The Case for Emerging Markets Debt Revisited

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Presented by:

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Stone Harbor Investment Partners®

The Case For Emerging Markets Debt Revisited

Investment case in the context of Fed “tapering” and slower EM growth

Challenges for EMD:

- Downgrades to EM growth outlook, including China
- Beginning of the end of QE
- Rising U.S. interest rates
- Outflows from fixed income funds

Our view:

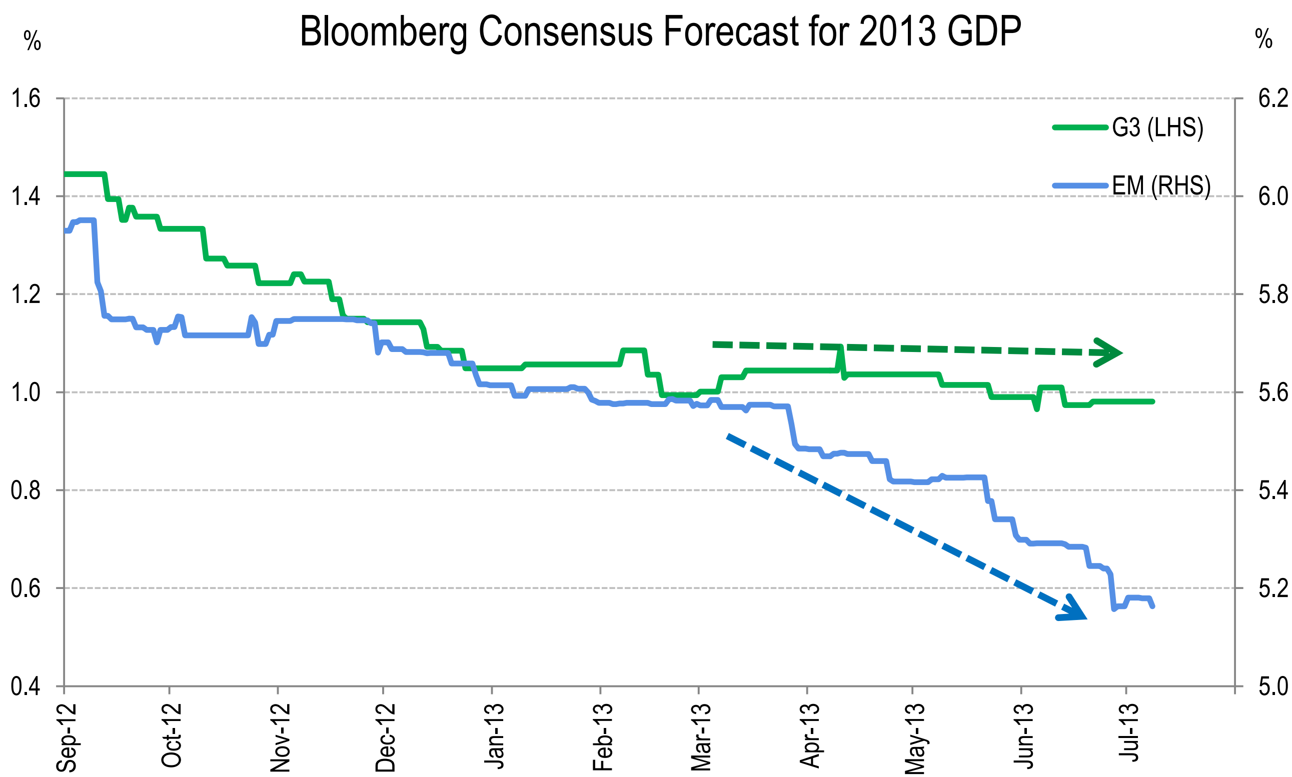
- EMs benefit from better DM growth
- Little policy tightening in EMs
- EM growth slowdown mostly behind us

- EM dependence on QE-fueled inflows is commonly overestimated
- Large share of past inflows have been strategic institutional allocations
- Fixed income outflows mainly from momentum-driven retail funds

- Yields and spreads in EMs have widened more than in DMs
- Valuations are attractive relative to historical levels and relative to other fixed income asset classes

