Asset Management

CREDIT SUISSE

Emerging market corporate bonds

An asset class of its own

Q1 2021

Foreword

An introduction to emerging market corporate bonds

Emerging markets have come a long way over the past 20 years, undergoing major economic and structural changes. Their growing importance is reflected in their increasing share of global GDP. However, the general perception of emerging markets still lags behind the economic importance and fundamental developments these markets have seen.

According to the International Monetary Fund (IMF), emerging markets will continue to increase their share of global GDP in the coming years. And with developed markets' relatively high debt to GDP levels and lower growth rates, investors with little or no allocation to emerging markets need to reconsider their positions.

Economic developments have been accompanied by major strides in the financial markets – nowhere more so than in emerging market corporate bonds. Rapid growth and increasing investor acceptance have seen emerging market corporate bonds turn into a distinct and diverse asset class filled with broad and attractive opportunities.

In this paper, we take a look at the history of emerging markets and the development of their debt markets. We analyze how the bond markets have evolved from a space led by sovereign debt into one where corporate bonds are now at the forefront. We also examine in detail the changing risk/return profile of corporate bonds and their correlation to other asset classes. The growth of the asset class now allows for investment in specific segments within emerging market corporates. We present two such cases – emerging market investment grade corporates and Latin American corporates – and show their specific characteristics. We also share recent developments related to ESG (environmental, social, and governance) and the growing importance of this topic for many emerging market corporates.

We hope this brochure provides an interesting introduction to the exciting opportunities that can be found in emerging market corporate bonds.

Gonzalo Borja
Head of Emerging Markets Fixed Income at Credit Suisse Asset Management

Andreas Fischer
Senior Portfolio Manager at Credit Suisse Asset Management

Claudia von Waldkirch
Senior Portfolio Manager at Credit Suisse Asset Management

Dominik Scheck
Head of ESG at Credit Suisse Asset Management

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Emerging markets – a brief history

Lessons learned from past crises have left emerging markets in a much better position to manage adverse conditions and economic shocks. At the same time, globalization and world trade have increased the importance of these markets to the point that investors can no longer ignore them.

The term "emerging markets" was initially coined by Antoine van Agtmael in 1981 when he was working as an economist at the International Financial Corporation, the private sector arm of the World Bank.[1] In the early 1980s these countries were usually referred to as "developing" or "third world" – a term with negative connotations for many people. By contrast, "emerging markets" was thought to create a positive and more aspirational image.

Since the term was first used, many of these countries have undergone significant economic development, and it is clear that today, the term's usefulness in grouping these countries together is limited. Fundamental differences between emerging markets can be far ranging, from net commodity importers to exporters and current account deficits all the way to surpluses. There is no single definition of what qualifies a country as an emerging market. For investors, it therefore becomes vital to understand which single country exposures underlying indices have.

Learning from crises

In the 1990s, as they opened their markets to the outside world, emerging markets were hit by several crises. The most notable were the Mexican (1994), Asian (1997), Russian (1998), and Argentine (2001) crises.

In general, there are three vulnerabilities[2] that can trigger an economic crisis:

1. A significantly misaligned exchange rate
2. Balance sheet problems in the form of nonperforming loans
3. Balance sheet problems in the form of mismatched exposures (maturity and/or currency)

All the abovementioned crises were triggered by at least one of these factors. One positive, however, was the lasting impact they had on many emerging countries, particularly in the way they managed their exchange rates, current account balances, foreign exchange reserves, and foreign-currency-denominated debt. As a result, they are now much better positioned to manage adverse economic conditions and capital outflows.

[1] Kynge and Wheatley, 2015.
[2] Dornbusch, 2001.

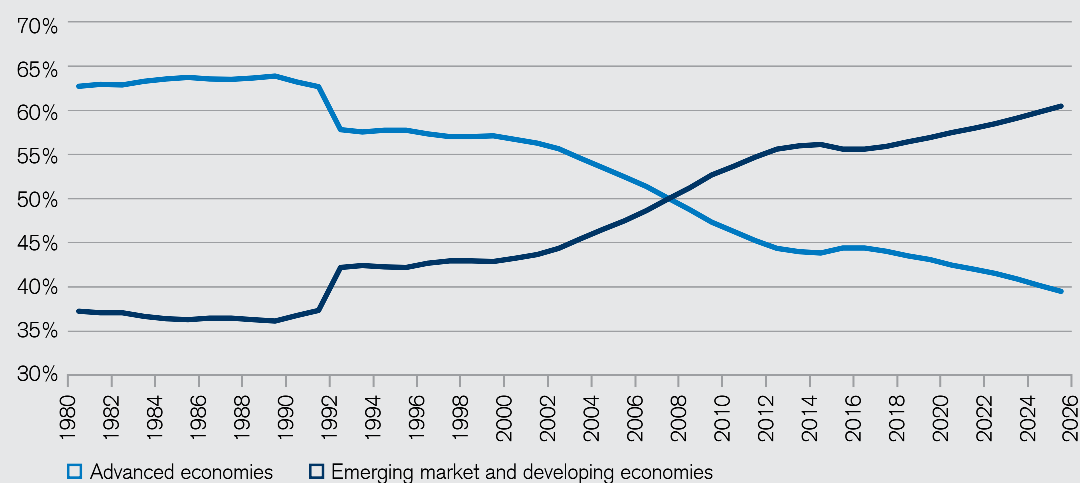
Emerging market debt

Riding the globalization wave
The sharp rise in globalization and world trade since the beginning of the 1990s has increased the importance of emerging economies for the Western world and global GDP growth, with world export volumes almost tripling since then. The rising importance of emerging economies is reflected in their increasing share of world GDP. Data from the International Monetary Fund (IMF) show that emerging and developing economies' share of GDP based on purchasing power parity (PPP) surpassed 50% for the first time in 2008, as can be seen in Figure 1. Data from 2019 show a further increase to 57%. This is a trend that the IMF expects to continue, as it reflects the overall higher GDP growth rates of these economies relative to their developed counterparts.

In our opinion, the general perception of emerging markets still lags behind their economic importance and the fundamental developments seen in these markets over the last 20 years. GDP share itself is, of course, not the perfect indicator of what an ideal allocation to emerging markets should be. Nevertheless, investors with a relatively low allocation to emerging markets should at least question if this stance is still justified.

Figure 1: Disparity in share of GDP set to grow further

GDP based on PPP, share of world (incl. forecast)



Source International Monetary Fund, World Economic Outlook. Data as of 31.10.2020.

In the 1970s there was no market for emerging market debt (EMD), with mainly multinational banks in the US and Europe serving as active lenders to developing countries, particularly to Latin America. EMD as a trading market began shortly after the Latin American debt crisis in 1982, when Mexico was unable to repay its debt to US commercial banks and other creditors. Other countries soon followed, with the four largest (Mexico, Brazil, Venezuela, and Argentina) owing commercial banks USD 176 bn – approximately 74% of the total outstanding less developed country (LDC) debt market.[3] Smaller commercial banks in particular wanted to sell their nonperforming LDC loans to reduce exposure, which in turn started a small secondary market for LDC debt.

The Brady Plan
A key development for EMD was the Brady Plan in 1989–90, which allowed countries to restructure their debt. Subjected to a "haircut" (i.e. a lower interest rate or face value), loans were converted into more tradable instruments (Brady bonds), with the principal amount usually collateralized by specially issued US Treasury 30-year zero-coupon bonds. This let commercial banks reduce the debt on their balance sheet and allowed sovereign risk to be diversified away from banks. The newly created Brady bonds had larger issue sizes, improving liquidity and trading in the secondary market. The plan was also successful in initiating economic reforms in many countries, leading to their subsequent access to international capital markets. While trading in Brady bonds made up over 60% of EMD trading in 1994, most of these bonds have since been exchanged or bought back.[4] The issuance of Brady bonds also led to the launch of USD-denominated emerging market sovereign indices in the early 1990s (JP Morgan EMBI), with emerging market local and corporate indices following in the early 2000s.

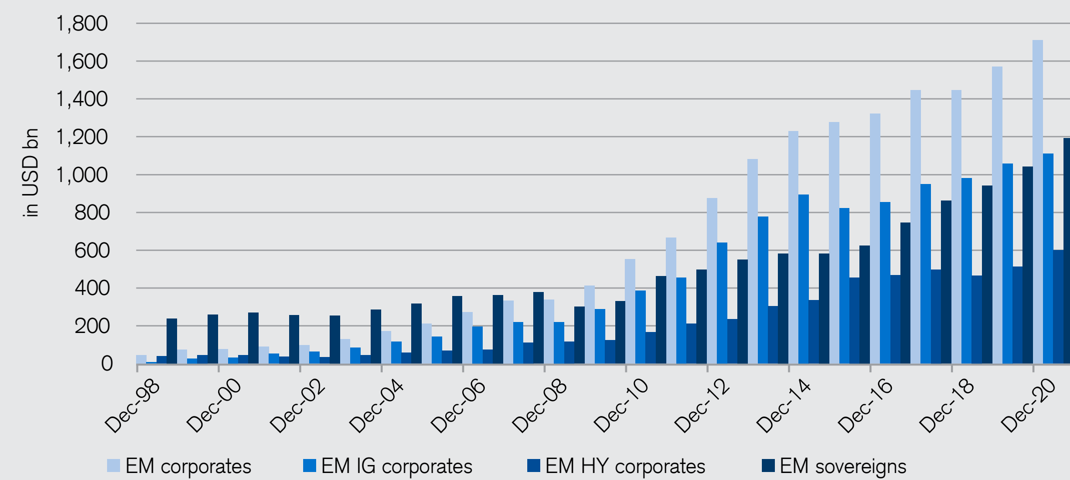
> "The corporate EMD market has been transformed from a niche market into a mature, diverse, and stand-alone asset class.

[3] Wellons, 1987.
[4] Trade Association for the Emerging Markets, 2015.

From sovereign to corporate
Initially, sovereign EMD was predominately a USD-denominated market as international investors did not want to take on emerging market currency risk. However, as fundamentals and credit ratings improved, more and more countries were able to issue local-currency-denominated debt. An analysis by Bank of America Securities shows that the stock of local market domestic government debt totaled USD 12.1 tn at the end of December 2019, compared with just USD 1.1 tn in December 2000. This increase in issuance allowed countries to reduce their foreign-currency-denominated debt, one of the key vulnerabilities during previous crises. Additionally, countries were also able to reduce maturity mismatches.

Today, the market for local-currency-denominated sovereign EMD is much bigger than for USD-denominated sovereign EMD. Figure 2 takes a closer look at EMD denominated in US dollars or euros. We can see that the amount of outstanding corporate bonds surpassed sovereign bonds in 2008. The size of the investment-grade-rated corporate EMD market is almost as large as the entire hard currency sovereign EMD market.

