INVESTING IN EMERGING MARKET DEBT: WHAT SOLUTIONS?

- In a backdrop that sees European investors faced with the low and sometimes negative yields offered by sovereign bonds, one segment is standing out particularly well within the bond universe: that of emerging market debt. The market is a fully-fledged asset class, offering attractive yield potential, in both relative and absolute terms, as well as good diversification capacity.
- Romain Bordenave and Jean-Jacques Durand, both Emerging Debt and Currencies Managers at Edmond de Rothschild Asset Management, provide us their view of emerging market debt and the approach they favour to take positions in it.

JEAN-JACQUES DURAND

ROMAIN BORDENAVE

INTERVIEW

What arguments currently play in favour of emerging market debt?

Diversifying investments is a real challenge and there are only very few opportunities at present. We need to look for risk in order to benefit from more attractive yields than those offered by developed markets.

In a backdrop of monetary tightening, bonds with the lowest yields are likely to suffer the most. In the case of emerging debt, assets currently harbour healthy fundamentals and upside potential, backed by more attractive valuation levels. We have positive forecasts for this market: growth is robust and the level of debt remains stable at around 50%. The impact of high 10-year US yields and the strong dollar, both of which tend to weaken the emerging bond class, should stabilise over the year.

The emerging sovereign bond market has witnessed clear growth thanks especially to the improvement in ratings of several economies in the zone. Increased interest and trust from international investors for this market has helped transform this niche category into a fully-fledged asset class. The market offers opportunities to diversify from traditional bond investments and opens up new prospects for investors only owning sovereign bonds from developed countries. Despite a difficult year in 2018, we are confident in the potential of the asset class in 2019. Note also that since 1991, hard currency emerging debt has not performed negatively two years in a row.

What expertise does Edmond de Rothschild Asset Management have in emerging market debt?

Edmond de Rothschild Asset Management has almost 20 years of expertise in the emerging markets segment. This expertise represents almost €2 billion in total assets under management, with a comprehensive range covering a wide market spectrum. The largest is the EdR Fund Emerging Bonds (around €445 million[1]), managed by our team since 2011. This is a conviction based fund that is able to stand out considerably from its benchmark index, while using the investment grade to high-yield rating spectrum and looking for high-potential shares in particular. In addition, the group manages a fund primarily invested in emerging-market credit. Today, EdR Fund Emerging Credit has roughly $500 million under management. The latest fund in the range is also specialised in emerging markets debt, EdR Fund Emerging Sovereign, the objective of which is to maintain a similar investment philosophy, but with a less aggressive profile, thereby aiming to limit risks.

SINCE 1991, HARD CURRENCY EMERGING DEBT HAS NOT PERFORMED NEGATIVELY TWO YEARS IN A ROW

Your expertise in emerging markets debt is focused on two funds: EdR Fund Emerging Bonds and EdR Fund Emerging Sovereign. What are the specific features of each fund?

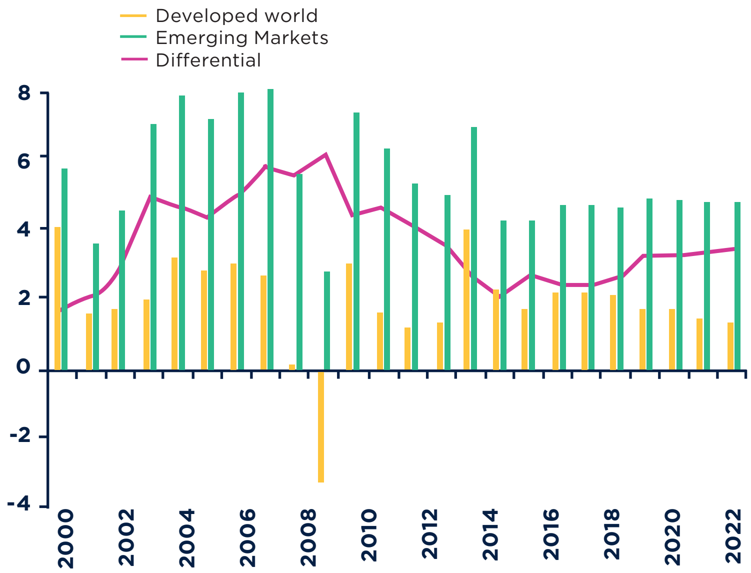
For both funds, EdR Fund Emerging Bonds and EdR Fund Emerging Sovereign, we have a flexible and opportunist approach. Emerging market debt offers a huge investment universe helping to diversify sources of performance. As such, we can invest in debt in hard currencies, in local currencies, in currencies and in sovereign, quasi sovereign and private issuers. Both funds are nevertheless primarily invested in sovereign and quasi-sovereign debt in hard currencies, given the very wide diversity of instruments in this category.