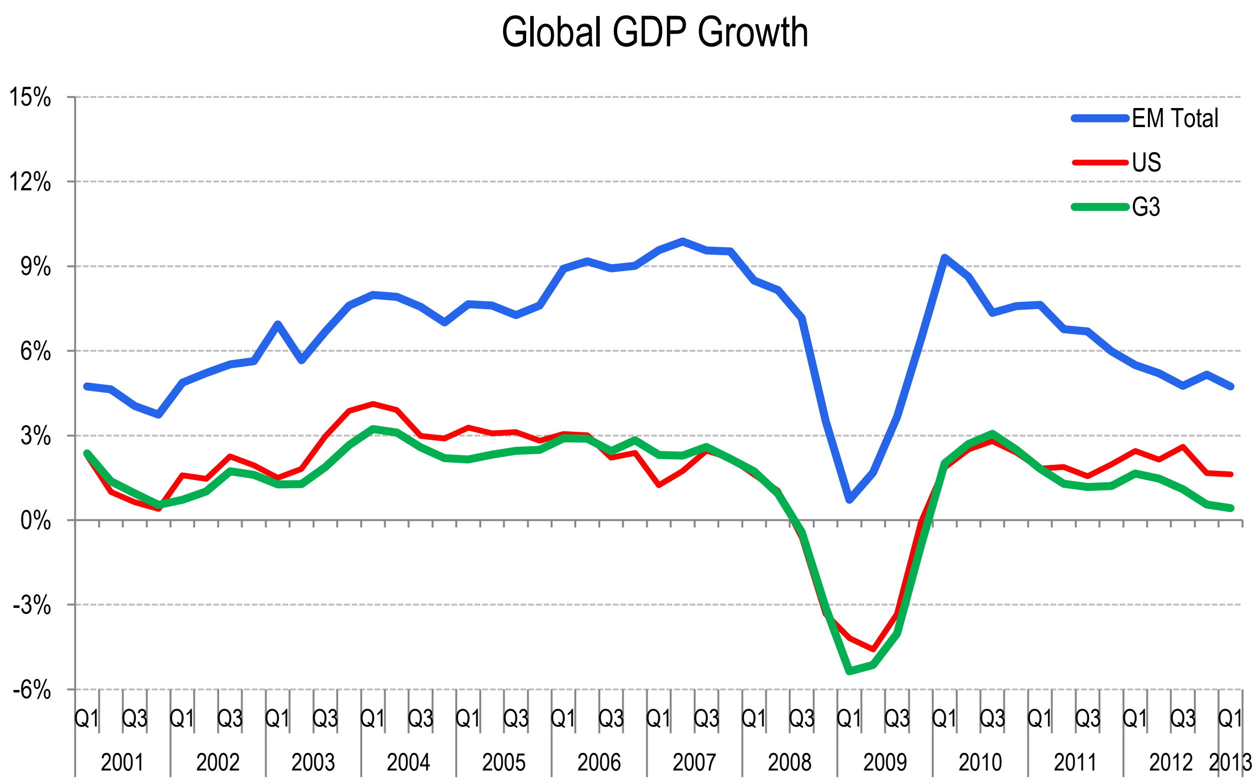
Sources: Stone Harbor Investment Partners LP

EM growth expectations bottoming?



Sources: Bloomberg, Stone Harbor Investment Partners LP

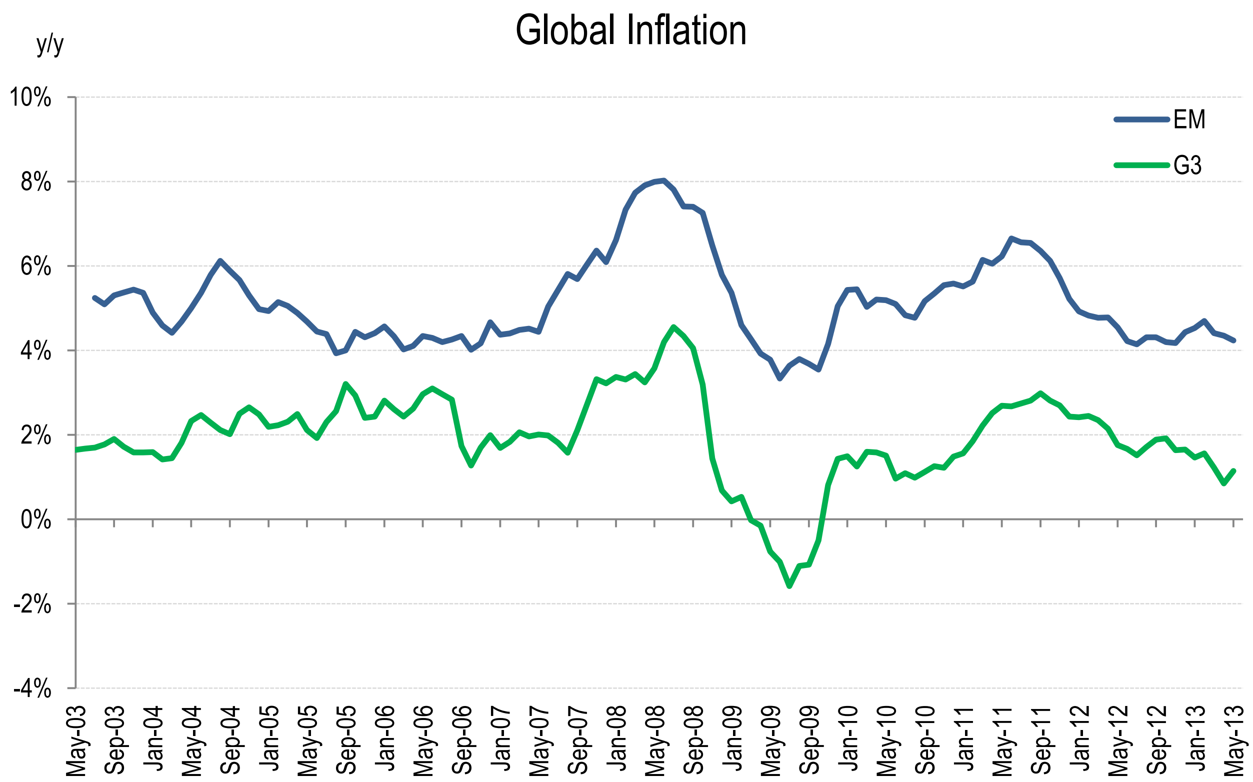
Actual slowdown occurred mostly during 2011 and 2012