Figure 2: USD-/EUR-denominated EMD has seen substantial growth

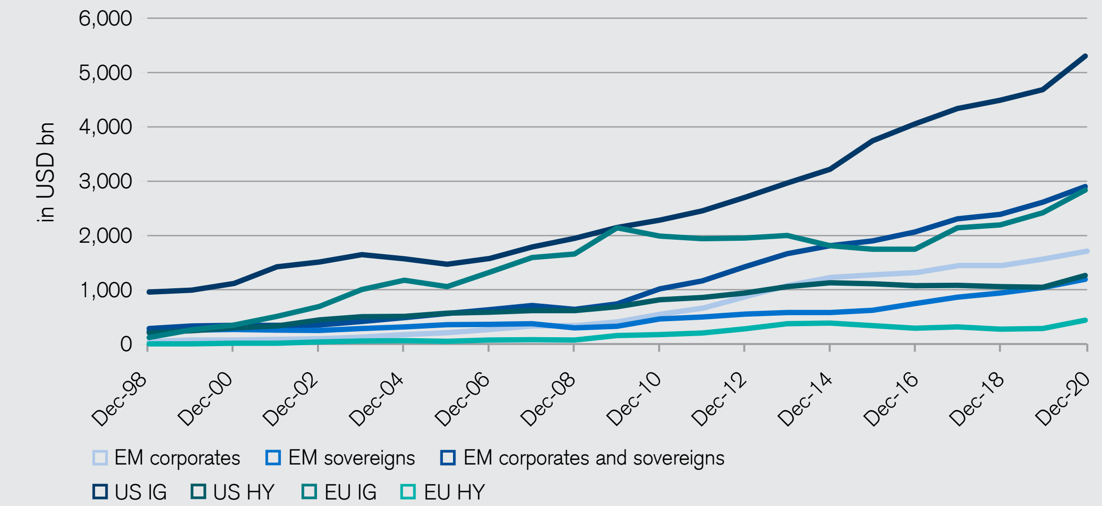


Source BofA Securities. Data as of 31.12.2020.

Over the last ten years, the corporate EMD market grew by 12% per year. To put this into perspective, it is now about one-third larger in size than the US high yield market, while outstanding corporate and sovereign EMD combined also surpass the EUR investment grade universe.

US dollars or local currency?
Today, the most important choice for investors when investing in emerging markets is to choose between USD-denominated and local-currency-denominated debt. Local currency debt has a very different risk profile as its volatility tends to be substantially higher due to the currency exposure. Within USD-denominated bonds, most institutional investors have historically allocated their exposure to sovereign indices. While this clearly made sense from a historical perspective given the size of the USD-denominated sovereign bond market, the strong growth in USD-denominated corporate EMD coupled with emerging market governments' preference to issue local debt is changing the landscape. The USD-denominated corporate EMD market now exceeds its sovereign equivalent.

Figure 3: USD-/EUR-denominated EMD growth relative to other markets



Source BofA Securities. Data as of 31.12.2020.

More than just a niche
The substantial growth for corporate EMD has only been made possible by the improving fundamentals and better ratings of many emerging economies since the start of this millennium. The increased interest and confidence of international investors to invest in emerging markets has helped transform corporate EMD from a niche market into a mature, diverse, and stand-alone asset class, allowing investors to diversify existing traditional fixed income allocations and offering additional opportunities for investors that only hold sovereign EMD. A robust corporate bond market is in the interest of emerging economies as it helps reduce reliance on bank financing and leads to improved diversification of funding sources.

Figure 4: Characteristics of key emerging market indices

	GBI-EM GD	EMBI GD	CEMBI BD
Yield to maturity	4.2	4.6	4.0
Duration	5.4	8.3	5.1
Rating (Moody's, S&P, Fitch)	Baa1/BBB+/BBB	Ba1/BB+/BB+	Baa3/BBB–/BBB–
Currency risk	EM exposure	USD only	USD only
Number of issuers	19	168	719
Number of instruments	251	861	1,752
Number of countries	19	74	58

GBI-EM GD: JP Morgan Government Bond Index – Emerging Market Global Diversified
EMBI GD: JP Morgan Emerging Market Bond Index Global Diversified
CEMBI BD: JP Morgan Corporate Emerging Markets Bond Index Broad Diversified

Source JP Morgan. Data as of 31.12.2020.

Emerging market corporate bonds – an attractive composition

Corporate bonds offer an exciting and potentially lucrative way to gain access to emerging markets. The maturity of the asset class and improved diversification have helped to significantly reduce risks, while regulatory developments and an increased focus on investors have also been positive factors.

Market development and characteristics
Emerging market corporate debt was only formally introduced in this millennium. The basis for today's most widely followed index was introduced in November 2007 when JP Morgan launched its Corporate Emerging Markets Bond Index (CEMBI) series. Historical data and statistics for the index date back to December 2001. As can be seen from the charts that follow, the composition has changed substantially since its launch, reflecting the growth and development of the asset class. The following tables show the different characteristics of the JP Morgan CEMBI Diversified at launch compared to the JP Morgan CEMBI Broad Diversified today. The latter is now the most widely used measure to track corporate EMD. The substantial improvement in diversification is of particular note.

Region and country allocation
The regional allocation has changed, particularly with regard to the Middle East and Africa, as initially only corporates from Israel and Egypt were part of the index. The Middle East and Africa now represent 17.9% and 6.2% respectively, while allocations to other regions, particularly Europe, are lower. Country diversification has also increased significantly, with 59 (up from 16) countries now represented in the index. In 2007, the top five countries made up almost 70% of the index, compared to 26% today. The top five countries have stayed the same with the exception of Singapore, which has been replaced by China. In fact, corporates from China currently have the highest allocation, reflecting the strong economic growth and large amount of issuance out of the country.

Sector allocation
As with countries, the sector allocation has also become more diverse, with 12 sectors now represented (up from 7), mainly due to a reduction in the exposure to industrials. Like many indices in developed markets, the financial sector makes up the largest share of the index, while natural resources (particularly oil & gas and metals & mining) are also well represented, reflecting the natural resources richness of many emerging economies. Commodity prices are therefore an important driver for overall credit spread movements of emerging market corporates. The sovereign and quasi-sovereign (only if 100% owned by the government) sectors are not part of the corporate index.

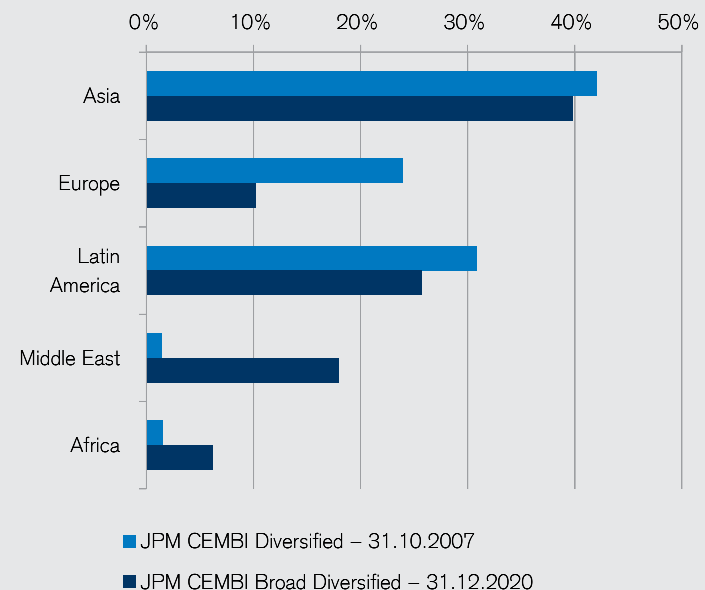
Emerging market corporate bonds – an attractive composition

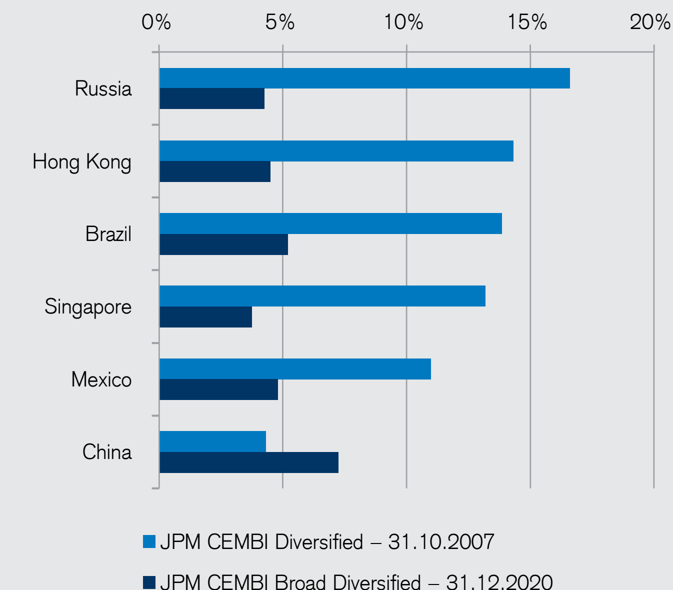
Rating allocation

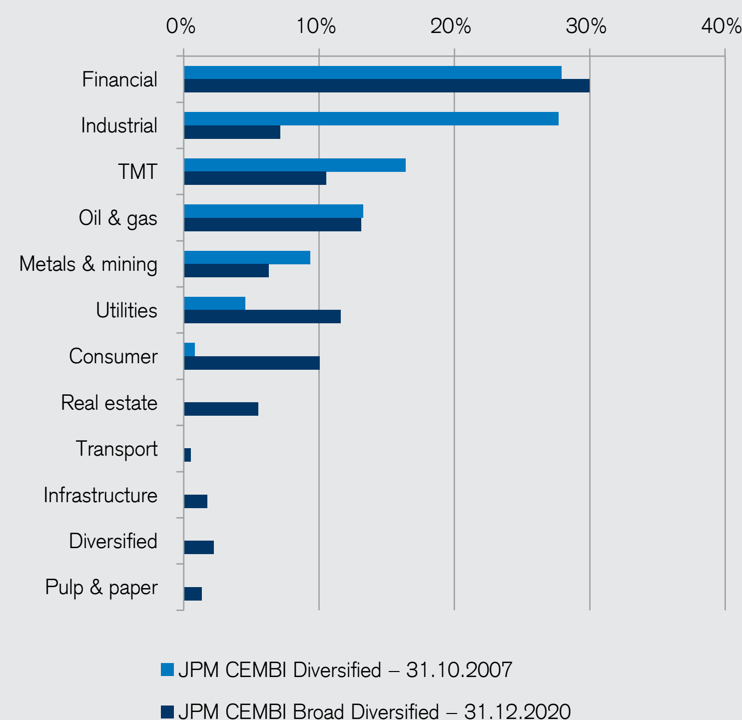
The current average rating of the JP Morgan CEMBI Broad Diversified Index is at the low investment grade range with a rating of Baa3/BBB–/BBB– (Moody's/S&P/Fitch). It is worth highlighting that the emerging market corporate universe is rated slightly higher than the emerging market sovereign universe overall, which is one notch lower with Moody's and Fitch (Ba1 and BB+), while on the same level with S&P (BBB–). This reflects the fact that it is often more difficult for corporates to issue bonds out of countries with weaker fundamentals and thus lower ratings.

