



Seeking Alpha in Emerging Markets Corporate Debt

After a decade of strong performance, the asset class deserves a serious look.

August 2019

KEY INSIGHTS

- Emerging markets (EM) corporate debt is now a larger market than U.S. high yield or EM sovereigns, with over USD 2 trillion of bonds across 50 countries.
- Thanks to an average BBB- rating and generally healthy fundamentals, the asset class generated a 6.9% annualized return over the past decade, with modest drawdowns.¹
- A scarcity of dedicated EM corporate investors, inefficient markets, and labor-intensive research needs create alpha opportunities across cycles, in our view.
- A benchmark-agnostic but risk-aware approach allowed the Emerging Markets Corporate Bond Strategy to outperform at the composite level over the three and five years ended June 30, 2019.



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Portfolio Manager, Emerging Markets Corporate Bond Strategy

Corporate debt is the fastest-growing area of hard currency emerging markets (EM) debt, with almost USD 2.3 trillion outstanding and new issuance averaging 15% of debt outstanding per year since 2011. The asset class generated strong risk-adjusted returns over the five years ended June 30, 2019, due to the broadly healthy balance sheets of most EM companies and a tilt toward investment-grade Asian markets. During 2018, when other emerging markets assets—particularly equities and local currency debt—suffered notable sell-offs, the EM corporate market proved relatively resilient.

Going forward, we see sustained opportunities in EM corporate debt, as new issuers continue to come to market and the asset class becomes more widely held among institutional investors. Additionally, we believe the asset class offers many opportunities for bottom-up fundamental managers such as ourselves to generate meaningful alpha for our clients.

Diverse Sources of Alpha

T. Rowe Price uses a benchmark-agnostic but risk-aware approach to select investment-grade (IG) and high yield (HY) positions that we believe have the potential to outperform the broader market over the medium term. As we evaluate the approximately 1,300 companies in

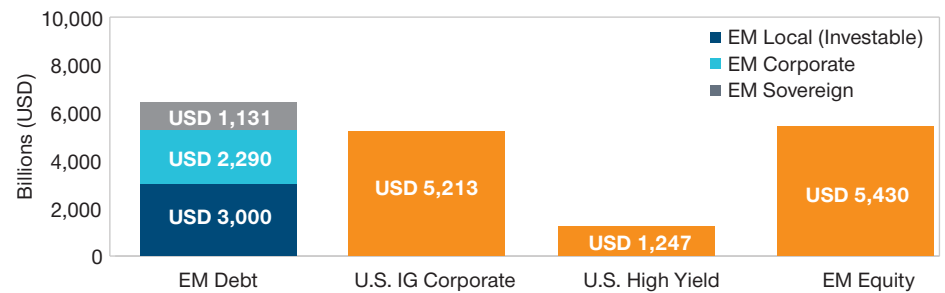
¹Credit rating and 10-year return are for the J.P. Morgan Corporate Emerging Markets Bond Index (CEMBI) Broad Diversified, as of June 30, 2019.

1,300

Number of companies, across 52 countries, that the EM corporate debt universe encompassed as of June 30, 2019.

(Fig. 1) Size of Global Bond Sectors

EM debt offers investors a large and diverse opportunity set. Debt outstanding, as of July 31, 2019



Sources: J.P. Morgan (see Additional Disclosures), Bloomberg Index Services Limited (see Additional Disclosures), and MSCI (see Additional Disclosures). EM sovereign: J.P. Morgan Emerging Markets Bond Index Global; EM corporate: J.P. Morgan Corporate Emerging Market Bond Index Broad Diversified; EM local: J.P. Morgan Government Bond Index—EM Global Diversified; U.S. IG corporate: Bloomberg Barclays U.S. Corporate Investment Grade Index; U.S. high yield: Bloomberg Barclays U.S. High Yield Index; EM equity: MSCI Emerging Markets Index.

our investment universe, we focus on corporate governance; liquidity; detailed financial and strategic analysis; and environmental, social, and governance (ESG) considerations to help us identify outperformers and avoid credit distress.