 Sources: Haver Analytics, Stone Harbor Investment Partners LP

Inflation pressures remain low

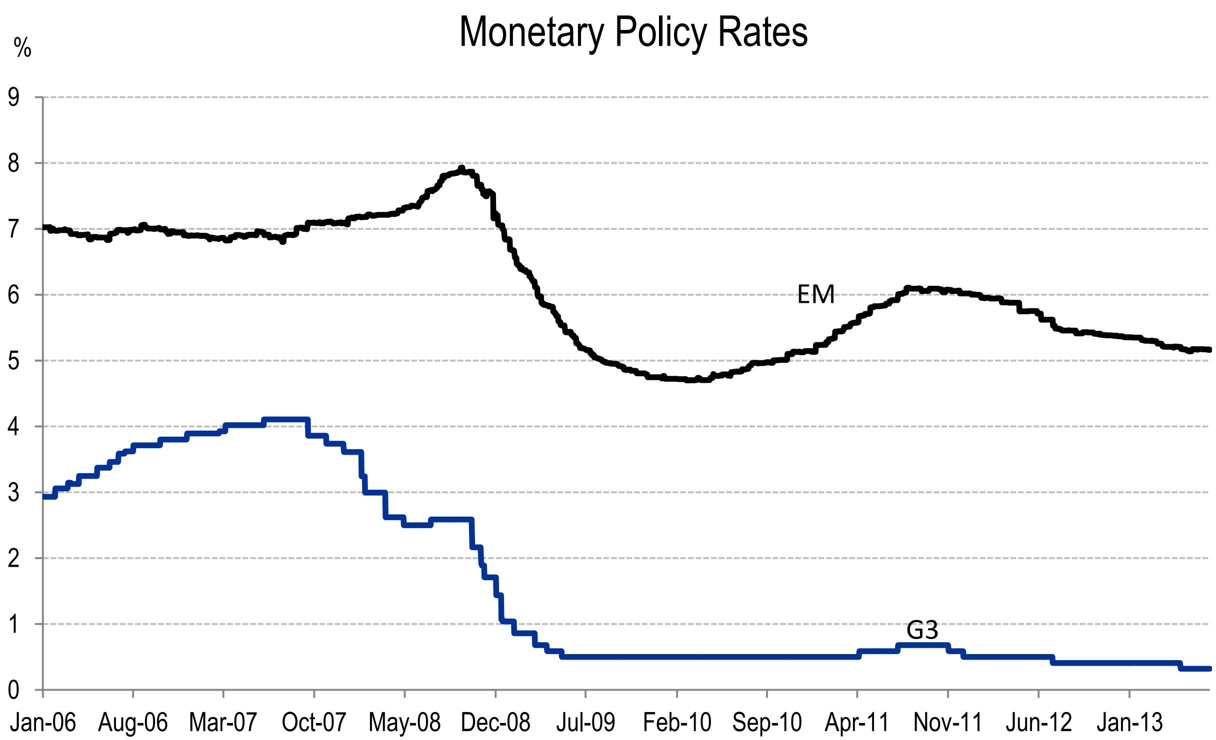
Average inflation rates, as of May 2013



Sources: Haver Analytics, Stone Harbor Investment Partners LP

EM monetary policy easing supporting growth