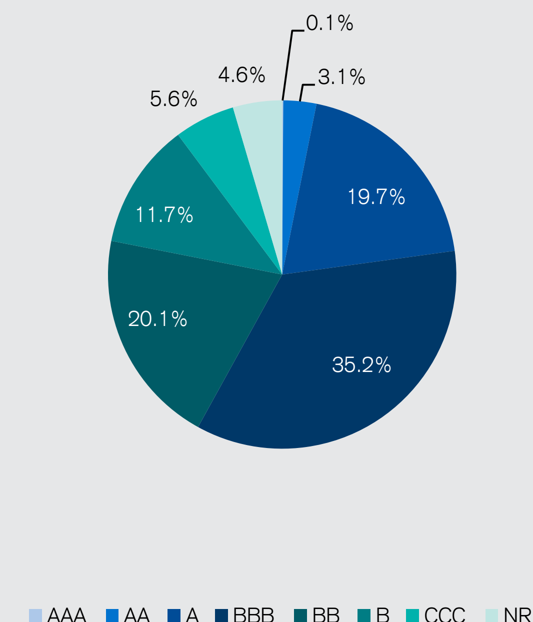
In terms of rating quality, the allocation to investment-grade-rated bonds has decreased from 84.6% to just below 60%, reflecting the strong growth of the asset class and investors' increased confidence in corporate EMD, allowing more noninvestment-grade-rated corporates to issue debt. In recent years, the downgrades of sovereign ratings from Brazil to noninvestment grade has also led to the downgrade of many corporates to noninvestment grade. For companies that are partly owned by the government or have a domestic focus, the sovereign rating provides a rating ceiling, and thus they have also been assigned a noninvestment grade rating.

Figure 5: The corporate emerging market bond universe has undergone significant change



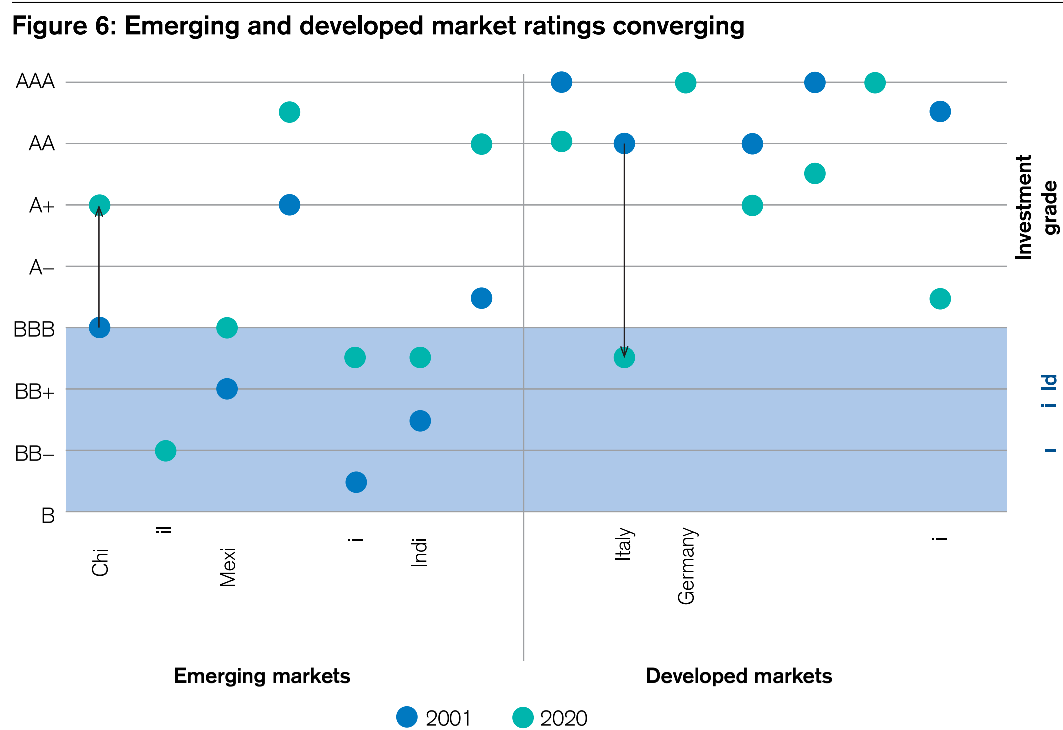






Source JP Morgan. Data as of 31.12.2020.

Figure 6: Emerging and developed market ratings converging



Sources Bloomberg, S&P, Moody's, Credit Suisse. Data as of 31.12.2020.

Quasi-sovereign bonds

Quasi-sovereign bonds play an important role within the emerging market universe. While there is no unique definition, most market participants define a bond as "quasi-sovereign" if the government owns more than 50% of its equity. In contrast to developed markets, there are several major companies in emerging economies that are still majority-owned by the government. Often these companies are of strategic importance to the government and fall into the oil & gas, metals & mining, utilities or financial sectors.

The debt of quasi-sovereign issuers is not explicitly guaranteed by the government, but there is an "implicit" guarantee, with investors expecting government support if needed. The level and likelihood of government support needs to be assessed and taken into account on a case-by-case basis when investing in quasi-sovereign bonds. Additionally, investors should also consider the standalone credit quality of the company.

In general, quasi-sovereign bonds benefit from a "Change of Control" clause. This means investors are protected if government ownership falls below 50%, as they have the right to put the bonds back to the company in exchange for early redemption.

From an index perspective, JP Morgan includes bonds from corporates that are 100% owned by the government (e.g. Pemex) in the sovereign universe, while all other quasi-sovereign bonds with less than 100% government ownership (e.g. Petrobras) are part of the corporate bond indices.

Risks within emerging markets
While asset class growth and improved diversification reduces overall risk, there are still specific emerging market related risks investors need to consider. In particular, political stability and the regulatory and institutional framework of emerging economies lag behind developed markets'. Differences within emerging markets can be very large, and investors need to assess whether the risk premium offered is large enough.

A main focus should be on the regulatory and supervisory framework that offers investor protection. Corporate governance issues are also an important consideration as companies are often important actors in the economy and in politics. As such, many emerging market companies still benefit from implicit government support or a majority ownership due to their strategic importance. This is most pronounced in the natural resources sector, with governments holding majority stakes in companies such as Gazprom and Petrobras. The relatively large number of companies with government involvement is a distinct difference to the universe of developed market corporate bonds and offers additional support in times of distress.

To assess the risk of defaults in emerging market corporates relative to developed market corporates, we can look at historical default rates in the high yield market. There is some misconception about default rates in emerging market corporates as people believe they carry a higher credit risk. However, as Figure 7 shows, there is no indication that they have structurally higher default rates; rather, they are in line with their US counterparts. An important point to make is that, as opposed to the US, bonds from emerging market countries do not form a homogeneous unit. The large number of countries ensures that they will be at different points on the economic cycle at any given point. This is positive for emerging market default rates overall, given they tend to follow the economic cycle.

After several years of very benign default rates, the COVID-19 pandemic has led to a rise in defaults. One interesting point is that, in 2020, default rates in the US high yield sector have been much higher compared to emerging high yield corporates. The reason is the underlying structure with the US high yield market having a much higher exposure to privately owned energy companies. The collapse in the oil price has put these companies under a lot of pressure. The energy sector within emerging markets tends to be dominated by larger companies that often also benefit from government support. Additionally, many of those have relatively low breakeven oil costs, and during a crisis they also benefit from the fact that their local currencies tend to depreciate versus the US dollar. Thus, in this specific scenario of a sharp drop in oil prices, the overall US high yield default rate is much higher, while the US high yield default rate excluding energy companies would be more in line with overall emerging market default rates.

Emerging market corporate bonds – an attractive composition

Some critics make the point that emerging markets are just a commodity play. While commodity prices are certainly important for many emerging market economies, it is also worth highlighting that several emerging economies are also importers of commodities. An analysis of the JP Morgan EMBI Global Diversified Index (emerging market sovereign bonds in US dollars) shows that 60% of the index is classified as commodity exporters, while importers account for 24.5% of the index.[5] Additionally, revenues of many commodity-related companies are in US dollars, while costs are often in their domestic currencies. In case of a more severe price drop in commodity prices, commodity-related currencies will often depreciate and thus mitigate the negative impact for these companies.

In terms of recovery rates, there have been notable regional differences. In particular, Latin America and Europe have experienced lower recovery rates, while EMEA (Emerging Europe, Middle East and Africa) have been slightly below the US. Asia has actually experienced the highest recovery rates. Ultimately, recovery rates strongly depend on which industry the defaults happen in, and so a simple comparison of regional recovery rates should only serve as a rough indication. As an example, recovery rates in the utility sector can be expected to be higher than in some other sectors (e.g. telecom, technology), as utility companies benefit from hard assets that have longevity and revenue-producing capacity.

> In 2020, default rates in the US high yield sector were much higher compared to default rates in emerging high yield corporates.

Figure 7: Emerging market default rates broadly in line with developed markets

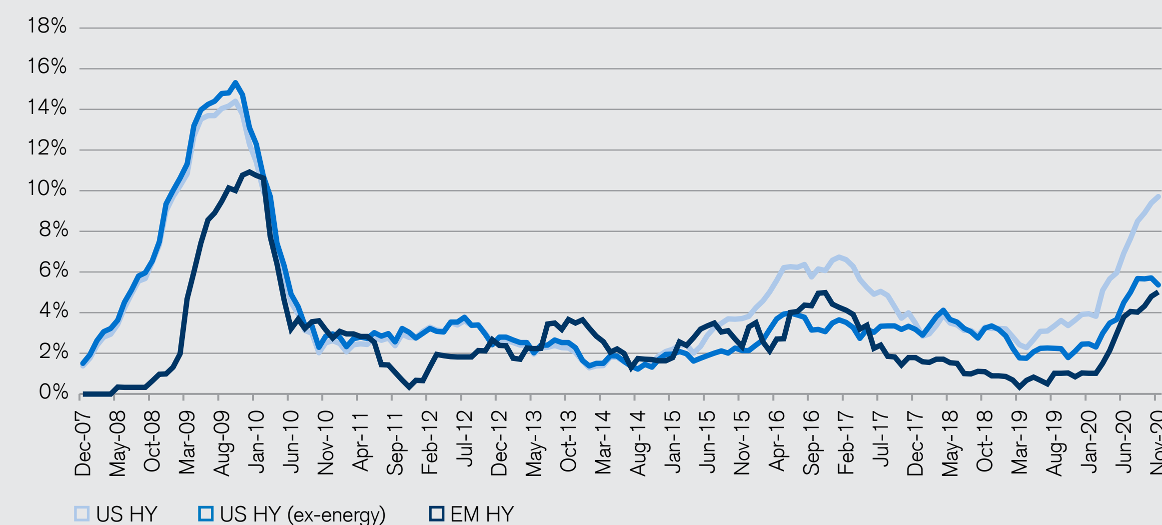
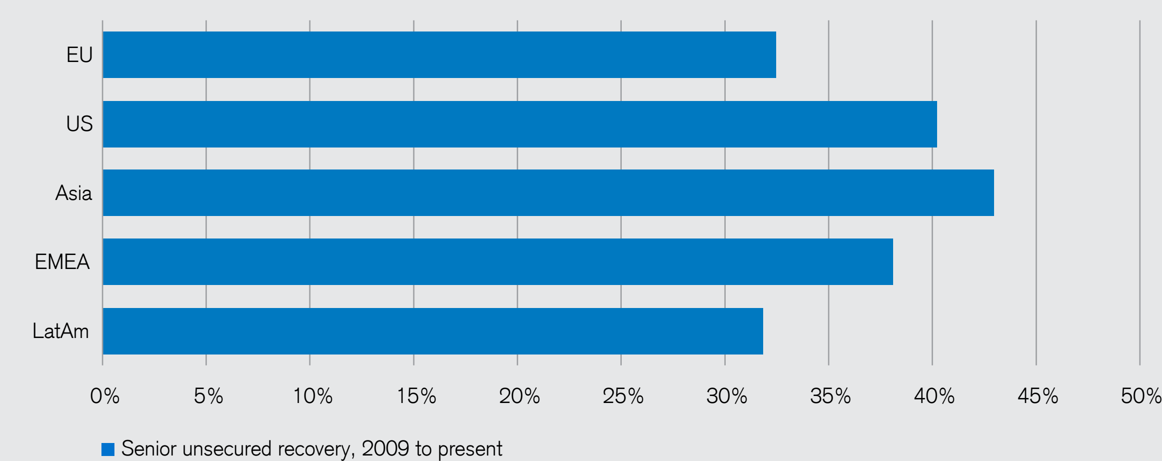


Figure 8: Asia leads the way in recovery rates



Source BofA Securities; recovery rate based on price one month after default. Data as of 30.11.2020.

