T.RowePrice®
INVEST WITH CONFIDENCE

PRICE POINT

March 2015

Timely intelligence and analysis for our clients.



Samy Muaddi
Portfolio Manager / Analyst, Emerging Markets Corporate Bond Strategy

EM Corporate Debt. A BUBBLE OR GROWING OPPORTUNITY?

EXECUTIVE SUMMARY

Emerging markets corporate debt has grown rapidly in recent years, but the market is not experiencing a bubble. Rather, it is still in the early stages of development and issuance as companies exploit the opportunity to access credit at longer maturities than typically extended by onshore banks.

In this Price Points, Samy Muaddi, a portfolio manager/analyst for T. Rowe Price's Emerging Markets Corporate Bond Strategy, explains why he believes emerging markets corporate debt maintains many attractive features—including solid credit quality, diversification potential, and appealing yields—particularly when compared with those of developed credit markets.

The emerging market (EM) external corporate bond market has doubled in size in the past five years to almost $2 trillion and now exceeds the U.S. high yield debt market and the more traditional hard currency sovereign bond market.[1] Many investors fret about such rapid growth and ask us, Are we are in a bubble? We firmly think we are not.

We believe that we are at the very early stages of growth of an asset class that is going to be a durable theme in the years ahead. To put things in perspective, the EM corporate debt market in U.S. dollars, the most prevalent type of issuance, still only accounts for less than 10% of the over $30 trillion in onshore private credit extended.[2] We see significant room for further expansion of the opportunity set, given the wide scope of companies spread across the EM landscape. Some 70% of corporate issues are investment grade, signaling relatively strong balance sheets.

---

[1] Source: Bank for International Settlements

[2] Source: T. Rowe Price

FIGURE 1: EM Corporate Fundamentals – High Yield

As of December 2014

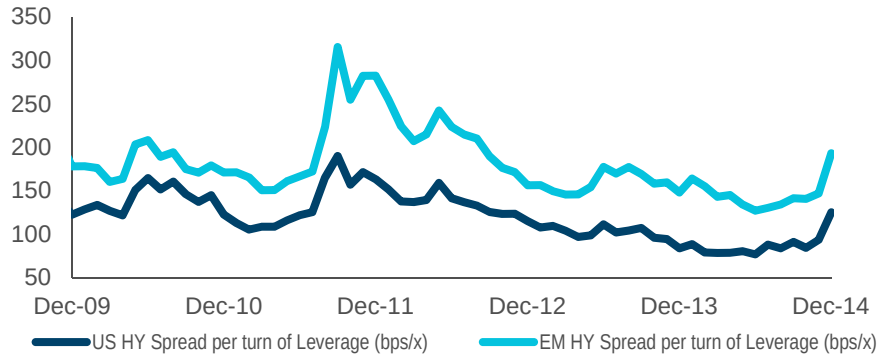
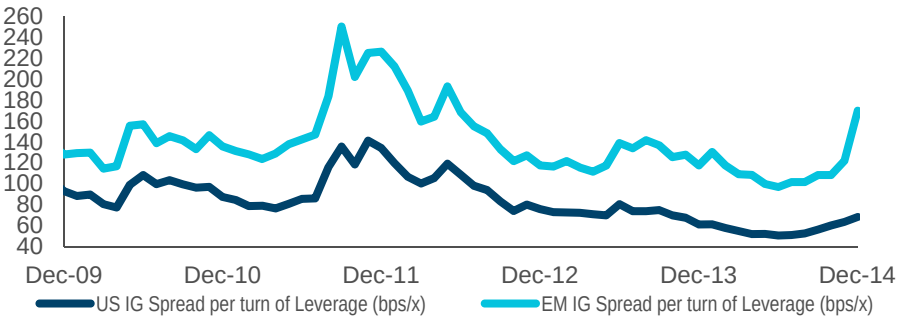


FIGURE 2: EM Corporate Fundamentals – Investment Grade

As of December 2014



Source: Bank of America/Merrill Lynch (as of December 2014)

COMPELLING VALUATIONS

In our view, the EM corporate market offers significant return potential for investors willing to assume the risks inherent in a less-established market. The asset class offers an average yield of 6%, with an average duration of about five years.[3] Not only are absolute valuations attractive in a low-yield environment, but relative value is also compelling versus both investment grade and high yield corporate debt. The average dollar-denominated emerging market BBB rated credit offers more than double the spread of a similar US-domiciled counterpart.[4] Investors can effectively double the spread with less leverage than in developed markets—an opportunity not seen since the global financial crisis. Not only this, EM corporates offer better spread compensation relative to balance sheet gearing. The gradual reduction of idiosyncratic headwinds as we move into 2015 is likely to offer an attractive entry point for investors over the coming months.