Average policy rates, as of 9 July 2013

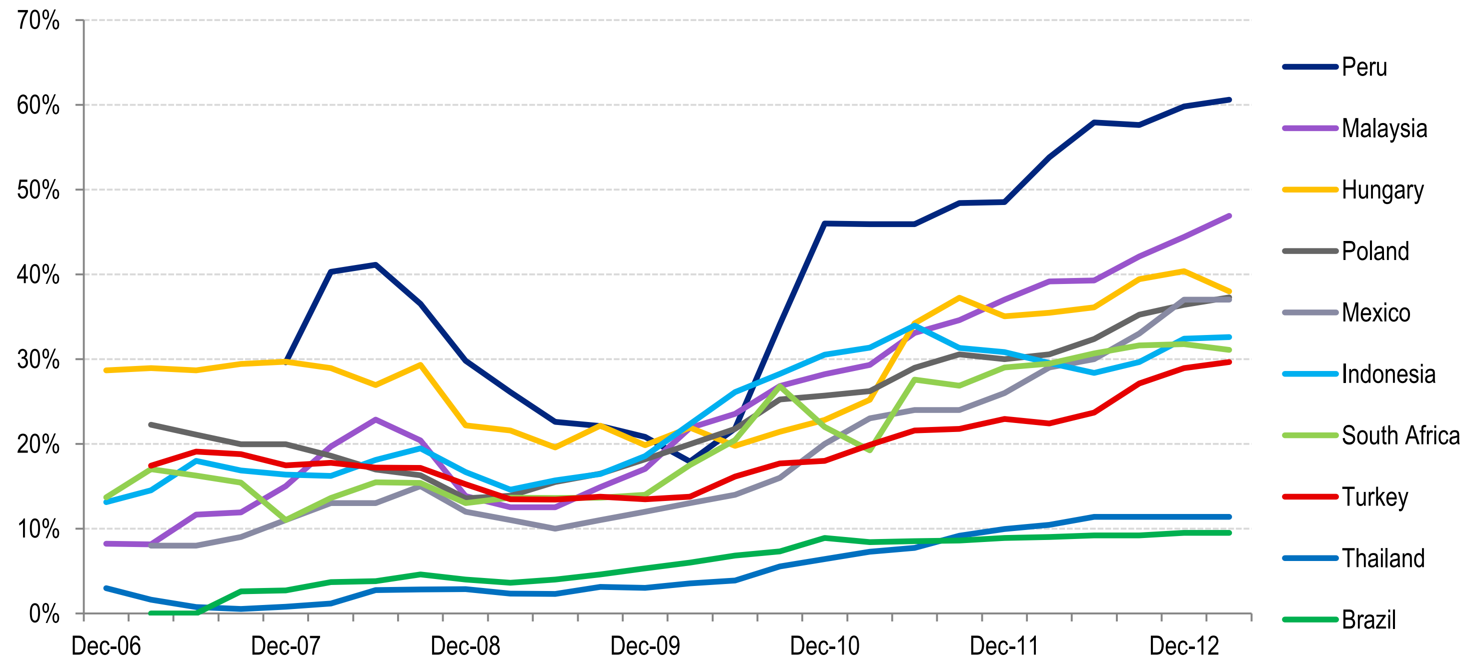


Sources: Bloomberg, Haver Analytics, Stone Harbor Investment Partners LP

EMs have become more exposed to foreign investors

As of March 2013

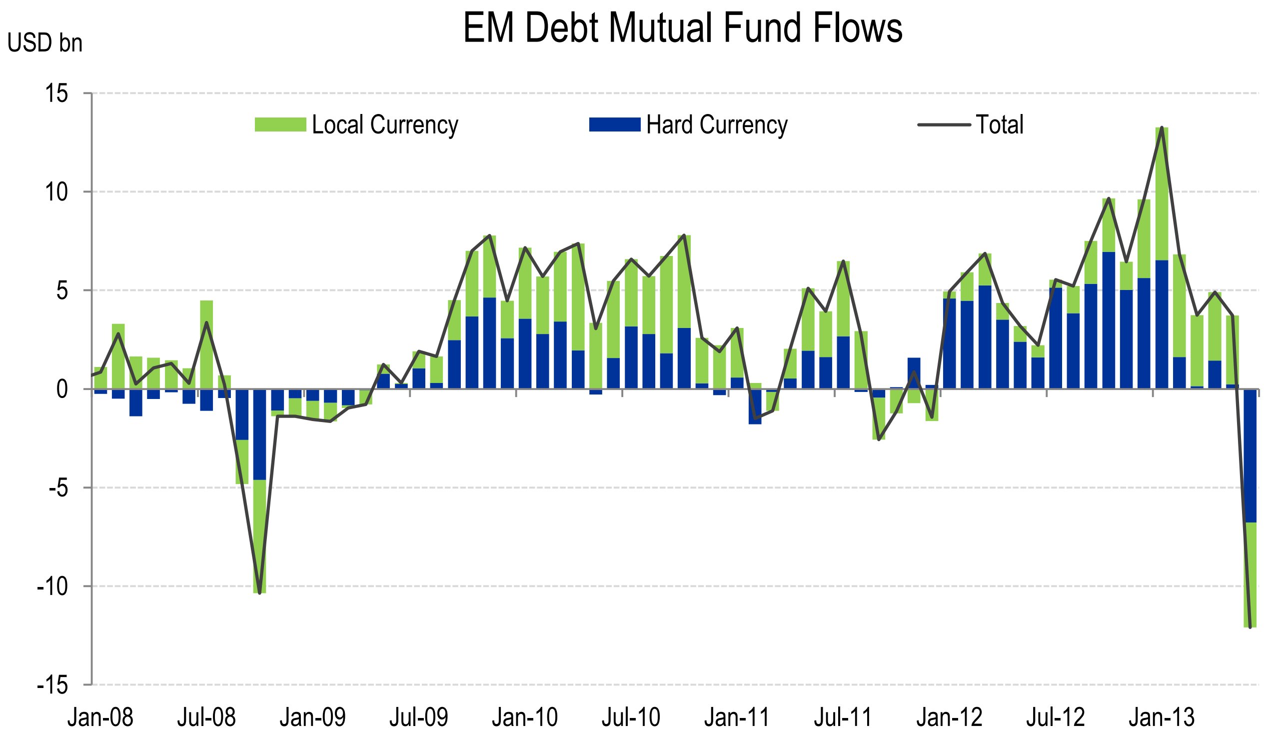
Foreign Ownership of EM Local Debt