One of the strengths of the EdR Fund Emerging Bonds is its ability to distance itself significantly from the make-up of major emerging market

KEY POINTS

- Two bond funds from the emerging markets universe, with the objective of making the most of the diversity and potential of these markets.
- A constantly increasing variety of issuers offering new diversification opportunities.
- Opportunist management, for which the guiding principle is conviction.
- Emerging markets can prove volatile and less liquid than developed markets.
- Investing in these funds presents the risk of capital loss.

GROWTH IN EMERGING MARKETS VS. THE DEVELOPED WORLD



Source: Edmond de Rothschild Asset Management - Bloomberg - Morgan Stanley. Data as at 31/10/2018.

debt indices and to make clear choices on investment cases, sometimes contrarian to the market consensus. A benchmarked management approach is not suited to this asset class due to the biases noted in the indices. We believe it is important to affirm clear and long-term convictions. In this market, outperformance plays every year in certain specific cases that we need to be able to identify.

TURKEY, ARGENTINA AND UKRAINE ARE CURRENTLY AMONG OUR STRONGEST CONVICTIONS

The objective of the EDR Fund Emerging Sovereign is to maintain a similar management philosophy, but with a less aggressive approach, aiming to limit market shocks. As such, we are ruling out the CCC category of the high-yield credit spectrum, which provides better amortisation of specific shocks, while maintaining a sufficiently vast investment universe. Associated with a precise risk-control process, this stance provides the fund a risk-return profile that is half way between emerging debt indices and the EdR Fund Emerging Bonds fund.

The EdR Fund Emerging Sovereign is your latest creation: what are your main current convictions for the fund?

The EdR Fund Emerging Sovereign portfolio is currently based on three major convictions, each representing around 10% of the allocation.

Our main position is Turkey. Macro-economic factors are favourable, especially inflation, which is set to fall in 2019 and a banking system that remains robust. The Turkish economy is well diversified, with a net debt/GDP ratio that remains low and relatively well controlled budgetary spending. Political risks seem to have calmed with Turkey pursuing its discussions with the US and the European Union. Finally, the valuation of its sovereign debt is generally attractive.

Our second conviction is located in South-America and is Argentina. Since the local government is extremely market friendly and is backed by the IMF, the country is a significant contributor to GDP in the region, such that our local exposure is currently at 10%. We are also 4% exposed to the Argentine pesos.

Finally, Ukraine is also a strong conviction. The country has substantial support from western countries and from the IMF. The reforms initiated under this framework are contributing to the gradual recovery of this economy and should resist coming elections.

Our convictions do not only concern investment in sovereign bonds, but also investment in local currencies, currently for around 10% of the portfolio and primarily in Argentine pesos, Mexican pesos and the Turkish lira, with the rest invested in hard currencies.

Aware of a number of risks in these markets, especially concerning the Chinese-US trade war, we maintain a liquidities segment, currently at around 20%, and have implemented hedging. We are maintaining this defensive approach, which does not nevertheless undermine our vision of the asset class and our convictions. This offers us an ability to seize opportunities in the event of significant market move.

1. Data at 28/02/2019

GLOSSARY

- **High-yield: bonds issued by companies that have a higher default risk than investment grade bonds and offer a higher coupon in exchange.**
- **Investment grade: bonds issued by companies for which the default risk varies from very low (almost certain redemption) to moderate. They correspond to a rating of AAA to BBB- (Standard & Poor's scale).**
- **Hard currency debt refers to bonds denominated in benchmark currencies, globally exchanged on forex markets. These are mostly the US dollar and the euro.**
- **Local currency debt refers to bonds denominated in the national currency of the issuing company.**

EDR FUND EMERGING SOVEREIGN INFORMATION *

Inception date:
21/12/2018

ISIN Codes:
A Share: LU1897613763
I Share: LU1897614902

Maximum management charges:
A Share: 1% TTC
I Share: 0,40 % TTC

Variable management fees: 15% of performance in excess of the benchmark.

Minimum initial subscription:
A share: 1 share
I share: 500 000 €

Front load charge:
A Share: 1% max
I Share: None

Redemption charge:
None

Benchmark:
JP Morgan EMBI Global Diversified ex CCC Index (EUR hedged)

Recommended investment horizon:
> 3 years

* Shares described herein are the main euro-denominated Shares. Please ask your sales contact or refer to the prospectus to have details concerning all the fund shares available.

MANAGEMENT COMPANY
EDMOND DE ROTHSCHILD ASSET MANAGEMENT (LUXEMBOURG)
16 boulevard Emmanuel Servais / LU - 2535 Luxembourg

PAYING AGENT IN SWITZERLAND
EDMOND DE ROTHSCHILD (SUISSE) S.A.
Rue de Hesse 18 / CH - 1204 Geneva

REPRESENTATIVE AGENT AND DISTRIBUTOR IN SWITZERLAND
EDMOND DE ROTHSCHILD ASSET MANAGEMENT (SUISSE) S.A.
Rue de l'Arquebuse 8 / PO Box 5441 / CH - 1211 Geneva 11
T.+41 58 201 75 40
contact-am-ch@edr.com

ch.edram.com