[5] JP Morgan, October 2020.

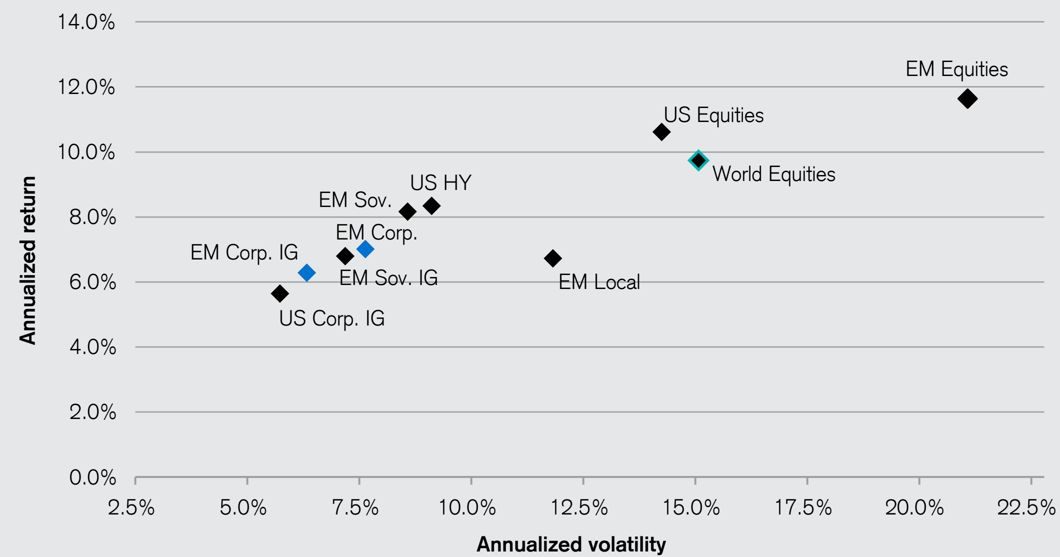
Risk/return figures

Historical characteristics and risk/return figures provide some insight into the behavior of different asset classes but, as every disclaimer notes, they are not indicative of future performance. The time period chosen can have a significant impact on the figures. In the case of emerging market corporate bonds, where the asset class has experienced such rapid growth, it makes interpreting long-term historical figures even more difficult as today's universe is fundamentally different than the one at inception in 2001. As such, the following figures show both a long-term analysis and a shorter-dated one.

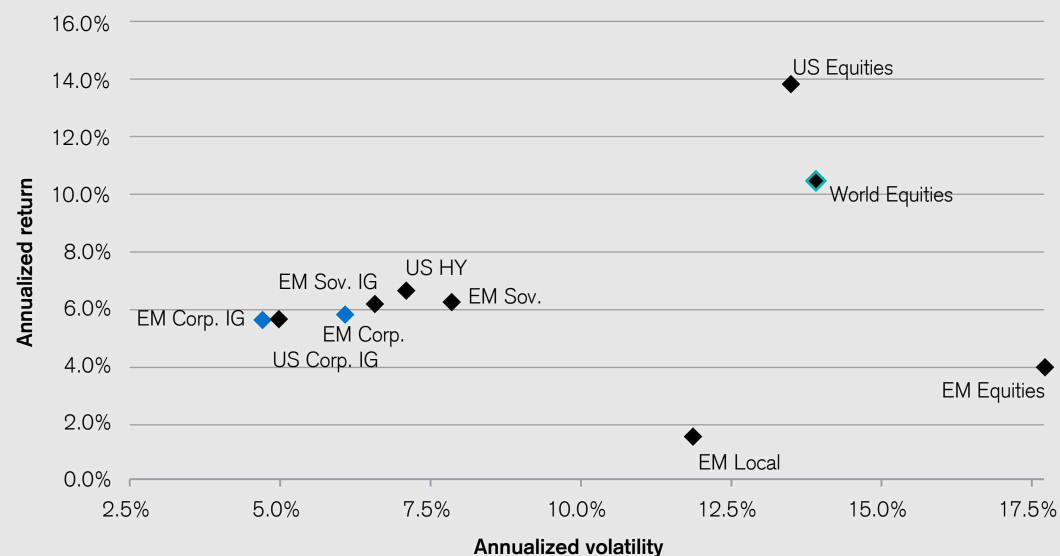
The long-term analysis starts at the end of 2002, when data for the JP Morgan local currency bond index first becomes available. This period therefore covers 18 years and includes the global financial crisis of 2008 and the outbreak of the COVID-19 pandemic. The second analysis starts at the end of 2010 and covers ten years. There were two reasons to choose this particular date. Firstly, emerging market corporate bonds as an asset class matured at this stage with a size of over USD 500 bn. Secondly, both the negative effect of the global financial crisis and the rebound effect are excluded. In 2008, the JP Morgan CEMBI Broad Diversified Index lost 15.9%, but this was more than offset in the following two years with gains of 34.9% and 13.1% respectively.

> **“By adding corporate EMD, investors can benefit from a credit spread pickup relative to sovereign EMD, and thereby increase the overall yield.**

Figure 9: Analysis of risk/return
31.12.2002–31.12.2020



31.12.2010–31.12.2020



Sources Bloomberg, JP Morgan, BofA Securities, Credit Suisse. Data as of 31.12.2020.
Historical performance indications and financial market scenarios are not reliable indicators of current or future performance.

Figure 9: Analysis of risk/return (cont.)
Long-term characteristics

Period (31.12.2002–31.12.2020)	EM Corp.	EM Corp. IG	EM Sov.	EM Sov. IG	EM Local	US HY	US Corp. IG	World Equities	US Equities	EM Equities
Statistics										
Annualized return	7.02%	6.28%	8.17%	6.80%	6.72%	8.34%	5.64%	9.74%	10.62%	11.64%
Maximum return (monthly)	6.15%	6.42%	7.46%	8.16%	9.84%	11.47%	5.55%	12.83%	12.82%	17.15%
Minimum return (monthly)	–17.44%	–14.56%	–16.03%	–11.91%	–14.07%	–16.30%	–7.47%	–18.93%	–16.80%	–27.35%
Sharpe ratio	0.74	0.78	0.79	0.75	0.45	0.76	0.75	0.55	0.65	0.49
Annualized volatility	7.64%	6.33%	8.58%	7.19%	11.83%	9.12%	5.73%	15.08%	14.25%	21.08%
Downside risk	10.58%	8.06%	10.22%	7.43%	9.56%	10.32%	5.42%	13.08%	12.06%	17.12%
% periods up	73.15%	69.91%	70.83%	71.76%	62.96%	72.22%	66.20%	64.81%	68.98%	59.26%
% periods down	26.85%	30.09%	29.17%	28.24%	37.04%	27.78%	33.80%	35.19%	31.02%	40.74%
Max. drawdown										
Max. drawdown (in %)	–24.30%	–19.99%	–21.81%	–16.54%	–29.32%	–33.23%	–16.07%	–53.65%	–50.95%	–61.44%
Length (in months)	5	5	5	5	32	18	8	16	16	16
Recovery (in months)	9	8	8	7	61	9	8	50	37	101
Peak	30.05.08	30.05.08	30.05.08	30.05.08	30.04.13	31.05.07	29.02.08	31.10.07	31.10.07	31.10.07
Valley	31.10.08	31.10.08	31.10.08	31.10.08	31.12.15	30.11.08	31.10.08	27.02.09	27.02.09	27.02.09

Since 2010

Period (31.12.2010–31.12.2020)	EM Corp.	EM Corp. IG	EM Sov.	EM Sov. IG	EM Local	US HY	US Corp. IG	World Equities	US Equities	EM Equities
Statistics										
Annualized return	5.78%	5.59%	6.22%	6.16%	1.49%	6.62%	5.62%	10.48%	13.88%	4.00%
Maximum return (monthly)	4.82%	3.46%	6.07%	4.68%	9.06%	5.96%	5.27%	12.83%	12.82%	13.26%
Minimum return (monthly)	–11.52%	–8.32%	–13.85%	–8.07%	–11.07%	–11.76%	–7.47%	–13.17%	–12.35%	–15.38%
Sharpe ratio	0.84	1.05	0.71	0.84	0.07	0.84	1.00	0.71	0.98	0.19
Annualized volatility	6.08%	4.71%	7.85%	6.57%	11.87%	7.10%	4.98%	13.91%	13.49%	17.71%
Downside risk	7.69%	5.77%	8.56%	6.14%	8.95%	7.34%	4.49%	10.97%	10.54%	12.77%
% periods up	72.50%	74.17%	67.50%	72.50%	57.50%	70.83%	65.83%	66.67%	70.83%	54.17%
% periods down	27.50%	25.83%	32.50%	27.50%	42.50%	29.17%	34.17%	33.33%	29.17%	45.83%
Max. drawdown										
Max. drawdown (in %)	–11.53%	–8.32%	–14.68%	–10.94%	–29.32%	–13.13%	–7.47%	–20.93%	–19.60%	–29.45%
Length (in months)	2	1	2	4	32	2	1	3	3	58
Recovery (in months)	4	4	8	12	61	5	3	5	4	16
Peak	31.01.20	28.02.20	31.01.20	30.04.13	30.04.13	31.01.20	28.02.20	31.12.19	31.12.19	29.04.11
Valley	31.03.20	31.03.20	31.03.20	30.08.13	31.12.15	31.03.20	31.03.20	31.03.20	31.03.20	29.02.16

Legend for Figures 9 and 10

Table	Legend
EM Corp.	JP Morgan CEMBI Broad Diversified
EM Corp. IG	JP Morgan CEMBI Broad Diversified Investment Grade
EM Sov.	JP Morgan EMBI Global Diversified
EM Sov. IG	JP Morgan EMBI Global Diversified Investment Grade
EM Local	JP Morgan GBI-EM Global Diversified (unhedged in USD)
US HY	BoA ML US High Yield
US Corp. IG	BoA ML US Corporate
World Equities	MSCI World Gross Total Return USD
US Equities	S&P 500 Total Return
EM Equities	MSCI Emerging Markets Gross Total Return USD

Sources Bloomberg, JP Morgan, BofA Securities, Credit Suisse. Data as of 31.12.2020.
Historical performance indications and financial market scenarios are not reliable indicators of current or future performance.

Emerging market corporate bonds
Emerging market corporate bonds have shown solid absolute performance over both the very long term and since 2010, with annualized returns of 7.0% and 5.8% respectively. The same holds true for investment-grade-rated emerging market corporate bonds only, with annualized returns of 6.3% and 5.6% respectively. The Sharpe ratio improves for both indices due to the lower volatility for the period since 2010 as the impact of the financial crisis is omitted.