Sources: J. P. Morgan, Stone Harbor Investment Partners LP

EM debt mutual funds experienced large outflows in June

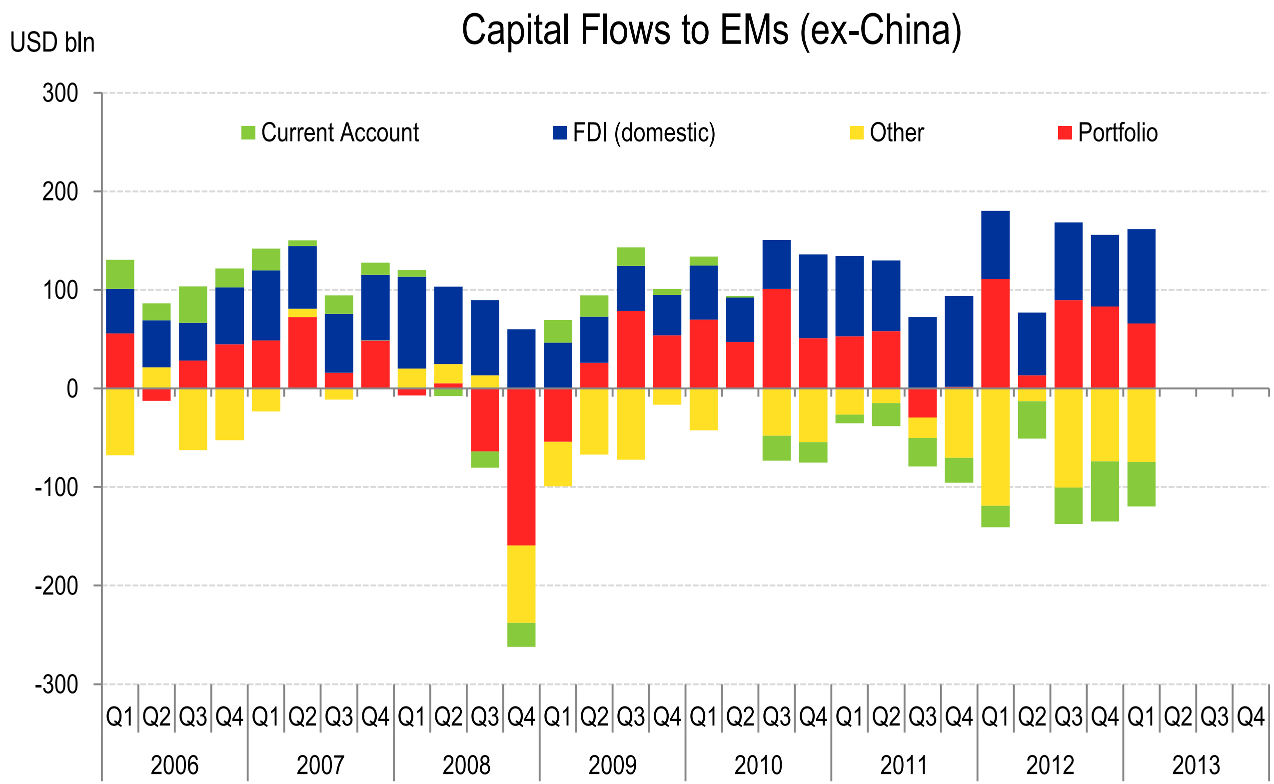
As of June, 2013



Sources: EPFR , J. P. Morgan, Stone Harbor Investment Partners LP

Portfolio flows are not the main source of capital flows to EMs

