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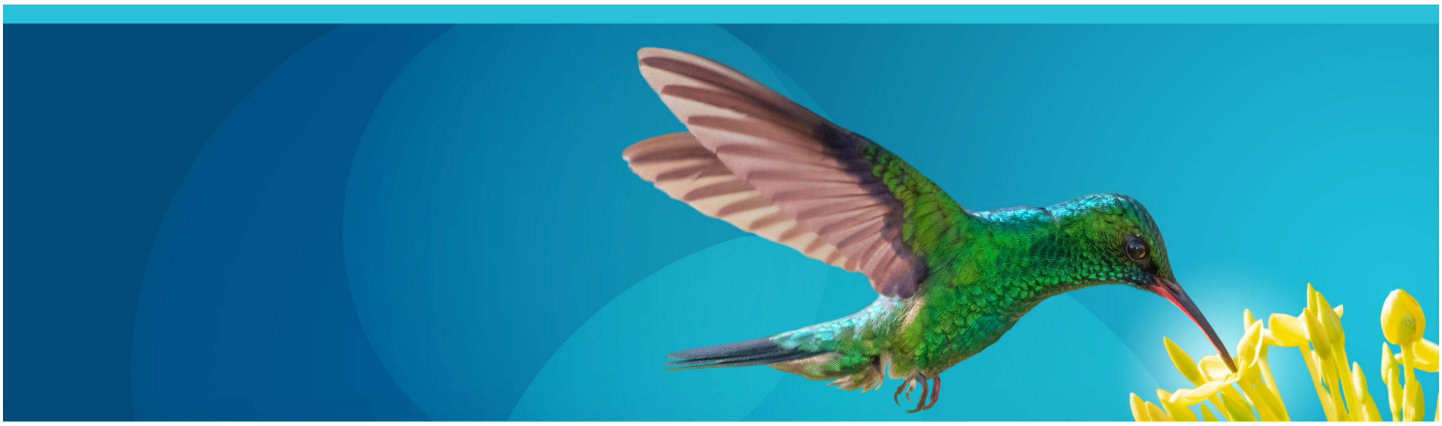
The inside story

Two EM consumer ideas in the portfolio



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Emerging Markets Corporate Bond Strategy

Tapping into emerging market (EM) consumption trends has historically been a good way of adding value in EM corporate bond investing. In this note I'll touch on two of our top investment ideas – one in consumer health products and the other in real estate.

Health & Happiness: Tapping into growth of the Chinese middle class

We pride ourselves on being able to find hidden gems in our market. An example of a relatively small and less well-known bond issuer is the Chinese company Health & Happiness H&H International Holdings (rated BB-) which is a health care product provider. Founded in 1999, H&H sells baby nutrition and care products into China (75% of sales) and Australia/New Zealand (25%).

One of the main reasons we like this business is the resilience of the baby products sector, which has contributed to stable profitability, with Ebitda margins around 20%, and strong cash flow generation. The company has a conservative management team, so they typically run leverage below two times earnings (not the kind of metric you'd expect from a sub-investment grade company) and in the past when they've made acquisitions, they've brought their leverage back down pretty quickly afterwards.

One risk to the company is the declining birth rate in China. But a more positive demographic trend is H&H's exposure to the rise of the middle class. Chinese consumers currently spend about 80% less on consumer health products than developed markets, so there is clearly a lot of room for that gap to narrow over time as spending catches up. We think H&H's increasing emphasis on premium products should position it well, especially as branded products take market share away from more generic offerings.

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MAF: Resilient real estate

Founded in 1992 in the United Arab Emirates, MAF is a leading real estate developer with an investmentgrade BBB credit rating. Its portfolio includes shopping malls, retail and leisure developments, and hotels. Additionally, it is the exclusive franchisee of Carrefour across 30 countries in the Middle East, Africa, and Asia (currently operating in roughly half of those).

MAF's operates real estate properties in 17 countries across the Middle East, Africa, and Asia. It estimates 140 million people visited its shopping malls in 2020, and its flagship—Mall of the Emirates—is one of the most prestigious in the region (among other things, it has been recognized for its indoor ski slope which recently won a World Ski Award.)

The company benefits from strong credit metrics, notably ample liquidity, with no near-term refinancing concerns. MAF's operations have proved relatively resilient to Covid given the defensive nature of its businesses such as food retail. We think its shopping malls, as well as its ventures segment, which includes cinemas and other leisure offerings, are positioned to do well as these economies start to open up and recovery takes hold post vaccine rollouts.

Risks - The following risks are materially relevant to the portfolio

China Interbank Bond Market risk - market volatility and potential lack of liquidity due to low trading volume of certain debt securities in the China Interbank Bond Market may result in prices of certain debt securities traded on such market fluctuating significantly.
Contingent convertible bond risk - contingent convertible bonds have similar characteristics to convertible bonds with the main exception that their conversion is subject to predetermined conditions referred to as trigger events usually set to capital ratio and which vary from one issue to the other.
Country risk (Russia and Ukraine) - in these countries, risks associated with custody, counterparties and market volatility are higher than in developed countries.
Credit risk - a bond or money market security could lose value if the issuer's financial health deteriorates.
Default risk - the issuers of certain bonds could become unable to make payments on their bonds.
Derivatives risk - derivatives may result in losses that are significantly greater than the cost of the derivative.
Emerging markets risk - emerging markets are less established than developed markets and therefore involve higher risks.
Frontier markets risk - small market nations that are at an earlier stage of economic and political development relative to more mature emerging markets typically have limited investability and liquidity.
High yield bond risk - a bond or debt security rated below BBB- by Standard & Poor's or an equivalent rating, also termed 'below investment grade', is generally subject to higher yields but to greater risks too.
Interest rate risk - when interest rates rise, bond values generally fall. This risk is generally greater the longer the maturity of a bond investment and the higher its credit quality.
Liquidity risk - any security could become hard to value or to sell at a desired time and price.
Sector concentration risk - the performance of a portfolio that invests a large portion of its assets in a particular economic sector (or, for bond portfolios, a particular market segment), will be more strongly affected by events affecting that sector or segment of the fixed income market.

General Portfolio Risks

Capital risk - the value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the portfolio and the currency in which you subscribed, if different.
Counterparty risk - an entity with which the portfolio transacts may not meet its obligations to the portfolio.
ESG and sustainability risk - ESG and sustainability risk may result in a material negative impact on the value of an investment and the performance of the portfolio.
Geographic concentration risk - to the extent that a portfolio invests a large portion of its assets in a particular geographic area, its performance will be more strongly affected by events within that area.
Hedging risk - a portfolio's attempts to reduce or eliminate certain risks through hedging may not work as intended.
Investment portfolio risk - investing in portfolios involves certain risks an investor would not face if investing in markets directly.
Management risk - the investment manager or its designees may at times find their obligations to a portfolio to be in conflict with their obligations to other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably).
Operational risk - operational failures could lead to disruptions of portfolio operations or financial losses.

Important information

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for the portfolio, and no assumptions should be made that the securities identified and discussed were or will be profitable.

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