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# Why invest in emerging markets debt?

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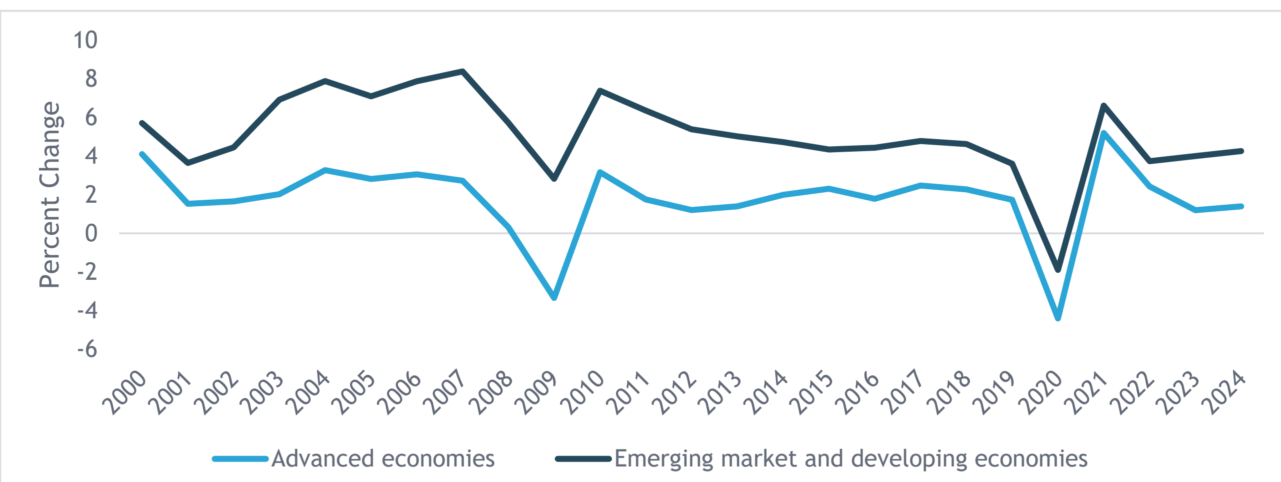
Emerging-markets debt (EMD) can provide investors with access to some of the fastest-growing economies around the world. The potential benefits of EMD include better-than-average long-term growth prospects, higher yields, and significant portfolio diversification. SEI has been investing in EMD, in a dedicated fund structure since 1997.

## Higher growth rates

Emerging markets are often characterized by higher economic growth rates than developed markets, driven by factors such as population growth, urbanization, and technological adoption. International Monetary Fund (IMF) forecasts from January 2023 have advanced economies growing at 1.2% in 2023 before marginally increasing to 1.4% in 2024, as shown in Exhibit 1. In contrast, emerging and developing economies are expected to grow at 4.0% and 4.2% in 2023 and 2024, respectively. China is a major factor powering this growth. The rapid spread of COVID-19 in China dampened growth in 2022, but the recent reopening has paved the way for a faster-than-expected recovery in emerging markets reflected in this growth wedge between developed and emerging economies.

Exhibit 1: Gross domestic product growth rates




Source: IMF. IMF forecasts for 2023 and 2024.

# Access to higher yields

The local currency market, on average, is rated as investment-grade credit quality. This rating, which is reserved for higher quality institutions, is a reflection of the transition emerging economies have made. Despite this, and as can be seen in Exhibit 2, the local currency sovereign market yields nearly 4% higher than the developed sovereign market. This difference is, in part, explained by home country bias (investors either prefer or are required by regulation to own their own government's bonds), the less liquid nature of local-currency EMD, and a reward for the greater volatility of purchasing bonds in foreign exchange rates exposing an investor to currency volatility. We expect a degree of convergence overtime as greater adoption of local debt occurs. Indeed one signal of this is the growth of the local-currency EMD market to over USD2.5 trillion (Source: SEI, J.P. Morgan Emerging Markets Bond Index (EMBI®) Monitor, March 2023 edition).

