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Investors Missing Out on Benefits of Emerging Market Debt VanEck Research

Sydney, 28 August 2019 – A new research paper from VanEck reveals that emerging market (EM) debt is seriously under-represented in global bond investors' portfolios and investment returns would likely benefit from boosting EM debt allocation substantially.

The research paper, *Why emerging market debt needs its own allocation: The case of the missing asset class*, reveals that an efficient frontier analysis suggests up to 31% of an investor's low volatility global bond portfolio should be allocated to EM debt. The Bloomberg Barclays Global Aggregate Bond Index, by contrast, has only a 5.9% allocation to EM debt.¹ Gaining access to this sector via a broad based global fixed income fund therefore does not realise the full potential of EM debt.

Eric Fine, Head of Unconstrained EM Debt VanEck, said: "Investors are not realising the benefits of EM debt and that comes at a cost to their portfolio. EM debt consistently features higher spreads for hard currency debt, and higher real yields for local currency debt, compared to the same-rated developed market debt. In other words, EM debt delivers a higher premium to investors for the 'same' fundamentals.

"In addition, EM bonds have at least similar, if not superior, liquidity to US high yield and US investment grade bonds that dominate global fixed income funds," said Fine.

EM debt is made up of US dollar sovereign debt, US dollar corporate debt, and local currency sovereign debt. The paper finds that sovereign debt in both local currency and US dollars is self-correcting. "We should emphasise, this doesn't mean that they cannot go down in price, only that there are identifiable limits to this.

"EM sovereigns are largely net creditors with debt management offices. If their bonds trade too weakly, they actively buy back debt and can do so credibly due to their net creditor status," said Fine.

Nor do currency fluctuations change the arguments for a greater allocation to EM debt away from developed market debt.

¹ As at June 2019



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“Whether I am a Euro (EUR) or Australian dollar (AUD)-based investor, this does not change anything. When looking at returns in EUR or AUD, the conclusion remains the same – a higher allocation to EM debt would improve returns. We can’t emphasise this conclusion enough, because we’ve seen a number of institutions frozen by these hedging considerations to the point that it is analysis paralysis. Some institutions get the case for EM debt, but don’t do anything about it because of the hedging discussion,” he said.

“Another response from investors is to access EM debt via a global fixed income fund, but this isn’t an optimal solution. Global fixed income funds do not provide optimal exposure to EM bonds because they have constraints that limit allocations or exclude certain EM debt sectors, and EM debt’s risk/return characteristics dominate other debt categories,” Fine said.

“To maximise the opportunities within the EM debt asset class, VanEck’s own strategy takes an index-agnostic approach to EM hard-currency, EM local-currency and EM corporate debt. This paper provides a rationale for why global bond investors should consider allocating to EM debt as a standalone asset class beyond global fixed income.”

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