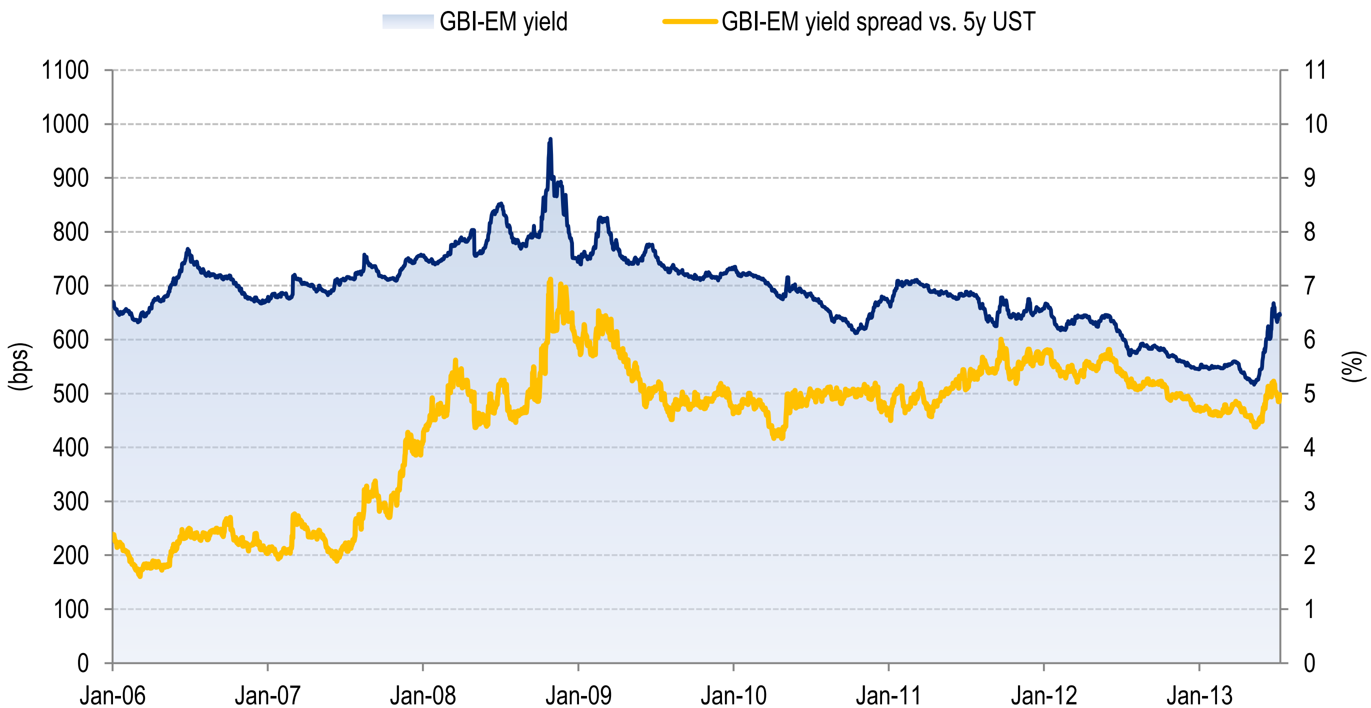
As of Q1 2013



Sources: Bloomberg, Haver Analytics, Stone Harbor Investment Partners LP

Valuations supportive for future inflows

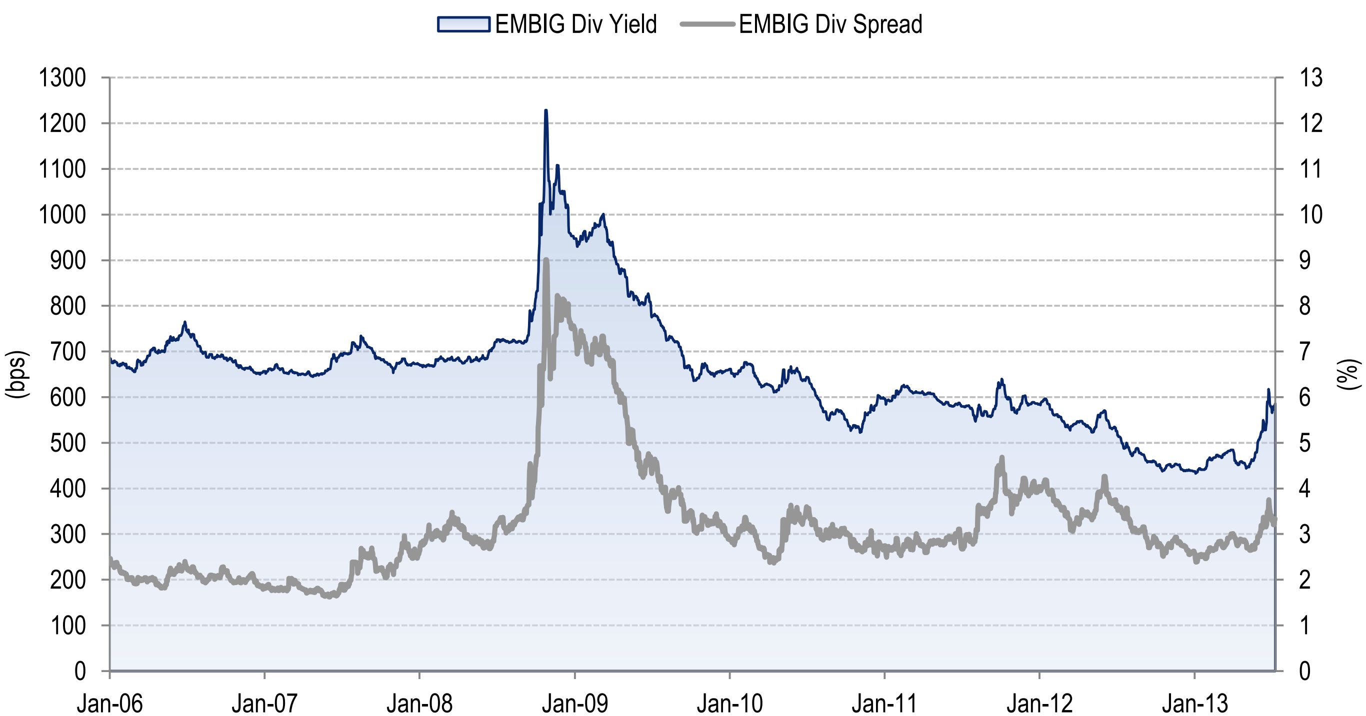
Local currency debt index yield and spread, as of 9 July 2013