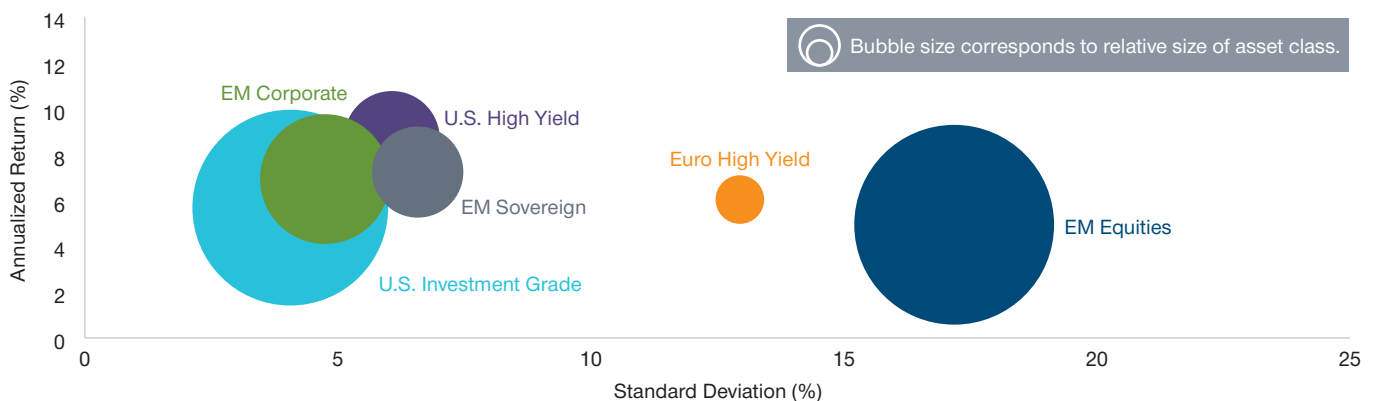
This systematic approach allowed us to outperform at the composite level both our benchmark and our eVestment peer

universe over the three and five years ended June 30, 2019, by capturing diverse sources of genuine excess return, rather than relying on carry or excessive portfolio concentration.

As of June 30, 2019, the EM corporate debt universe encompassed over 1,300 companies across 52 countries. Since 2011, the market has grown an average

(Fig. 2) Risk and Return Profiles

EM corporate bonds have featured relatively strong risk-adjusted performance. July 31, 2009, Through July 31, 2019



Past performance is not a reliable indicator of future performance.

Sources: J.P. Morgan (see Additional Disclosures), MSCI (See Additional Disclosures), Bloomberg Index Services Limited (see Additional Disclosures). U.S. investment grade = Bloomberg Barclays U.S. Investment Grade Index; EM sovereign = J.P. Morgan EMBI Global Index; EM corporate = J.P. Morgan CEMBI Broad Diversified; U.S. high yield = Bloomberg Barclays U.S. High Yield Index; Euro high yield = Bloomberg Barclays European High Yield Index; EM equity = MSCI Emerging Markets Index.

of 15% per year, fueled by numerous debut issuers, unlike the stable-to-shrinking U.S. high yield and EM sovereign debt markets.

Higher credit quality, USD denomination, and a structural tilt toward Asia made EM corporate debt among the most defensive EM assets during recent market corrections. In 2018, for example, the J.P. Morgan CEMBI Broad

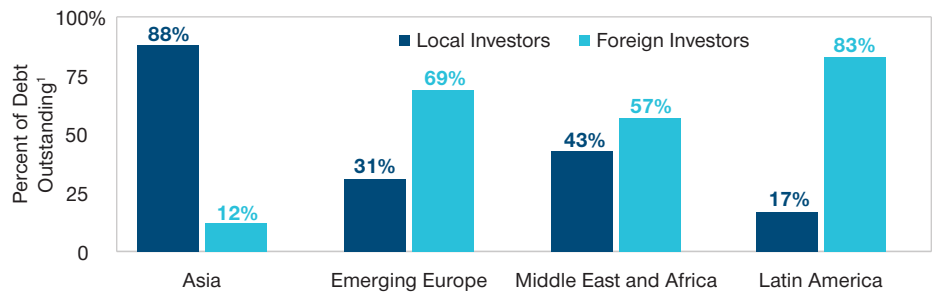
Diversified declined 2% while most other EM assets declined 5%–15%.