One argument we make for emerging market corporate bonds is that the asset class has become much broader and better diversified. This should have a positive effect on market volatility as unsystematic (company-specific) risk should be reduced through better diversification. If we exclude the impact of the global financial crisis and analyze the volatility figures since inception (31.12.2001) of the corporate indices until the end of 2007, the annualized volatility for emerging market corporates and investment grade emerging market corporates is 5.0% in both cases.

If we compare these figures with the period since 2010, we see that the volatility for emerging market corporates is higher at 6.1%, while the volatility for investment-grade-rated bonds is a touch lower at 4.7%. The volatility figures since 2010 are heavily affected by the COVID-19 pandemic in 2020. This can be seen by taking the period from the end of 2010 until the end of 2019, which would result in volatilities of 4.5% and 3.7% for emerging market corporates and investment grade emerging market corporates. The COVID-19 pandemic should be viewed as an external event resulting in an overall increase of volatility across all risk asset classes and thus is not specific to emerging markets. Therefore, to make a proper comparison, it should be excluded. Additionally, it needs to be noted that the comparison is not like-for-like, because the allocation to more volatile high yield bonds is much higher today. Taking both these points into account suggests that the evolution and broadening of the asset class did have a positive effect on lowering the volatility of the asset class.

Emerging market corporate bonds versus sovereign bonds
Comparing historical figures for emerging market corporate versus sovereign bonds provides some interesting insights. First, looking at risk-adjusted returns in the form of the Sharpe ratio, sovereign bonds have a similar ratio for the entire period, while corporate bonds (particularly investment grade) are the winner over the period since 2010 with a much shorter average duration. Volatility, particular over the last ten years, is generally lower for corporate bonds, which should not be surprising given the considerably higher duration of emerging market sovereign versus corporate bonds, as well as the slightly lower average credit quality.

From an investment perspective, the short-term figures strongly suggest that by looking only at sovereign EMD, investors miss interesting risk-adjusted opportunities in the corporate EMD market. Given the relative market size and growth trends, we believe that an emerging market corporate solution including emerging market sovereign/quasi-sovereign bonds offers investors the best opportunity set to get USD-denominated emerging market exposure. With regard to emerging market sovereign debt in local currency, the historic volatility figures of almost 12% clearly show the different nature of this asset class compared to USD-denominated emerging market debt.

Emerging market corporate bonds versus US credit indices
Comparing emerging market corporates versus US credit indices, we again argue that the significant growth of the asset class means the more recent period provides a better basis for comparison. The US high yield market experienced the highest volatility, followed by emerging market corporate bonds. Within the investment grade universe, US investment grade corporates actually experienced a slightly higher volatility compared to emerging market investment grade corporates. Even though the US corporate investment grade index does have a slightly better rating quality, it also has a duration that is about 2.5 years longer, thus offsetting the lower volatility implied by the better rating quality. During the period, investment grade indices achieved the highest Sharpe ratio (emerging market investment grade: 1.0, US investment grade: 1.0), with emerging market corporate bonds (0.8) and US high yield (0.8) both slightly below these levels. These figures all suggest that emerging market corporates have a similar risk profile to other credit markets and should be considered within an overall credit allocation.

Correlation among asset classes
From a portfolio construction perspective, correlation between the different asset classes is a key measure to assess diversification benefits. As can be seen from the correlation matrix, emerging market corporate bonds have the highest correlation with emerging market sovereign indices. This should not be surprising given the similar country universe of both indices. From the perspective of credit investors, correlations with US credit indices are of particular interest. Emerging market corporate bonds do have a relatively high correlation with US credit indices over the long term, as well as the more recent period. One reason for this is that both indices only invest in USD-denominated debt, i.e. both have the US Treasury curve as their underlying interest rate risk.

The relative credit spread movement is the main differentiation. As can be seen from the rolling correlation charts in Figure 10, the correlation between emerging market and US investment grade corporate bonds has been relatively high and stable over time. In contrast, the correlation between emerging market corporates and US high yield has increased over time. This is in line with the increased share of high yield within the emerging market corporate universe over time.

If we look at the local currency emerging market index, we find a lower correlation with US credit indices than for emerging market corporates. This reflects the additional currency risk as well as the different underlying interest rate risk. Nonetheless, a correlation coefficient above 0.6 versus US high yield looking at a three-year period is still relatively high. It is also an indication of the sensitivity to risky assets that both of these asset classes have. As can be also seen from the rolling correlation charts, the relationship of local currency emerging market bonds with US high yield is much less stable than for emerging market corporate bonds, particularly from a 12-month perspective.

The relatively high correlation with US corporate bonds suggests that emerging market corporate bonds can serve as a complement for US-credit-only investors to increase their opportunity set and overall yield. The high correlation with USD-denominated emerging market sovereign debt also implies that investors exclusively focusing on this asset class are at risk of missing other attractive opportunities within the emerging market universe. By adding corporate EMD, investors can benefit from a credit spread pickup relative to sovereign EMD, and thereby increase the overall yield.

Figure 10: Analysis of correlations

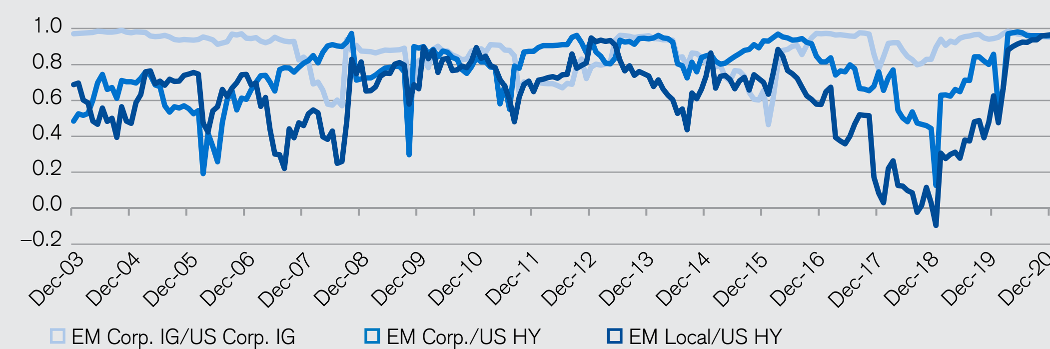
Long term

Correlation monthly returns (31.12.2002–31.12.2020)	EM Corp.	EM Corp. IG	EM Sov.	EM Sov. IG	EM Local	US HY	US Corp. IG	World Equities	US Equities	EM Equities
EM Corp.	1.00									
EM Corp. IG	0.97	1.00								
EM Sov.	0.93	0.91	1.00							
EM Sov. IG	0.86	0.90	0.93	1.00						
EM Local	0.72	0.65	0.79	0.72	1.00					
US HY	0.80	0.72	0.79	0.67	0.66	1.00				
US Corp. IG	0.83	0.89	0.81	0.87	0.56	0.65	1.00			
World Equities	0.64	0.54	0.63	0.50	0.69	0.76	0.42	1.00		
US Equities	0.58	0.48	0.56	0.44	0.60	0.72	0.37	0.97	1.00	
EM Equities	0.66	0.57	0.67	0.54	0.79	0.73	0.44	0.85	0.77	1.00

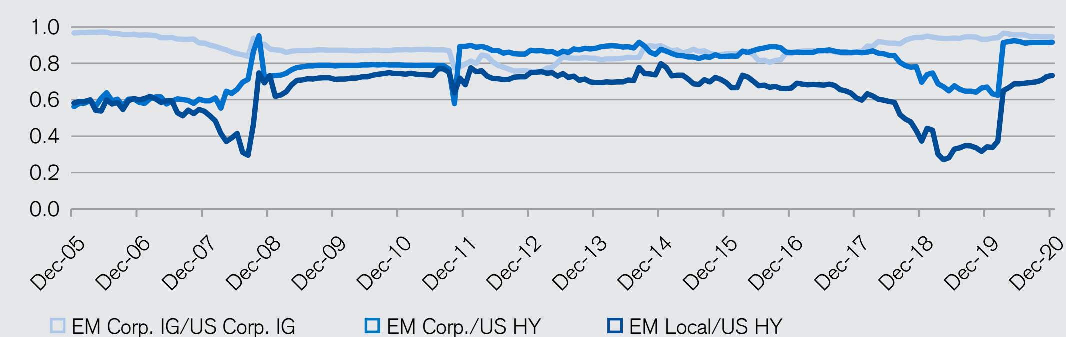
Since 2010

Correlation monthly returns (31.12.2010–31.12.2020)	EM Corp.	EM Corp. IG	EM Sov.	EM Sov. IG	EM Local	US HY	US Corp. IG	World Equities	US Equities	EM Equities
EM Corp.	1.00									
EM Corp. IG	0.95	1.00								
EM Sov.	0.94	0.94	1.00							
EM Sov. IG	0.84	0.93	0.92	1.00						
EM Local	0.77	0.71	0.80	0.71	1.00					
US HY	0.89	0.81	0.81	0.70	0.68	1.00				
US Corp. IG	0.78	0.89	0.78	0.84	0.55	0.68	1.00			
World Equities	0.70	0.57	0.63	0.49	0.64	0.81	0.42	1.00		
US Equities	0.64	0.53	0.57	0.44	0.55	0.77	0.39	0.97	1.00	
EM Equities	0.75	0.65	0.70	0.58	0.83	0.76	0.48	0.81	0.74	1.00

12-month rolling correlation



36-month rolling correlation



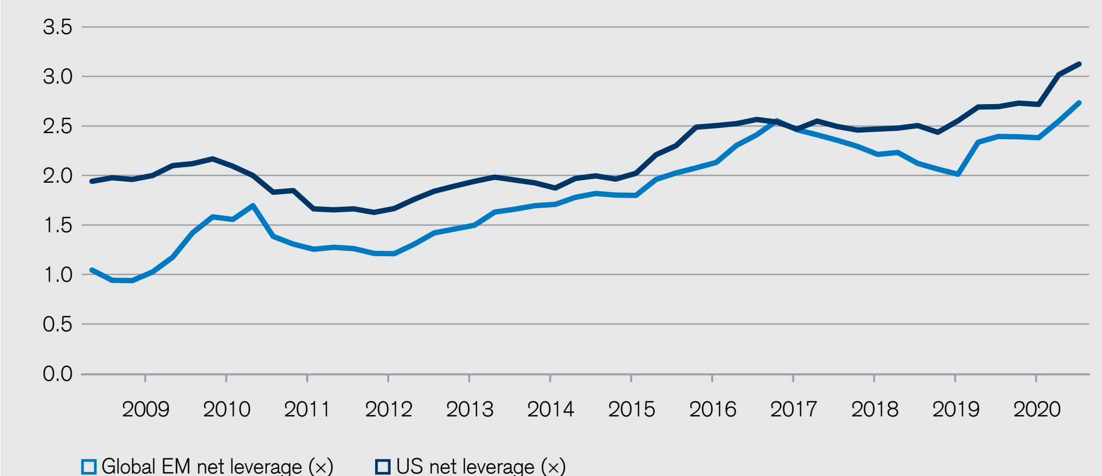
Sources Bloomberg, JP Morgan, BofA Securities, Credit Suisse. Data as of 31.12.2020.