## Exhibit 2: Developed market and local-currency EMD bond characteristics

| | Developed market sovereigns | EMD local currency |
|---|---|---|
| **Credit Quality** | AA | BBB |
| **Duration** | 7.40 | 4.94 |
| **Yield** | 2.84% | 6.59% |

Source: Bloomberg Global Treasury Index, JPM GBI-EM GD index, as of 3/31/23.

The hard currency market sits on the top rung of high-yield ratings with an average BB+ rating. This reflects the greater coverage of the hard currency focused JPM EMBI GD Index with near 70 issuers, many of which are earlier in their development cycles. For these "early stage" sovereigns, lending in hard currency is intuitively simpler given it eliminates the currency exposure to these lesser traded currencies. The higher yield reflects the increased risk of stress and default resultant from their fundamentals. Further, funding in a foreign currency creates challenges if the local currency becomes devalued against hard currencies—for example, the recent and ongoing restructuring of hard-currency obligations by Sri Lanka. These risks are rewarded with a higher yield (7.66% as of March 2023).

## Exhibit 3: Bond characteristics

| | UK Credit | U.S. high yield | EMD hard currency |
|---|---|---|---|
| **Credit Quality** | A- | B+ | BB+ |
| **Duration** | 6.59 | 3.78 | 7.03 |
| **Yield** | 5.51% | 8.25% | 7.66% |

Source: Bloomberg US Aggregate Bond Index, ICE BofA US High Yield Constrained Index, JPM EMBI GD index, as of 3/31/23.

# Diversification within a broader portfolio

SEI has developed an approach to EMD investing which allows for access to our best ideas in both hard currency and local currency debt by blending an allocation to the two assets. This balances exposure to the higher yields on offer in the asset class with an appropriate assessment of risk.

The blended debt allocation in SEI's EMD portfolio provides diversification as these markets often have different economic cycles and risk profiles to developed markets. A percentage of less than 100% in Exhibit 4 evidences the diversification benefit gained from blending EMD with another asset as part of a total portfolio solution.

Exhibit 4: Bond characteristics

| **Correlation to EMD** | |
|---|---|
| | Emerging Market Debt -- Hedged |
| Global Factor Equity | 71.48% |
| Global Managed Volatility | 67.20% |
| Global Dynamic Asset Allocation | 67.20% |
| UK Credit Fund | 34.05% |
| Global Credit | 41.07% |
| Vista (Global Macro) | 29.74% |
| US High Yield -- Hedged | 70.44% |
| UK Property* | 17.11% |
| Infrastructure Equity* | 41.27% |

Source: SEI. Data as at March 2023. Inputs used for SEI capital market assumptions.

*Only available to institutional investors.

# Risks

There are geopolitical risks to investing in EMD, such as a greater escalation of the Russia-Ukraine conflict, but these same risks often impact emerging and developed economies alike. For example, oil and food supply pressure has been felt across economies globally, pressuring global growth forecasts. These externalities need to be assessed country by country, developed and emerging. We believe active management can be useful in evaluating these risks.

## SEI Capital Market Assumptions (“CMA”)

There are figures in this commentary based on SEI’s Capital Market Assumptions (CMA). Asset class assumptions are set using a combination of empirical and forward-looking analysis and are designed to be long-term in nature. Assumptions include estimates of annual return, volatility and correlations by asset class, as well as prospective ranges for these values over various time horizons.

Changes in assumptions may have a material impact on the simulated performance presented. Past performance is not a reliable indicator of future performance.

All projected returns are presented gross of all fees and charges, which will have the effect of reducing the illustrated performance.

The CMAs are revisited regularly on a minimum basis to reflect the changes in the market environment.

The forecasts shown on those pages are not indicative of the future or likely performance of the portfolios, especially over a short-term time period. CMAs are not predictions of how asset classes will perform or reliable indicators of future performance. The data includes or has been based on anticipated future performance determined using various assumptions. Such forecasts are not a reliable indicator of future performances.

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