There are signs that global investors, who are underweight emerging market debt, are beginning to return as headwinds have begun to wane, according to recent fund flows data.[5] Political risk has diminished over the past year, with most of the elections in 2014 resulting in new governments that seem willing to adopt more market-oriented reforms. Local currencies have also reached more competitive levels, which should help stimulate economic growth. And valuations are attractive relative to developed market debt. These trends, along with the powerful force of expanding middle classes with increasing purchasing power, are likely to support the continued growth of EM corporate debt in the years ahead.

REFINANCING DRIVES GROWTH

With economic activity likely to pick up, companies will need to raise capital to finance expansions. Indeed, the growth of the EM corporate debt market has been driven mainly by companies seeking long-term financing rather than an increase in leverage. Emerging market banks tend to offer short-duration loans due to a history of high inflation, while the external bond market offers an average tenor of seven years. Companies are therefore increasingly issuing corporate bonds to improve their capital structures and finance long-term capital expenditures.

New issuers have contributed a large amount of the supply to the market, underscoring the fact that companies are refinancing existing debt into longer-term debt.

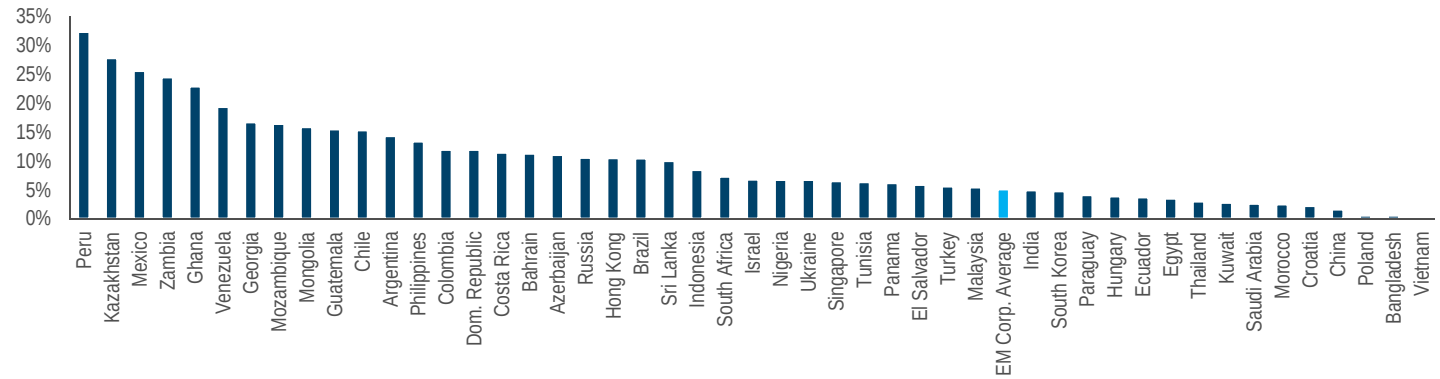
[3] Source: T. Rowe Price; as at December 31, 2014

[4] Source: JP Morgan

[5] Source: EPFR

FIGURE 3: EM Corporate Offshore Bond Market as % of Onshore Private Credit

As of December 2014



Source: T. Rowe Price, Fitch, J.P. Morgan as of December 2014
Private credit includes onshore private sector credit and excludes local bond markets and cross border bank financing

MAJORITY BBB RATED

The largest component of the emerging market opportunity set is made up of BBB-rated companies, about 41% of the total market[6], while the more speculative CCC-rated bracket is less than 3%. That compares with about 20% CCC exposure in the more mature US corporate debt market. The balance sheets of emerging market corporates also compare favorably with those of their developed market peers. It is quite reasonable, in our view, that the asset class has now eclipsed high yield debt in size. Bear in mind that emerging market corporates are the blue chip companies for the rest of the world outside of developed countries, whereas high yield companies in developed markets occupy the lower end of the quality spectrum.

Although emerging markets credit ratings have been on a long-term uptrend, we are likely to see a much more uneven world in the future, with less correlation and more divergent results. Recently, downgrade pressure has arisen, although largely related to sovereign stress, and a wide variety of ratings activity has persisted, and is expected to continue. Investors will increasingly need to differentiate between companies, sectors, and countries as credit trends diverge.

FOCUS ON CORPORATE GOVERNANCE

The potentially high rewards from investing in EM corporate debt entail particular risks associated with emerging markets. These include challenging recovery rates in countries with fragile judicial systems and bankruptcy processes, generally low levels of liquidity, or poor corporate governance.

