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Absalon Emerging Market Corporate Debt

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An allocation suitable for an uncertain world

Benefits of Emerging market corporate debt (Hard Currency)

- Shorter duration – JPM CEMBI duration 4.7 yrs, JPM EMBIG 8.7 years, Absalon EMCD 2.2yrs
- Larger universe – 719 hard currency corporate issuers versus 168 sovereign issuers
- Less tail risk - less exposure to CCC+ and poor-quality Frontier countries in hard currency corps
- Lower forecasted default rates - (JP Morgan forecast EM HY default at 2% v Sovereign HY 6.5% in 2021)
- High recovery rates compared to US HY – recovery rates have remained stable in EM HY but have deteriorated markedly in US HY
- Less leverage - although leverage has risen during 2020 on a spread per turn of leverage basis EM Debt still offers greater reward
- Attractive technicals - less issuance/strong inflows

With more than 80% of global sovereign debt now yielding less than 0.5% there is an obvious lack of income generating opportunities for investors. With rates at such low levels a mild pick-up in inflation as we have witnessed over the last couple of months has had negative consequences for duration sensitive assets like sovereign and investment grade corporate debt.

We believe emerging market corporate debt (hard currency) has some notable advantages over sovereign and local currency corporate debt given the market backdrop we face at the start of a new year. With investment grade spreads compressing back to levels seen at the start of 2020 and some areas of the high yield market also looking fully valued we think the easy money has been made. Going forward the benefit of an active, unconstrained value focused approach will allow investors to capture opportunities across the entire market, irrespective of rating, geography, or sector. As a value investor we offer a high yielding portfolio - 6.2% versus 3.4% for JPM CEMBI BD. Historically we have been able to limit permanent loss of capital by keeping defaults below the benchmark, while collecting the excess carry. Our skew towards high yield also means lower duration risk - currently around 2.2 years. Our focus remains identifying cheap, out of favour bonds which do not employ excessive leverage. When we compare our current portfolio, we have an average ratings two notches below the index, BB versus BBB-. Yet, we offer a spread per turn of leverage of 155bps versus 92bps for the index. We would also note that while the recovery from last March has been dramatic, it has remained focused in the large/mega cap issuers within emerging markets. We believe that given our value approach, the portfolio contains many undervalued bonds which the market has yet to recognise.

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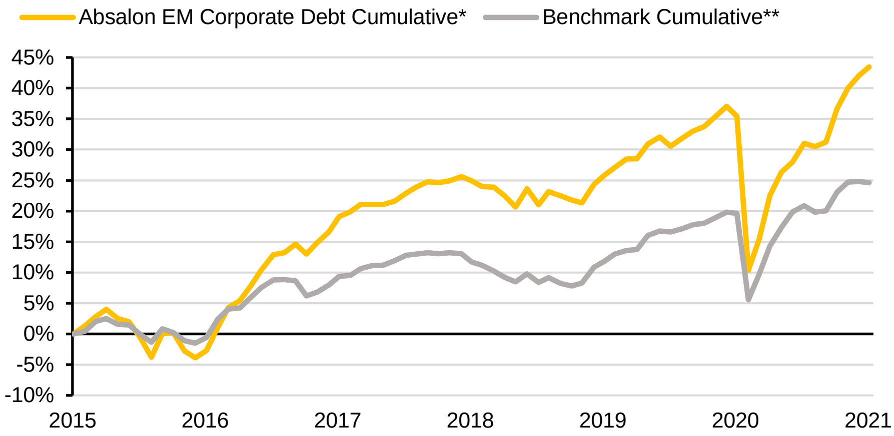
Having experienced multiple shocks to individual markets and regions over the past 15 years we believe our ability to identify attractive value opportunities in often very unloved countries will continue to deliver for investors, especially those looking for a genuinely active, high conviction value orientated approach. Below we highlight some of the key differences bet ween the two main indices offered by JP Morgan – JPM CEMBI Broad Diversified and JPM EMBIG Broad.

Table 1. Key differences between CEMBI and EMBIG

	EMBIG Diversified	CEMBI Broad Div.	Absalon EM Corporate Debt
Credit Quality	BB+	BBB-	CEMI higher average credit quality
Diversification	861 bonds 168 issuers 74 countries	1752 bonds 719 issuers 58 countries	Expanding group of issuers in CEMBI, static in EMBIG (large country risk)
Duration	8.3 years	4.7 years	CEMBI offers greater protection from rising rates
Exclusions	South Korea (socio economic criteria) Singapore (socio economic criteria)	Low quality countries aren't part of the index – Venezuela/Sub Saharan Africa	Corporates increasingly global businesses Corporate governance is improving within CEMBI
Low quality exposure	28% B/C rated	17% B/C rated	CEMBI weighting to IG falling as market expands
Market Cap	$1327bn	$1247bn	CEMBI BD larger than USHY
ETF exposure	Large	Small	ETF investors often more short term
Yield	4.53%	3.42%	Absalon EMCD portfolio yield 6.2%
Default Risk	Significant country risk (eg Argentina 2.15% weight in index at time of default, Ukraine 2.3% at time of default)	Historically very low rates of default. Well supported by fundamentals/technicals	

Source: Absalon Capital

Chart 1. Historical Performance



**Absalon – EM Corporate Debt (Bloomberg: ABEMCIE LX (Gross of fees))*
***JPM CEMBI Broad Diversified (EUR Hedged)*
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Source: JPM. Bloomberg. Absalon Capital

Document
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