Fundamentals

Historical leverage
While there are several figures and ratios one can look at to assess nonfinancial companies, one of the most important ones for bondholders is leverage. Rating agencies often define threshold levels that a company needs to observe to maintain their rating. Gross leverage assesses total balance sheet debt relative to EBITDA, a rough measure of cash earnings available to service debt. So a gross leverage figure of three means that the debt is three times as large as the EBITDA generated over the last 12 months. The net leverage figure adjusts the debt stock for the available cash, i.e. net leverage ratios will be lower than gross leverage ratios (assuming a positive cash balance).

In Figure 11, we can see the historical development of net leverage figures for emerging market and US corporates. As the universe for emerging market corporates changes over time, current net leverage figures are not easily comparable to 2008, though one can say that overall net leverage has historically been lower for emerging market corporates versus US corporates. Changes over the relatively short term are interesting as they are not much affected by structural changes, such as the development of net leverage figures over the first half of 2020 due to the COVID-19 pandemic. Not surprisingly, net leverage has increased for both emerging market and US corporates in this time due to the collapse in global economic growth. Specifically, one can see that the net leverage increase in emerging market corporates was slightly lower at 0.35× versus 0.41× for US corporates.

Figure 11: The COVID-19 pandemic has increased net leverage ratios



Source BofA Securities. Data as of 30.06.2020.

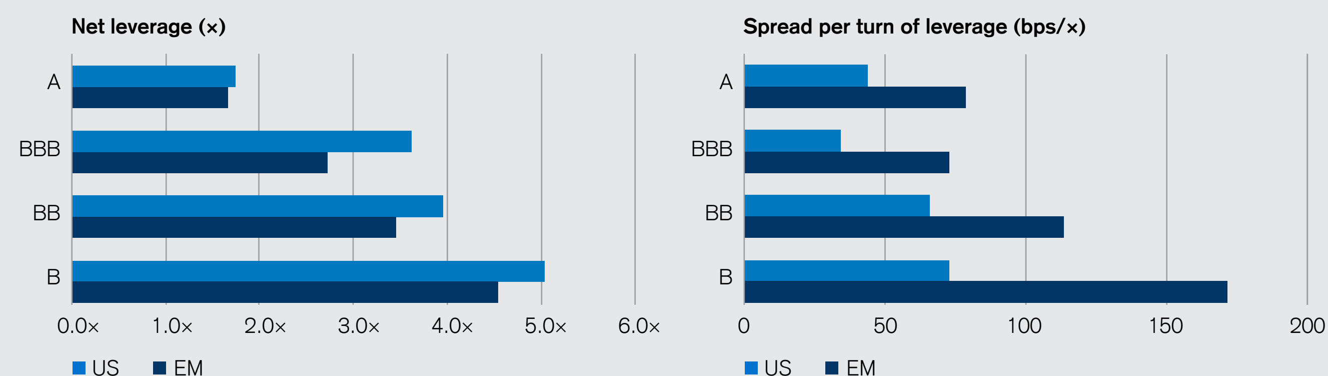
Interesting opportunities within emerging market corporates

Leverage per rating bucket
While overall leverage figures give a good general indication of the trend in leverage, a better basis to compare emerging market and US corporates is to look at net leverage within the same rating buckets. As seen in Figure 12, this comparison shows that emerging market corporates generally have a lower net leverage ratio relative to US corporates.

The attractiveness of any investment depends on the compensation for the risk taken. For corporate bond investors this is the credit spread, i.e. the additional risk premium above US Treasury bonds. The measure that puts credit spreads in relation to net leverage ratios is called spread per turn of net leverage. This shows how much credit spread investors can get for each unit of net leverage. As an example, BBB-rated emerging market bonds have a credit spread of 196 basis points (bps) with a net leverage of 2.7×. This gives a spread per turn of leverage of 73 bps (196 divided by 2.7). The analysis shows that the compensation for emerging markets is much higher per unit of net leverage compared to the US. As previously discussed, there are some additional risks when investing in emerging market bonds, particularly with regard to corporate governance and the political/institutional environment.

At the same time, the broad exposure to various countries within the emerging market universe allows investors currently only focusing on developed markets to enhance their country diversification. As Figure 12 shows, particularly in the BBB and B areas, the credit spread paid per unit of net leverage is clearly higher for emerging market relative to US credits.

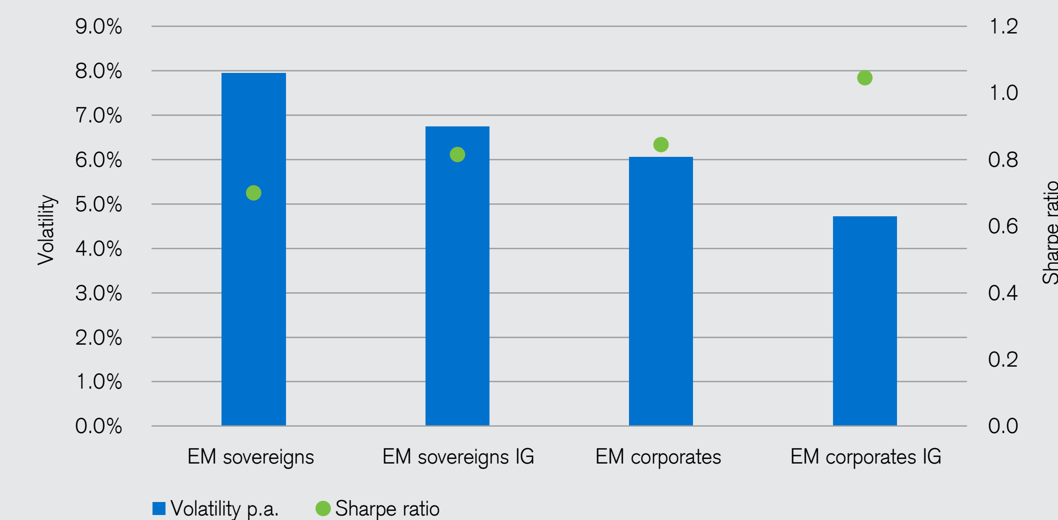
Figure 12: EMD investors are well rewarded for credit risk



Source BofA Securities. Data as of 30.06.2020 (net leverage) and as of 31.12.2020 (spread).

High grade emerging market corporates
An investment-grade-only solution within emerging market corporates offers an opportunity to enhance overall yield within a global fixed income portfolio. The rating restriction as well as the broad country diversification ensure that overall risks are limited and have historically led to the lowest volatility and the highest risk-adjusted returns among the major EMD investments over the last decade (see Figure 13). A close look at the composition of the underlying universe reveals part of the reason.

Figure 13: Attractive risk/return characteristics of EM IG corporate bonds relative to other USD-denominated EM bonds



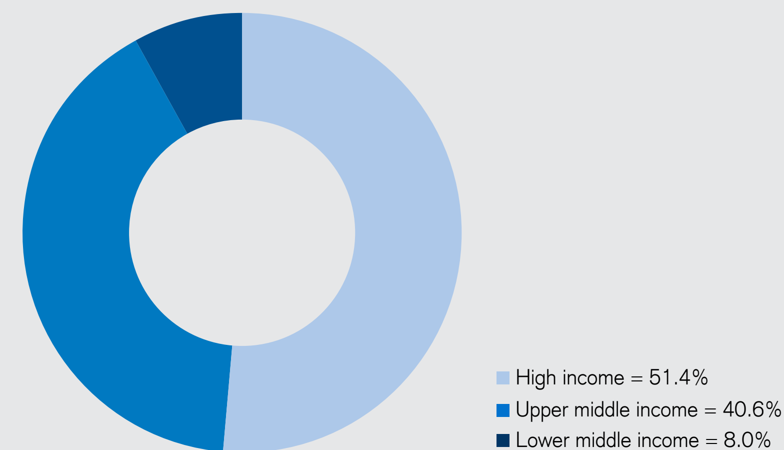
Sources Bloomberg, JP Morgan, Credit Suisse. Time period: 31.12.2010–31.12.2020.

We use the JP Morgan CEMBI Broad Diversified High Grade Index, as this is the benchmark that is commonly used by emerging market investment grade corporate bond funds. It makes sense from a risk perspective to start by looking at the country composition of the index, as the rating on the specific sovereign usually provides a ceiling for many companies. Some exceptions exist for large private global companies with solid credit fundamentals, which can have a higher rating than the respective country.

According to World Bank classification, more than 50% of the countries within the index are classified as "high income" (see Figure 14) and thus fall in the same group as developed economies. These countries have generally seen their rating quality improve considerably, and nowadays have more in common with developed economies than what people think of as emerging economies. Additionally, about 37% of the companies in the index are partially owned by the respective governments, which are expected to provide financial support if needed. Prominent examples that fall into this category are companies such as Saudi Aramco and Gazprom.

From a regional perspective, just under half of the exposure is to issuers from Asia. Latin America and the Middle East each have an allocation of just over 20%, with the rest mainly in Eastern Europe. Exposure to Africa is limited to very few issuers, mainly supranational institutions, due to the investment grade rating requirement. On top of the regional allocation, the methodology of the index ensures a broad country diversification, with China as the largest country only having an allocation of just over 10%. All these features result in a well-diversified exposure with an automatic credit-risk-stabilizing effect due to the minimum investment grade rating requirement.

Figure 14: World Bank country classification of EM IG universe



- High income = 51.4%
- Upper middle income = 40.6%
- Lower middle income = 8.0%

Sources World Bank, JP Morgan, Credit Suisse. Data as of 31.10.2020.

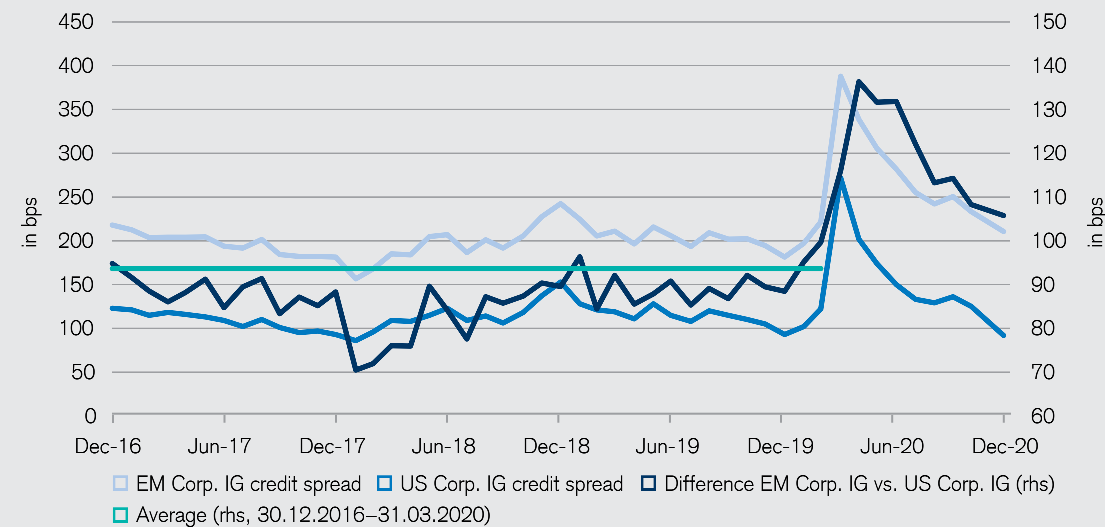
In an environment of historically low yields, we believe emerging market investment grade corporate bonds can also be a very interesting substitute for US or European corporate bond allocations. Investing essentially means comparing the specific risk/return trade-off of the investments involved. Starting on the risk side, we can use the average rating of a specific index. As an example, the Bloomberg Barclays US Corporate Bond Index, which invests in investment grade rated issuers, has an average rating of A–. In contrast, the JP Morgan CEMBI Broad Diversified High Grade Index has an average rating of BBB+, which is only one notch lower, i.e. only a slightly lower overall credit quality. Developed market investment grade credit indices also generally have a longer duration compared to emerging market credit.