The bar for corporate governance has to be high in these circumstances. We devote much time, attention, and care to this factor, and place great emphasis on gaining insights into companies well ahead of their bond issues. Our investment team evaluates opportunities in public and private companies across the capital structure. This process also involves extensive consultation with our equity colleagues, as many new debt issuers have longer track records in equity markets, and input from a large team of experienced analysts based across the globe. We devote considerable resources to emerging markets, covering 68 countries that are evaluated by 48 investment professionals who represent 17 nationalities and 22 languages.[7]

As an aside, in our experience, corporate management teams are forced to be more honest in their capital allocation plans when speaking to both shareholders and creditors in the same room.

CAPITAL APPRECIATION OPPORTUNITIES

The dramatic drop in commodity prices has affected emerging market companies in a variety of ways, creating a divergence between winners and losers, which reinforces the need for active management. The

[6] Source: T. Rowe Price

[7] As of September 30, 2014

silver lining is that we are beginning to see opportunities now not just for current yield but also for capital appreciation, particularly in sectors such as energy and mining, where the debt of some companies has sold off more than the fundamentals would warrant. Many issuers should in fact benefit from lower input costs amid commodity-price weakness, helping them to protect margins.

ENCOURAGING FUNDAMENTALS

We believe emerging markets debt possesses many attractive features, including solid credit quality, diversification potential, and attractive yields when compared with those of developed markets. We are encouraged by the sector's long-term positive fundamentals, which should support inflows of funds as global investors address underinvestment to emerging markets. Most emerging markets have stronger financial positions, larger currency reserves, and more flexible foreign exchange policies than they did a decade ago. All this, and the expected pickup in economic growth after a long period of underperformance, supported by reforms and growing middle classes with increasing purchasing power, stand to benefit private sector activity in these countries.

INVEST WITH CONFIDENCE®

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

To learn more, please visit troweprice.com.

Important Information
This document, including any statements, information, data and content contained therein and any materials, information, images, links, sounds, graphics or video provided in conjunction with this document (collectively "Materials") are being furnished by T. Rowe Price for your general informational purposes only. The Materials are not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the Materials and in certain countries these Materials are only provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction. Under no circumstances should the Materials, in whole or in part, be copies, redistributed or shown to any person without consent from T. Rowe Price. The Materials do not constitute a distribution, an offer, an invitation, recommendation or solicitation to sell or buy any securities in any jurisdiction. The Materials have not been reviewed by any regulatory authority in any jurisdiction. The Materials do not constitute investment advice and should not be relied upon. Investors should seek independent legal and financial advice, including advice as to tax consequences, before many any investment decision.

Issued in Australia by T. Rowe Price International Ltd ("TRPIL") (ABN 84 104 852 191), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. TRPIL is exempt from the requirement to hold an Australian Financial Services license ("AFSL") in respect of the financial services it provides in Australia. TRPIL is authorised and regulated by the UK Financial Conduct Authority (the "FCA") under UK laws, which differ from Australian laws. For Wholesale Clients only.

Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services. T. Rowe Price (Canada), Inc. is not registered to provide investment management business in all Canadian provinces. Our investment management services are only available for use by the Accredited Investors as defined under National Instrument 45-106 in those provinces where we are able to provide such services.

Issued in the Dubai International Financial Centre by TRPIL. This material is communicated on behalf of TRPIL by the TRPIL Representative Office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

Issued in the EEA by T. Rowe Price International Limited ("TRPIL"), 60 Queen Victoria Street, London EC4N 4TZ which is authorised and regulated by the Financial Conduct Authority. For Qualified Investors only.

Issued in Hong Kong by T. Rowe Price Hong Kong Limited ("TRPHK"), 21/F, Jardine House, 1 Connaught Place, Central, Hong Kong. TRPHK is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Issued in Japan by T. Rowe Price International Ltd, Tokyo Branch ("TRPILTB") (KLFB Registration No. 445 (Financial Instruments Service Provider), JIAA Membership No. 011-01162), located at GranTokyo South Tower 7F, 9-2, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-6607. This material is intended for use by Professional Investors only and may not be disseminated without the prior approval of TRPILTB.

Issued in New Zealand by T. Rowe Price International Ltd ("TRPIL"). TRPIL is authorised and regulated by the UK Financial Conduct Authority under UK Laws, which differ from New Zealand laws. This material is intended only for use by persons who are not members of the public, by virtue of section 3(2)(a)(ii) of the Securities Act 1978.

Issued in Singapore by T. Rowe Price Singapore Private Limited ("TRP Singapore"), No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. TRP Singapore is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

Issued in Switzerland by T. Rowe Price (Switzerland) GmbH ("TRPSWISS"), Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

T. ROWE PRICE, INVEST WITH CONFIDENCE and the Bighorn Sheep design are, collectively and/or apart, trademarks or registered trademarks of T. Rowe Price Group, Inc. in the United States, European Union, and other countries. This material is intended for use only in select countries.