



# EMERGING MARKETS CORPORATE BONDS: THE ACTIVE OPPORTUNITY

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At a time when passive investing continues to gain market share, emerging market (EM) corporate bonds are an asset class that remains inefficient and under-researched enough to reward active security selection, potentially allowing active managers to add value consistently over time.

One source of active opportunity is lack of dedicated sponsorship. Of the roughly US\$2.2 trillion EM corporate debt market, only about 5% is owned by dedicated investors—entities that specialize in this asset class and are benchmarked to the J. P. Morgan CEMBI indices. The rest is held by retail investors, crossover investors (e.g. investment-grade managers dipping into high-yield names to pick up additional yield) and other non-specialists. Non-specialist investors tend to be slower to identify and exploit mis-pricings or

dislocations in the market. They can also be more sensitive and likely to sell in response to negative news flow, which may cause them to miss out on longer-term fundamental improvements.

A second source of opportunity is wide dispersion of valuations. For example: the marks in **Display 1** show the yields at which new single B rated issues have come to market since 2016. The line in the chart shows the average yield on the B rated portion of the EM corporate index.

**Display 1 Wide Dispersion of Valuations**  
Yields of B-Rated Emerging Market Corporate Bonds



As of 30 September 2019

The chart shows yield to maturity of B-rated bonds issued by emerging market corporates in USD terms. It is a comprehensive universe including issues in or off the J.P. Morgan CEMBI Broad Diversified Index. Source: Bond Radar, J.P. Morgan Chase & Co.

THE EMERGING  
**EDGE**

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The yields were widely dispersed, ranging from less than 4% to almost 14%, for a single rating category. This implies that being able to differentiate between good and bad credits is crucial to success in this asset class, and that managers need enough research resources to do so.

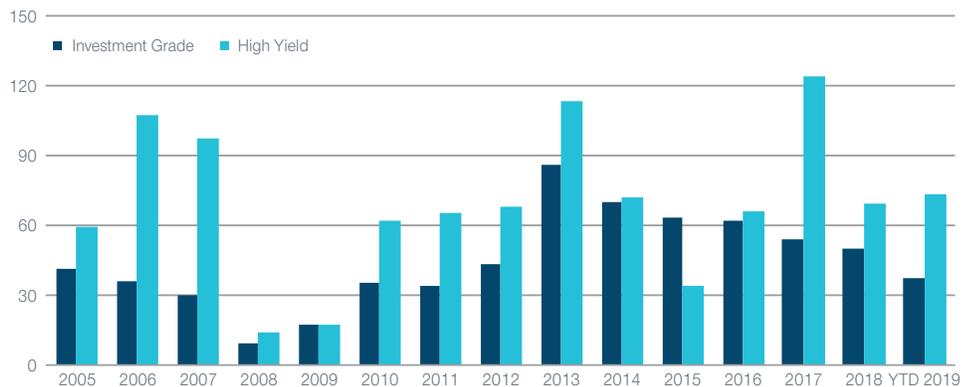
The third potential source of active advantage is the research demands of the asset class. **Display 2** shows the number of new issuers coming to the EM corporate bond market since 2005—an average of around 70 new names a year for the high-yield segment alone. New issues often come up at short notice. Analysts typically have an underwriting period of three to five days to assess the industry, the management team, perhaps even a new country, and build an analytical model.

We believe one of our credit analysts’ advantages is being able to tap into our firm’s EM equity resources. For example, most EM companies issue shares well before they enter the bond markets, so although a company may be a new bond issuer, our EM equity team may have been covering it for decades.

Our EM credit analysts also sometimes draw on the expertise of our developed-market industry specialists, looking for parallels that can be applied in EM, identifying potential success factors or warning signals.

Having these research resources enables us to be highly selective—we only participate in 10% to 15% of new issues—and to have high conviction in the names we do decide to buy.

**Display 2 A Major Research Challenge**  
**Number of New Issuers in the EM Corporate Market**



As of 30 September 2019  
 Source: Bond Radar, J.P. Morgan Chase & Co.

**Additional Information**

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## RISKS

The following risks are materially relevant to the strategy:

**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 (China)**—all investments in China are subject to risks similar to those for other emerging markets investments. In addition, investments that are purchased or held in connection with a QFII licence or the Stock Connect program may be subject to additional risks.

**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 strategy that invests a large portion of its assets in a particular economic sector (or, for bond strategies, a particular market segment), will be more strongly affected by events affecting that sector or segment of the fixed income market.

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