill Lynch.

<sup>4</sup>Source: JP Morgan.

The external corporate bond market has a market capitalisation of around \$620 billion<sup>5</sup>, or more than four times the size of the European high yield market. The geographic profile of the market has also evolved from one dominated by Latin American corporates to a global market where all four major regions – Africa & Middle East, Asia, Emerging Europe and Latin America – are represented. Despite this, emerging market corporates still tend to be treated as a niche asset class or subset of an overall emerging market debt portfolio.

There is also a local market corporate bond universe, which given its size of \$2.8 trillion<sup>6</sup> would appear to dwarf the external market. However, this market is still fairly difficult to access, with a large part of the market dominated by Chinese companies. Nonetheless, access to domestic corporates for foreign investors is growing and markets such as Brazil and Russia offer a good choice of names. In our view, this market

is set to grow exponentially in the coming years and it is one where we have existing and growing expertise.

Insight has long taken a non-indexed approach to investing in EMD given the rapidly changing nature of the asset class. We also want to avoid the constraint of a benchmark that does not accurately represent the available universe and that could expose our investors to potentially unwanted levels of volatility. With the Absolute Insight Emerging Market Debt fund, our approach is to seek out the best risk/reward investment opportunities from across the sectors within EM, and also to make use of associated derivatives. We combine these ideas in a tightly risk-controlled portfolio, with the objective of participating in market upside while controlling volatility to avoid the downside associated with a traditional benchmarked approach.

**For further information please contact:**

### Institutional Business Development

business.development@  
insightinvestment.com  
020 7321 1547

### Wholesale Business Development

brokersupport@bnymellon.com  
0500 66 00 00

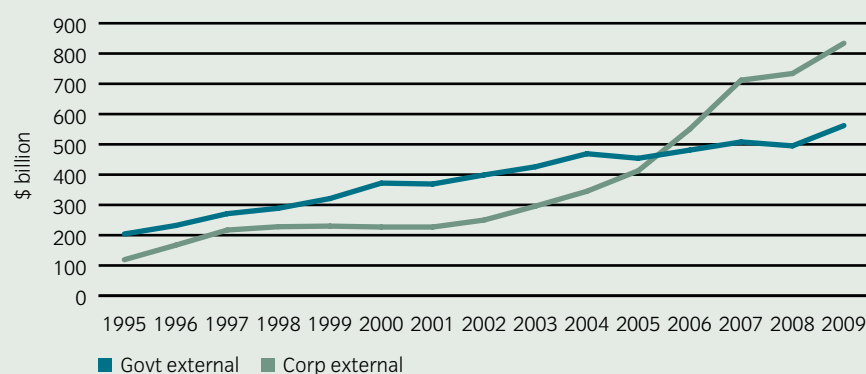
### International Business Development

internationalsales@bnymellon.com  
+44 (0)20 7163 2367

[www.insightinvestment.com](http://www.insightinvestment.com)

Telephone calls may be recorded.  
Call charges may vary by provider.

**Chart 2: External debt issuance trends**



Source: Merrill Lynch, Insight Investment 2010.

<sup>5</sup>Source: JP Morgan.

<sup>6</sup>Sources: Bank for International Settlements, Bank of America Merrill Lynch.

The value of investments and any income will fluctuate (this may be partly due to exchange rate fluctuations) and investors may not get back the full amount invested. Unless otherwise attributed the views and opinions expressed are those of the fund manager at the time of publication and are subject to change. The content of this document is valid for one month from date of issue.

This document is only directed at investors resident in jurisdictions where our funds are registered. It is not an offer or invitation to persons outside of those jurisdictions. Insight Investment reserves the right to reject any applications from outside of such jurisdictions. Issued by Insight Investment Funds Management Limited. Registered office 33 Old Broad Street, London EC2N 1HZ. Registered in England and Wales. Registered number 1835691. Authorised and regulated by the Financial Services Authority. FSA Firm reference number 122259.

➤ A BNY MELLON COMPANY<sup>SM</sup>

[www.insightinvestment.com](http://www.insightinvestment.com)



07617-07-10