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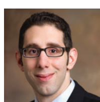
WHEN THE GOING GETS TOUGH: THE RESILIENCE OF EM CORPORATE DEBT

November 2019



Samy Muaddi
Portfolio Manager, Emerging Markets Corporate Bond Strategy

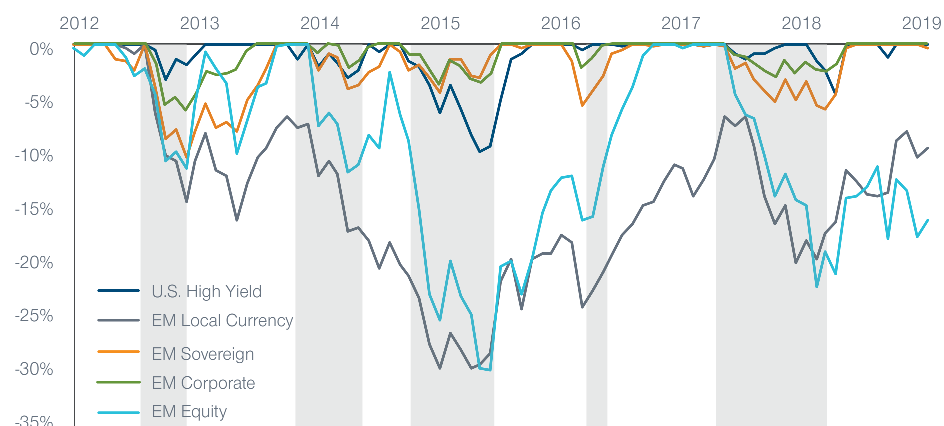
Some investors view emerging markets in general as risky, and this perception sometimes carries through to emerging market (EM) corporate debt. But the downside experience in this asset class has been remarkably limited.

Display 1 shows the losses suffered by different risk assets in falling markets. EM corporate debt has consistently outperformed EM sovereign debt, EM local currency debt and EM equities during bear markets.

We think this pattern is likely to repeat in the future, because EM corporates are, on average, an investment-grade credit quality asset class, with a moderate duration (i.e. interest-rate exposure) profile.

Display 2 *(next page)* shows rolling one-year returns—made up of capital gains/losses and coupon income—for the EM corporate and hard-currency sovereign markets (the return history for corporates starts in 2003).

Display 1 EM Corporates Resilient at Times of Turbulence
Performance During Market Sell-Offs



Past performance is not a reliable indicator of future performance.
As of 30 September 2019.
EM Local Currency—J.P. Morgan GBI-EM Global Diversified; EM Sovereign—J.P. Morgan EMBI Global; EM Corporate—J.P. Morgan CEMBI Broad Diversified; US High Yield—Bloomberg Barclays U.S. Corporate High Yield; EM Equity—MSCI Emerging Markets. Returns are in US dollars. Source: Bloomberg Index Services Limited, J.P. Morgan, MSCI. See Additional Information.

THE EMERGING
EDGE

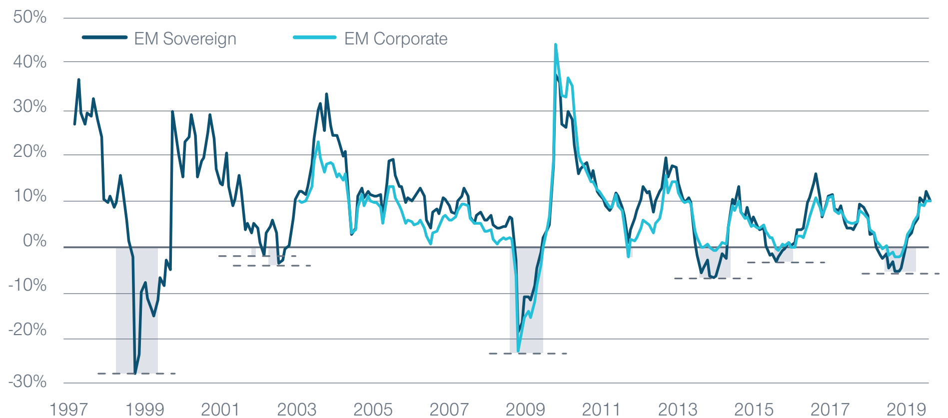
Except for double-digit falls during the 2008 global financial crisis, EM corporate losses have been moderate. Given the attractive yields available—typically in the 5% to 7% range—if investors had continued to hold the bonds, the coupon income alone would have allowed them to recoup the capital loss even if bond prices had remained flat. Historically, however, prices have often tended to recover quite swiftly, rewarding investors who bought the dips. As shown in the chart, drawdowns were typically followed by double-digit recoveries the subsequent year.

The volatility of EM corporates has become more muted over time, and this has to do with the rising average credit quality of EM debt. Back in the 1990s, this was primarily a high yield asset class, dominated by countries like Argentina, Turkey, Brazil and Russia. Since then, the asset class has transformed. Asia credit has gone from 5% of the market to over 50% of the market. This has deflated the historical volatility of returns.

Emerging markets corporate debt, like any other risk asset, goes through patches of volatility. But in the past decade it has offered investors better compensation for risk than any other EM asset class, and market inefficiencies and information gaps have offered frequent opportunities for active managers to outperform the index. For investors looking for higher yield or emerging markets exposure, we believe that EM corporates have a valuable part to play in long-term portfolio allocation.

Display 2 Trend Towards Less Volatile Returns

Rolling One-Year Returns



Past performance is not a reliable indicator of future performance.

Returns in US Dollars. As of 30 September 2019. EM Sovereign—J.P. Morgan EMBI Global Index; EM Corporate—J.P. Morgan CEMBI Broad Diversified.

Source: J.P. Morgan. See Additional Information.

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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