EM Corporates Offer Diversification Potential

While many institutional investors currently do not have strategic allocations to EM corporate debt, the asset class offers meaningful potential diversification benefits relative to many widely held institutional assets,

(Fig. 3) EM Corporate Debt Ownership

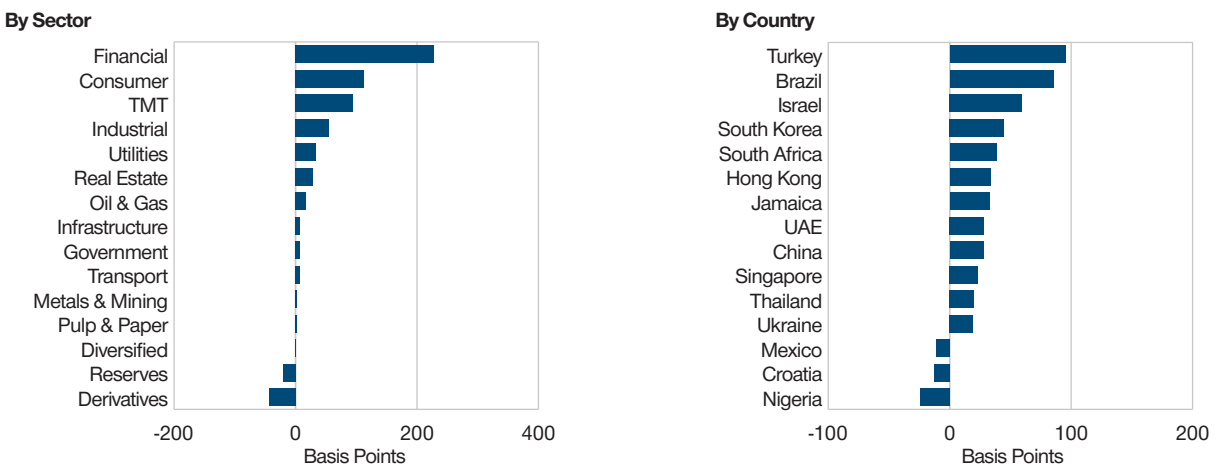
Different buyer bases potentially allow managers to exploit regional inefficiencies. Debt outstanding, as of July 31, 2019



Source: J.P. Morgan (see Additional Disclosures).
¹ Not including unidentified securities. Normalized to total 100%.

(Fig. 4) Contributions to Excess Returns for Emerging Markets Corporate Bond Representative Portfolio

Most sectors and countries contributed meaningfully to positive performance.¹
 Three Years Ended June 30, 2019



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The representative portfolio is an account in the composite we believe most closely reflects current portfolio management style for the strategy. Performance is not a consideration in the selection of the representative portfolio. The characteristics of the representative portfolio shown may differ from those of other accounts in the strategy. Please see the GIPS® Disclosure page for additional information on the composite. Sector classifications based on T. Rowe Price internal classifications. Source: T. Rowe Price.

¹ Versus the J.P. Morgan CEMBI Broad Diversified.

particularly commodities, core fixed income, and U.S. equities.

In addition to generating attractive risk-adjusted returns at the index level, a closer examination of the EM corporate debt universe shows that different regions historically have offered significantly different risk/return profiles, allowing investors to calibrate their exposures throughout a market cycle.

Very different domestic buyer bases also potentially allow active managers to exploit technical inefficiencies across regions. In Asia, large numbers of local buyers historically have tended to provide support during market sell-offs, generating a more defensive return profile. In Latin America, by contrast, foreign investors—including U.S. crossover investors—dominate the market, making for more frequent technical dislocations.

Global Research and Trading Capabilities

To exploit this opportunity set, T. Rowe Price has built truly global research and trading platforms. We believe our commitment to on-the-ground research and value-added trading gives us the ability to identify and thoroughly evaluate ideas across regions as the opportunity set shifts.

In our view, it is difficult, if not impossible, to fully assess an EM corporate bond issue without understanding the home country's politics, economics, and equity markets. Therefore, members of our EM corporate debt team often travel with our sovereign debt and equity analysts, collaboratively sharing their views on a given country and its issuers. Our teams typically make over 200 visits to emerging markets each year.

In addition, T. Rowe Price's trading resources help us identify potential

A Disciplined, Risk-Aware Investment Process

To achieve their objectives, our EM corporate bond professionals employ a five-step investment process.