Investors will then need to look at the credit spread to see how they are compensated for the specific risk. As can be seen from the chart, emerging market investment grade corporates have generally provided an attractive pickup relative to US investment grade corporates. This is similar for European credit exposure. Thus emerging market investment grade corporate bonds can also be interesting for investors that currently have a large part of their credit exposure in developed markets. Substituting part of this allocation can lead to an increase in the overall yield while broadly keeping the overall credit quality.

The outbreak of the COVID-19 pandemic and the corporate bond buying program of the US Federal Reserve Bank has in general led to a widening of the relative credit spread. As shown in Figure 15, the pickup of emerging market investment grade versus US investment grade corporates was relatively stable before the COVID-19 pandemic, averaging just below 90 bps from 2017 until 2019. For EUR-based investors, the hedging costs also need to be taken into account, and these will depend largely on EU and US central bank rates. Figure 16 shows the historical yield pickup of emerging market investment grade corporate bonds on a EUR-hedged basis versus EUR-denominated investment grade corporate bonds.

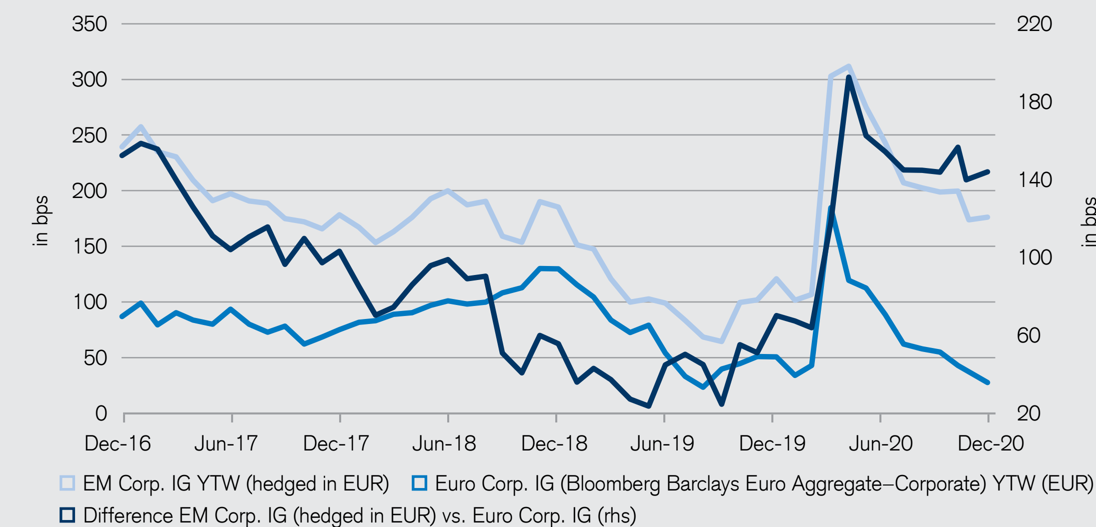
> “Emerging market investment grade corporate bonds have experienced the lowest volatility and the highest risk-adjusted returns among the major EMD investments over the last decade.

Figure 15: Credit spread difference between EM IG and US IG corporates



Sources JP Morgan, Bloomberg, Credit Suisse. Data as of 31.12.2020.

Figure 16: Credit spread difference between EM IG hedged in EUR and European IG corporates



Sources JP Morgan, Bloomberg, Credit Suisse. Data as of 31.12.2020.

In our opinion, the points mentioned above clearly show that, for both US and European investors, emerging market investment grade corporates can offer an interesting and diversified complement to existing developed market credit exposure. By definition, the focus on investment grade corporates excludes more risky high yield credits and at the same time offers a favorable yield pickup to developed market peers with similar ratings.

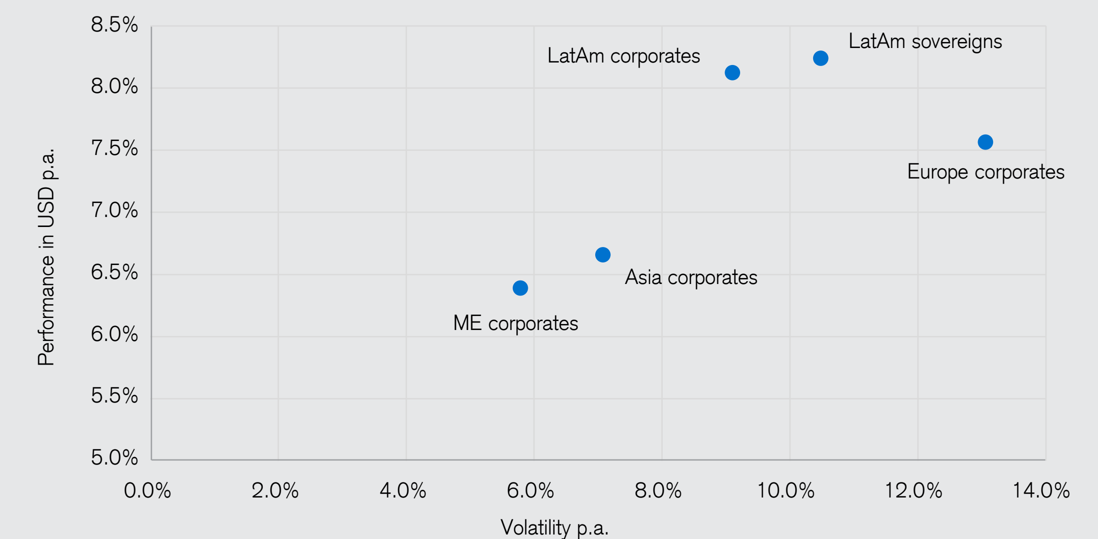
Latin American corporate bonds

Brazil and Mexico have a long and storied history in the emerging market space. Accordingly, companies from these countries – and, by extension, from all of Latin America – have accumulated extensive track records and experience with debt issuance in different economic environments.

When investing in corporate bonds from Latin America, the overriding concern is idiosyncratic risk. Investors need to closely examine companies' fundamentals, especially as governments tend to offer relatively little financial support in this particular region.

Historically, corporate bonds from Latin America offer robust performance, as Figure 17 shows. Taking into account the historical volatility, past risk-adjusted returns are also very solid. Only government bonds from this region have generated a slightly higher performance, but this comes with a much longer duration versus corporate bonds, and with a higher volatility. We therefore view corporate bonds from Latin America as offering comparably better rewards for risk.

Figure 17: Comparison of performance in relation to volatility



Sources Bloomberg, Credit Suisse. Time period: 30.04.2002–31.12.2020.

Interesting opportunities within emerging market corporates

The Latin America region offers a broad diversification of issuers. Fourteen sectors and 17 countries spread across all rating levels provide an interesting opportunity set for active managers. In the commodity sector alone, oil and gas, gold, silver, iron ore, copper, soybeans, paper and dissolving pulp, and meat and meat products all play important roles.

Slightly more than half of the companies in this region are in the high yield segment, many of them headquartered in high yield countries. Their rating often comes down to the aforementioned country ceilings. In some cases with internationally active and/or export-oriented companies or large companies with very strong fundamentals, rating agencies exercise a certain amount of discretion and give the company in question a somewhat higher rating than the country. In any case, a low country rating will usually depress the rating of a fundamentally sound company – a dynamic that presents intriguing possibilities to the investor. Figure 18 shows the strong fundamentals of Latin American companies, in particular in the high yield segment.

Figure 18: Comparison of net leverage (×)

Sources BofA Securities, Credit Suisse. Data as of 30.06.2020.

Currently, a number of factors support companies in the region and speak of a favorable investment environment going forward. Companies from Latin America are crisis-tested and have emerged successfully from the COVID-19 pandemic. This crisis has even created winners. Meat producers, for example, have not only been spared any adverse effects, but have even been able to expand their business because they export the majority of their products.

Many companies now have a global footprint and generate a solid slice of their sales in US dollars. Increasingly, issuers also hedge their interest owed and debt principal in US dollars. Furthermore, short-term liabilities are often refinanced at an early stage when windows of opportunity present themselves on the market, which makes for robust maturity profiles across the region.

Finally, in response to investor demand, Latin American firms offer a high degree of transparency – in the form of standardized quarterly reports, for example – something that is not readily available elsewhere in emerging markets. This allows the active manager to distinguish between concerns on the level of the individual firm, or those stemming from macroeconomics or policy.

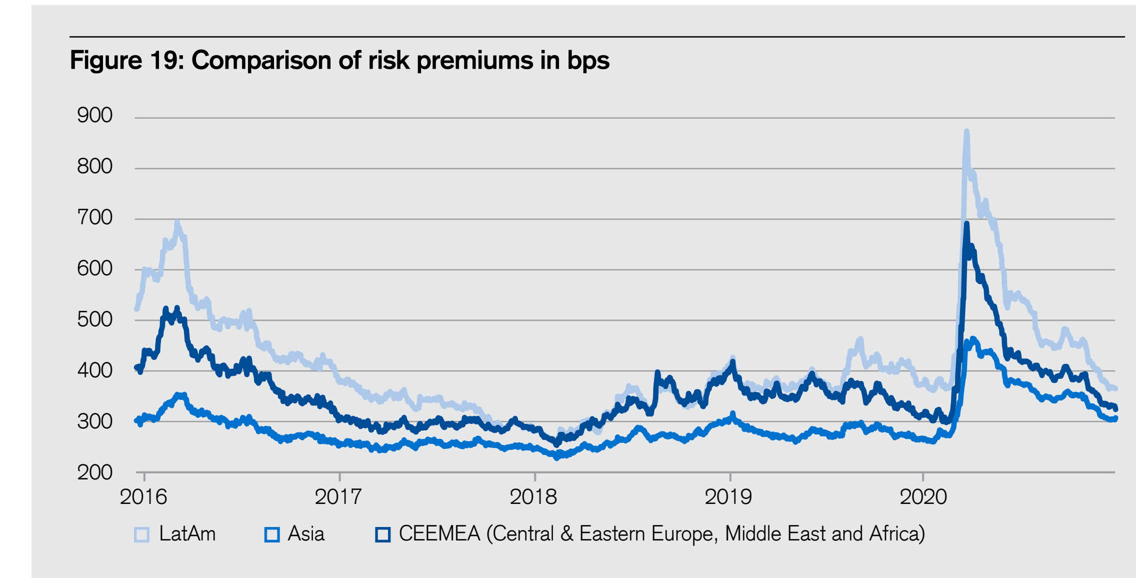


Figure 19: Comparison of risk premiums in bps

Sources JP Morgan, Bloomberg, Credit Suisse. Data as of 31.12.2020.

