

# Emerging Market Corporate Bonds

## An Evolving Asset Class

**Emerging markets have come a long way over the past twenty years, undergoing major economic and structural changes. Their growing importance is reflected in their increasing share of global GDP. According to the International Monetary Fund, emerging markets will continue to increase their share of global GDP in the coming years. And with developed markets' relatively high debt to GDP levels and lower growth rates, investors with little or no allocation to emerging markets need to reconsider their positions.**

At the same time as economic developments, there have been major strides in the financial markets of these countries. The USD-denominated bond markets have changed in particular, from a sovereign debt led one to one where corporate bonds are now at the forefront. Rapid growth and growing investor acceptance has seen emerging market corporate bonds turn into a distinct and diverse asset class filled with broad and attractive opportunities.

The last decade has seen the corporate emerging market debt (EMD) market grow by 17% p.a. To put this into perspective, it is now larger in size than the US high yield market, while outstanding corporate and sovereign EMD combined also surpasses the EUR investment grade universe.

### A distinct asset class

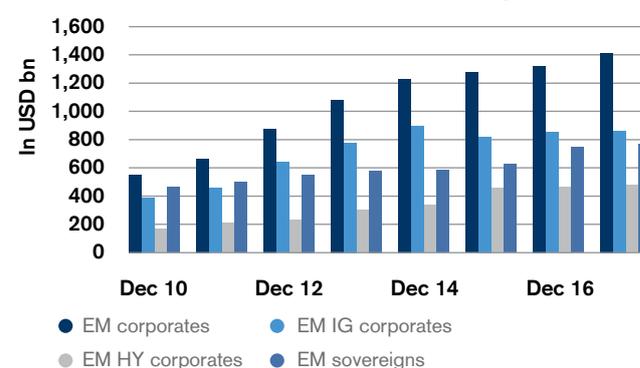
The substantial growth for corporate EMD has only been made possible by the improving fundamentals and better ratings of many emerging economies since the start of this millennium. Increased interest and confidence on the part of international investors in investing in emerging markets has helped transform corporate EMD from a niche into a mature, diverse and stand-alone asset class, allowing investors to diversify existing traditional fixed income allocations and offering additional op-

portunities for investors that only hold sovereign EMD. A reflection of how much these markets have changed is the significantly reduced volatility for investment grade rated emerging market corporate bonds compared to earlier years, as well as more attractive risk-adjusted returns.

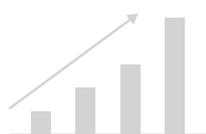
### US dollar or local currency?

Today, the most important choice for investors when investing in emerging markets is to choose between USD-denominated and local currency denominated debt. Local currency debt has a very different risk profile as its volatility tends to be substantially higher due to the currency exposure. Within USD-denominated bonds, most institutional investors have historically allocated their exposure to sovereign indices. While this clearly made sense from a historical perspective given the size of the USD-denominated sovereign bond market, the strong growth in USD-denominated corporate EMD, coupled with emerging market governments' preference to issue local debt, is changing the landscape.

USD/EUR-denominated EMD has seen substantial growth



Source: Bank of America Merrill Lynch. Data as at 31.07.2017



Emerging market share of world GDP in PPP terms expected to exceed **60% by 2020**



Emerging market universe offers **broad exposure** to corporates from over **50 countries**



**Attractive yield pick-up** versus developed markets



**1.11: Sharpe ratio** of emerging market corporate bonds since 31.12.2010

Source: Credit Suisse. Data as at 31.07.2017

Historical performance indications and financial market scenarios are no reliable indicators of future performance. The performance data do not take into account the commissions and costs incurred on the issue and redemption of fund units.

**“The corporate EMD market has been transformed from a niche into a mature, diverse and stand-alone asset class full of opportunities.”**

### **Opportunities in a sovereign crisis**

One interesting feature about corporate EMD relative to sovereign EMD is the fact that many of these companies operate on a global basis. This means that their revenue streams are better diversified and the impact of a slowdown in the domestic economy is mitigated. In times of a sovereign crisis, the spreads on corporates from these countries widen in sympathy. Some of this can be explained by the rising uncertainty, deteriorating country fundamentals and the risk of a corporate rating downgrade on the back of a sovereign rating downgrade.

However, for some companies, the spread widening in these times looks out of context relative to their credit fundamentals and this can create opportunities. In particular, companies that generate revenues in USD but have at least part of their cost in local currency can benefit from the currency depreciation that usually occurs during a crisis.

### **Quasi-sovereign bonds**

Quasi-sovereign bonds play an important role within the emerging market universe. In contrast to developed markets, there are several major companies in emerging economies that are still majority owned by the government. Often these companies are of strategic importance to the government and fall in the oil and gas, metals and mining, utilities, and financial sectors. While the debt of quasi-sovereign issuers is not explicitly guaranteed by the government, there is an “implicit” guarantee. This offers additional support in times of distress.

### **Our solutions**

At Credit Suisse, we can offer investors a broad exposure to different emerging market corporate bond strategies, with a focus on hard currencies. Focusing on global emerging markets, Asia and China, the strategies have strong track records against both the benchmark and peer group. Our 14 strong and highly experienced investment management team, based in Zurich, Singapore and Hong Kong, follow a disciplined investment process that combines top-down and bottom-up analysis to deliver portfolios that are well diversified across regions, countries and sectors.

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### **Do you have any questions?**

Please get in touch. We will be delighted to help.

#### **CREDIT SUISSE ASSET MANAGEMENT (Switzerland) Ltd.**

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