Sources: Bloomberg, Stone Harbor Investment Partners LP

Valuations supportive for future inflows

Hard currency sovereign debt index yield and spread, as of 9 July 2013



Sources: Bloomberg, Stone Harbor Investment Partners LP

Appendix

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World Economic Outlook Database Assumptions and Data Conventions

The *World Economic Outlook* (WEO) database contains selected macroeconomic data series from the statistical appendix of the World Economic Outlook report, which presents the IMF staff's analysis and projections of economic developments at the global level, in major country groups and in many individual countries. The WEO is released in April and September/October each year.

Assumptions
A number of assumptions have been adopted for the projections presented in the *World Economic Outlook*. It has been assumed that real effective exchange rates remained constant at their average levels during February 11–March 11, 2013, except for the currencies participating in the European exchange rate mechanism II (ERM II), which are assumed to have remained constant in nominal terms relative to the euro; that established policies of national authorities will be maintained (for specific assumptions about fiscal and monetary policies for selected economies, see Box A1); that the average price of oil will be $102.60 a barrel in 2013 and $97.58 a barrel in 2014 and will remain unchanged in real terms over the medium term; that the six-month London interbank offered rate (LIBOR) on U.S. dollar deposits will average 0.5 percent in 2013 and 0.6 percent in 2014; that the three-month euro deposit rate will average 0.2 percent in 2013 and 0.4 percent in 2014; and that the six-month Japanese yen deposit rate will yield on average 0.2 percent in 2013 and 2014. These are, of course, working hypotheses rather than forecasts, and the uncertainties surrounding them add to the margin of error that would in any event be involved in the projections. The estimates and projections are based on statistical information available through early April 2013.

Data Conventions
Data and projections for 188 economies form the statistical basis of the *World Economic Outlook* (the WEO database). The data are maintained jointly by the IMF's Research Department and regional departments, with the latter regularly updating country projections based on consistent global assumptions.
Although national statistical agencies are the ultimate providers of historical data and definitions, international organizations are also involved in statistical issues, with the objective of harmonizing methodologies for the compilation of national statistics, including analytical frameworks, concepts, definitions, classifications, and valuation procedures used in the production of economic statistics. The WEO database reflects information from both national source agencies and international organizations.
Most countries' macroeconomic data presented in the *World Economic Outlook* conform broadly to the 1993 version of the System of National Accounts (SNA). The IMF's sector statistical standards—the *Balance of Payments and International Investment Position Manual, Sixth Edition* (BPM6), the *Monetary and Financial Statistics Manual* (MFSM 2000), and the G*overnment Finance Statistics Manual 2001* (GFSM 2001)—have been or are being aligned with the 2008 SNA. These standards reflect the IMF's special interest in countries' external positions, financial sector stability, and public sector fiscal positions. The process of adapting country data to the new standards begins in earnest when the manuals are released. However, full concordance with the manuals is ultimately dependent on the provision by national statistical compilers of revised country data; hence, the *World Economic Outlook* estimates are only partially adapted to these manuals. Nonetheless, for many countries the impact of conversion to the updated standards will be small on major balances and aggregates. Many other countries have partially adopted the latest standards and will continue implementation over a period of years.
Note: Many other countries are implementing the 2008 SNA and will release national accounts data based on the new standard in 2014. A few countries use versions of the SNA older than 1993. A similar adoption pattern is expected for the BPM6. Although the conceptual standards use the BPM6, the World Economic Outlook will continue to use the BPM5 presentation until a representative number of countries have moved their balance of payments accounts into the BPM6 framework.
Consistent with the recommendations of the 1993 SNA, several countries have phased out their traditional fixed-base-year method of calculating real macroeconomic variable levels and growth by switching to a chain-weighted method of computing aggregate growth. The chain-weighted method frequently updates the weights of price and volume indicators. It allows countries to measure GDP growth more accurately by reducing or eliminating the downward biases in volume series built on index numbers that average volume components using weights from a year in the moderately distant past.
Composite data for country groups in the *World Economic Outlook* are either sums or weighted averages of data for individual countries. Unless noted otherwise, multiyear averages of growth rates are expressed as compound annual rates of change. Arithmetically weighted averages are used for all data for the emerging market and developing economies group except inflation and money growth, for which geometric averages are used. The following conventions apply.