 1. Investment Screening	 2. Fundamental Analysis	 3. Relative Value Analysis
<p>Trim the investment universe from over 1,300 to approximately 700 issues based on liquidity (issues over USD 250 million), market inefficiency (B to BBB credits), and strong corporate governance histories. We will not lend our clients' money to issuers who have not proven to be reliable stewards of capital.</p>	<p>We evaluate the quality of a company's business and its financial strength. Spending time with company management and collaborating with our equity team are key aspects of this process.</p>	<p>We evaluate the risk-adjusted absolute return potential of a bond compared with its peers and based on company fundamentals.</p>
 4. Position Sizing	 5. Risk Management	
<p>To ensure that no position contributes a disproportionate amount of risk to our portfolio, position sizes range from 50 to 300 basis points (bps) based on relative value, country macro backdrop, sponsor history, and the level of tail risk.</p>	<p>We employ ongoing risk management at four levels. Credit analysts focus on fundamental credit analysis and corporate governance. Portfolio managers and quantitative analysts run systematic risk screens to measure sources of risk and assess liquidity. Our in-house ESG team evaluates every position, assigning each issuer an ESG risk score. Enterprise risk management provides a final oversight layer, reviewing portfolio positioning, risk levels, and issues such as counterparty risk.</p>	

“Over time, our investment process enabled the Emerging Markets Corporate Bond Strategy to generate a positive return stream, with only a few periods of notable underperformance.

price dislocations while ensuring that we are adequately compensated for providing liquidity to the market and can execute trades during local market hours across the globe. Although our security selection process primarily is based on company fundamentals, our quantitative analysis team and our enterprise risk team both help us evaluate and hedge systematic risk.

Our investment process is designed with two goals in mind:

- to identify diverse and repeatable sources of alpha,
- to avoid permanent capital impairment due to default.

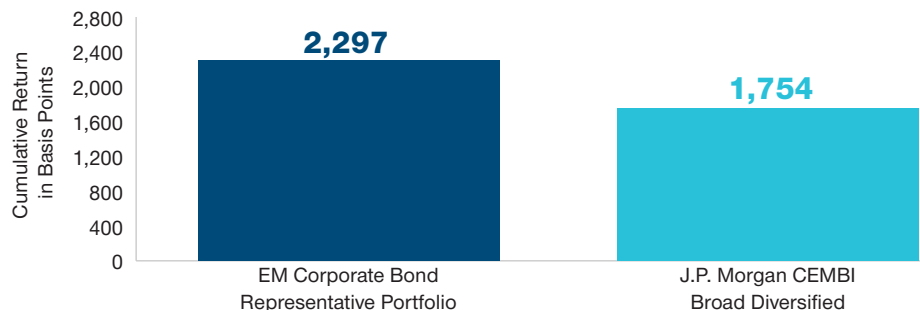
Positive Three- and Five-Year Performance Results

Over time, our investment process enabled the Emerging Markets Corporate Bond Strategy at the composite level to generate a positive return stream, with only a few periods

(Fig. 5) Performance

The Emerging Markets Corporate Bond Representative Portfolio outperformed its benchmark.

Three Years Ended June 30, 2019, in USD, Gross of Fees



Past performance is not a reliable indicator of future performance.

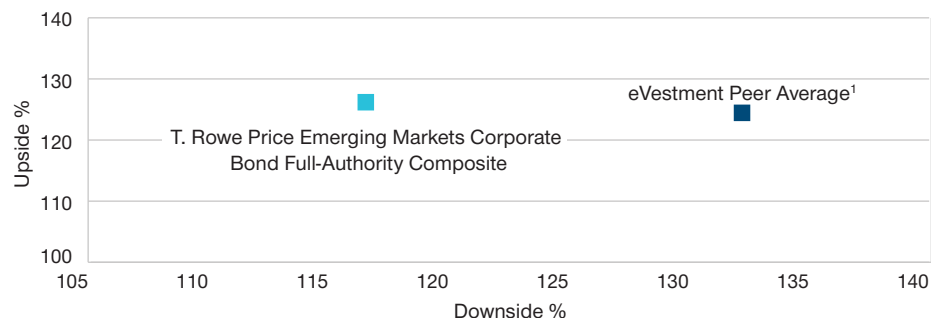
Source: T. Rowe Price.

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(Fig. 6) Upside/Downside Capture Versus Peer Group

The strategy seeks to overweight high yield in up markets while avoiding weaker credits in drawdowns.

June 30, 2016, Through June 30, 2019



Source: eVestment Alliance, LLC. eVestment peer universe = EM corporate bond managers excluding high yield-only, investment-grade-only, and short-duration-only strategies.

¹ eVestment data for the second quarter of 2019.

of notable underperformance as of June 30, 2019. We have achieved these results primarily through principal appreciation and by avoiding defaults, rather than simply out-carrying the benchmark.

Decomposing attribution by sector and country sheds some light on how returns were generated. Consistent with our approach, there were no outsized detractors while most sectors and countries contributed meaningful amounts

of excess return over the three years ended June 30, 2019, with most positions adding 20–100 bps over that period.

Up/down market capture results reflect a similar pattern. Over the three years ended June 30, 2019, the strategy outperformed at the composite level by a large margin during up markets by selectively overweighting high yield credits while avoiding the weakest parts of the market during drawdowns.

WHAT WE'RE WATCHING NEXT

In our view, the past few years have demonstrated that EM corporate debt is an underowned asset class that offers potentially attractive risk-adjusted returns at the index level as well as many potential opportunities for outperformance through security selection.

Over time, we expect that the asset class will become more widely embraced by institutional investors as the U.S. high yield market shrinks and the size and depth of the EM corporate opportunity set become better understood.

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GIPS® Disclosure

Emerging Markets Corporate Bond Full-Authority Composite

Period Ended June 30, 2019

Figures Are Shown in U.S. Dollars

	2011 ²	2012	2013	2014	2015	2016	2017	2018	YTD 2019
Gross Annual Returns (%)	-3.29	19.41	-0.41	4.36	0.56	12.40	10.20	-0.54	9.40
Net Annual Returns (%) ¹	-3.60	18.76	-0.96	3.79	0.00	11.79	9.60	-1.09	9.11
J.P. Morgan Corporate Emerging Market Bond Index Broad Diversified (%)	-1.24	15.02	-0.60	4.96	1.30	9.65	7.96	-1.65	8.83
Composite 3-Yr. St. Dev.	N/A	N/A	N/A	5.94	5.67	5.36	4.71	4.13	3.94
J.P. Morgan Corporate Emerging Market Bond Index Broad Diversified 3-Yr. St. Dev.	7.67	5.75	6.03	4.50	4.43	4.13	3.70	3.39	3.26
Composite Dispersion	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Comp. Assets (Millions)	11.5	48.6	141.2	172.4	132.9	77.4	80.7	79.3	97.3
# of Accts. in Comp.	1	2	2	2	2	2	2	2	1
Total Firm Assets (Billions)	493.1	579.8	696.3	749.6	772.4	817.2	1,000.2	972.7	1,136.4 ³

¹ Reflects deduction of highest applicable fee schedule without benefit of breakpoints. Investment return and principal value will vary. Past performance cannot guarantee future results. Monthly composite performance is available upon request. **See below for further information related to net of fee calculations.**

² May 31, 2011, through December 31, 2011.

³ Preliminary—subject to adjustment.

T. Rowe Price (TRP) has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®). TRP has been independently verified for the 22 year period ended June 30, 2019 by KPMG LLP. The verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

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Some portfolios may trade futures, options, and other potentially high risk derivatives which generally represent less than 10% of a portfolio.

Benchmarks are taken from published sources and may have different calculation methodologies, pricing times, and foreign exchange sources from the composite.

Composite policy requires the temporary removal of any portfolio incurring a client initiated significant cash inflow or outflow greater than or equal to 15% of portfolio assets. The temporary removal of such an account occurs at the beginning of the measurement period in which the significant cash flow occurs and the account re enters the composite on the last day of the current month after the cash flow. Additional information regarding the treatment of significant cash flows is available upon request.

The firm's list of composite descriptions and/or a presentation that adheres to the GIPS® standards are available upon request.

Fee Schedule

Emerging Markets Corporate Bond Full-Authority Composite.

As of June 30, 2019. The Emerging Markets Corporate Bond Full-Authority Composite is comprised of portfolios seeking current income and capital appreciation primarily through investment in a broader universe of fixed income corporate debt securities and quasi-sovereign debt securities issued by companies located or having a business activity in emerging/developing countries. While largely focused on dollar-denominated corporate bonds, the composite has the ability to invest in local currency corporates as well as dollar-denominated sovereigns. The Full-Authority Composite maintains broader discretion seeking to invest in the entire emerging markets corporate universe. (Created December 2017) (Formerly known as Emerging Markets Corporate Bond Composite)

First 50 million (USD)	55 basis points
Next 50 million (USD)	50 basis points
Above 100 million (USD)	45 basis points on all assets ¹
Above 200 million (USD)	40 basis points on all assets ¹
Minimum separate account size	50 million (USD)

¹A transitional credit is applied to the fee schedule as assets approach or fall below the breakpoint.

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.

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.

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.

INVEST WITH CONFIDENCESM

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

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