- Composites for other data relating to the domestic economy, whether growth rates or ratios, are weighted by GDP valued at purchasing power parity (PPP) as a share of total world or group GDP.
- Composites for data relating to the domestic economy for the euro area (17 member countries throughout the entire period unless noted otherwise) are aggregates of national source data using GDP weights. Annual data are not adjusted for calendar-day effects. For data prior to 1999, data aggregations apply 1995 European currency unit exchange rates.
- Composites for fiscal data are sums of individual country data after conversion to U.S. dollars at the average market exchange rates in the years indicated.
- Composites unemployment rates are weighted by labor force as a share of group labor force.
- Composites relating to external sector statistics are sums of individual country data after conversion to U.S. dollars at the average market exchange rates in the years indicated for balance of payments data.
- Composites of changes in foreign trade volumes and prices, however, are arithmetic averages of percent changes for individual countries weighted by the U.S. dollar value of exports or imports as a share of total world or group exports or imports (in the preceding year).
- Composite data are provided for various groups of countries organized according to economic characteristics or region. Unless otherwise noted, country group composites represent calculations based on 90 percent or more of the weighted group data.

The following conventions have been used throughout the *World Economic outlook*:
- Domestic economy series are expressed in billions of national currency units
- External accounts series are expressed in billions of U.S. dollars.
- "Billion" means a thousand million; "trillion" means a thousand billion.
- Missing data are indicated by "n/a".
- Blank row means that data are not available or not applicable.
- "/" means between years or months (for example, 2012/2013) to indicate a fiscal or financial year.
- In the reports, shaded areas indicate IMF staff projections.
- Minor discrepancies between sums of constituent figures and totals shown reflect rounding.
- For some countries, the figures for 2012 and earlier are based on estimates rather than actual outturns.
- Data refer to calendar years, except for a few countries that use fiscal years. Please refer to the country information section of the WEO online database for a complete listing of the reference periods for each country.
- Projections for Cyprus are excluded due to the ongoing crisis.
- Mongolia is classified as Developing Asia (previously classified as a member of the Commonwealth of Independent States).
- Afghanistan and Pakistan, previously classified as Developing Asia, have been added to the Middle East and North Africa (MENA) to create the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) region. The MENA aggregate (excluding Afghanistan and Pakistan) will be maintained.
- Data for the Marshall Islands and Micronesia are now included in the Developing Asia region.
- As in the October 2012 World Economic Outlook, data for Syria are excluded for 2011 and later due to the uncertain political situation.
- Starting with the April 2013 World Economic Outlook, the Newly Industrialized Asian Economies (NIEs) grouping has been eliminated.
- Composite data are provided for various groups of countries organized according to economic characteristics or region. Unless otherwise noted, country group composites represent calculations based on 90 percent or more of the weighted group data.
- As used here, the terms "country" and "economy" do not in all cases refer to a territorial entity that is a state as understood by international law and practice. In addition, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.

Endnotes

Indices referred to herein are broad-based securities market indices. Broad-based securities indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. Investments cannot be made directly in an index.

Benchmark Definitions

The Citigroup High Yield Market Index (previously the Salomon Smith Barney High Yield Market Index) is a total rate-of-return index which captures the performance of below investment-grade debt issued by corporations domiciled in the United States or Canada. This index comprises Citigroup's broadest market measure and includes cash-pay and deferred-interest securities. All the bonds in the high-yield indices are publicly placed, have a fixed coupon and are non-convertible.

The J.P. Morgan Corporate Emerging Markets Bond Index (CEMBI): The CEMBI tracks total returns of U.S. dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. Both indices are also available in Diversified version.

The J.P. Morgan EMBI Global Diversified (EMBI Global Diversified) limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts outstanding. The countries covered in the EMBI Global Diversified are identical to those covered by the EMBI Global.

The J.P. Morgan GBI-EM consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. The index is market capitalization weighted with a cap of 10% to any one country.

The J.P. Morgan GBI-EM Global Diversified consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. The weightings among the countries are more evenly distributed within this index.

The MSCI EAFE tracks stocks in Europe, Australia, and East Asia. It is considered one of the most important indices for stocks outside the United States; indeed, its strong performance in the 1980s and early 1990s has been credited with spurring American interest in foreign investment. It is weighted for market capitalization.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of January 2009 the MSCI Emerging Markets Index consisted of the following 23 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

The S&P 500 is an index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

The S&P GSCI (formerly the Goldman Sachs Commodity Index) serves as a benchmark for investment in the commodity markets and as a measure of commodity performance over time. It is a tradable index that is readily available to market participants of the Chicago Mercantile Exchange. It is a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The returns are calculated on a fully collateralized basis with full reinvestment. The combination of these attributes provides investors with a representative and realistic picture of realizable returns attainable in the commodities markets.

Endnotes

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