In summary, it can be said that investments in Latin American companies are well rewarded. Firstly, amid the high sensitivity to idiosyncratic risk, corporates from Latin America exhibit generally higher risk premiums compared to other regions across the world, as can be seen in Figure 19. And secondly, the firms are supported by strong fundamentals. This positive mixture has led to above-average returns within the emerging market corporate landscape. For active managers, the asset class offers a wide selection of interesting idiosyncratic investment opportunities, allowing for solid performance backed by broad diversification.

The importance of ESG

It is all about sustainability. This statement is particularly true in the investing world. More and more private and institutional investors are taking environmental, social, and governance (ESG) considerations into account. While several existing approaches to sustainable investing make no distinction between investments in developed and emerging markets, in day-to-day investment decisions, there is clearly a considerable gap between the two – not only in terms of information availability and ESG data coverage, but also in terms of transparency. While in Europe, and to a lesser extent in North America, significant progress in terms of ESG standards are observable, some emerging market companies lag behind their peers in developed markets. This is especially true for small- and mid-cap sized companies in emerging markets, which are often at least partially family owned or managed by entrepreneurs. Also, small- and mid-cap sized companies in emerging markets tend to suffer more strongly from poor investor relations and substantial corporate governance issues.

The most widely used approach to sustainable investing is the definition and introduction of exclusions. The objective is to exclude those sectors and industries that have detrimental effects on our society and on the environment. Usual suspects that are chosen by most investors and asset managers are tobacco manufacturers, weapons producers, and, most recently, a growing number of companies that are involved in unconventional oil and gas production and thermal coal (production of coal and generation of electricity from coal). While developed market companies have started to reduce their exposure to coal and transform their business models to become renewable energy providers, a large number of coal producers are still domiciled in emerging markets.

Sustainable investing, however, goes beyond exclusions. Key ESG indicators can provide additional information on potential rewards and risks for investment decisions and thus are increasingly supplementing traditional fundamental analysis. Integrating relevant sector-specific ESG data into the investment process makes it possible to obtain a differentiated view of companies, which should exert a positive impact on performance in the long run.

Many ESG approaches mainly look at social and environmental issues, but the decisive factor in terms of performance impact is neither the E nor the S, but rather the G (governance).

> “More and more private and institutional investors are taking environmental, social, and governance (ESG) considerations into account.

The G factor

On the equities side, sustainable emerging market indices have consistently outperformed traditional indices for a number of years.[6] Analysis has shown that the main reasons for this are comparatively low levels of governance in emerging markets, which has led to companies going bankrupt, being involved in governance scandals, or being subject to fraud and deception. As broadly available indices do still not exist on the emerging market corporate bond side, there is no objective source to verify the same for fixed income investments. Nevertheless, experience has shown that it is wiser to scrutinize companies that are poor on the governance side and to look twice before starting to invest. Additionally, not only the companies themselves need to be analyzed in terms of governance issues, but also the countries in which they are located. In a number of cases, the private market-public policy partnership link might have a strong impact as well.

Integrated research and engagement

There are two ways to be successful in emerging market investing. One is rigorous research and the other is company-specific engagement. We combine both: macroeconomic and company-specific fundamental analysis combined with sustainability risk analysis and a continual dialog. Our bottom-up fundamental research considers all relevant information, including sustainability-related risks and questions, the latter mainly referring to legal risks, a transparent supply chain, as well as operational and reputational risks.

We follow two different approaches on the engagement side: individual engagement and collaborative engagement. We assess companies on a case-by-case basis, meaning that our individual engagement is very much focused on company-specific issues and problems. Once we identify problems or issues, we address these in private meetings with the management team, the board of directors or even controlling stakeholders. On the collaborative engagement side, Credit Suisse Asset Management is a member of the Climate Action 100+ initiative, an industry-wide investor initiative committed to reducing greenhouse gas emissions and fighting climate change.

[6] The MSCI ESG Emerging Market ESG Leaders Index has outperformed its parent index, the MSCI ESG Emerging Market Equity Index, by 269 bps p.a. since August 2010 (data as of the end of December 2020).

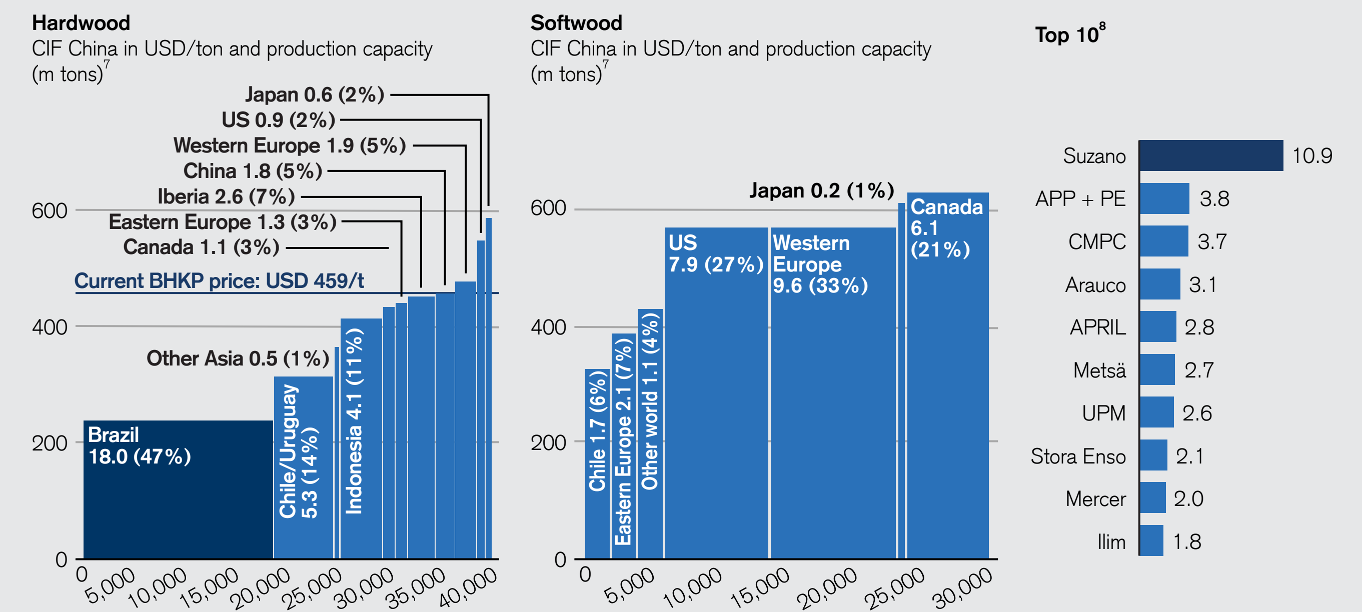
Case studies

The following case studies should illustrate points we have previously made with some examples. The emerging market corporate universe offers a broad opportunity set across corporates located in many different countries. This is an important point, as specific country risk premiums will also depend on the specific country characteristics (fiscal policy, institutional framework, etc.).

Case study 1: Suzano

The Brazilian company Suzano is the world's largest producer of market pulp, as Figure 20 shows, running a capacity of 11 million tons of bleached eucalyptus kraft market pulp. It is also Brazil's number one manufacturer of coated and uncoated printing and writing paper as well as paperboard. Over 80% of Suzano's revenues stem from globally diversified pulp exports. In addition to its leading position in market pulp, Suzano has the benefit of relatively low production costs. It enjoys a high level of vertical integration with substantial self-sufficiency in wood fiber as well as energy and the proximity of its pulp mills to its own forest and port facilities. Its location in Brazil provides nearly ideal conditions for extremely efficient tree plantations, giving the company a sustainable advantage in costs of fiber and the production of pulp. The Feffer family remains Suzano's largest shareholder with a stake of roughly 45.3%. The free float is 53.4%. The company's shares are listed on the B3 and NYSE.

Figure 20: Cost structure of hardwood and softwood and top 10 producers



[7] Source: Hawkins Wright, September 2020.
[8] Market pulp capacity production including hardwood and softwood volumes. Source: Hawkins Wright, June 2020.

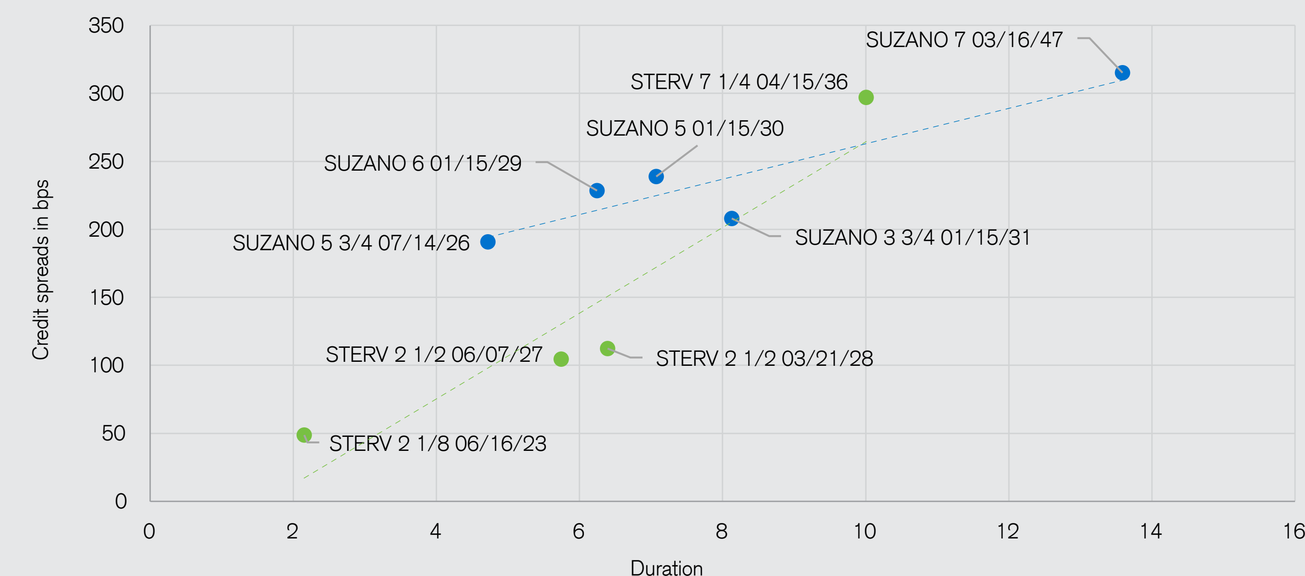
Source Suzano company reports and presentations, Hawkins Wright.

ESG considerations
Most salient for Suzano's business profile is the forestry asset, where the firm takes a sustainable approach in growing trees – including a zero-deforestation policy and the maintenance of substantial biodiversity acreage. In a further step, Suzano has issued a sustainability-linked note, where the sustainability-linked securities framework established a greenhouse gas emissions intensity reduction target with an interest rate step-up if Suzano fails to meet the target. Also, the company has pledged to reducing withdrawal by 15%, increase renewable energy exports by 50%, reduce specific emissions by 15%, and reduce industrial waste sent to landfill by 70% by 2030.

Suzano aims to integrate the sustainability perspective into business management practices and promote the connections between sustainability and innovation. The company has been providing sustainability reports for over ten years.

This company is an example of a higher credit rating than the country of domicile, in this case due to a high share of revenue from exports. Brazil (BB/BB–) is rated lower than Suzano (BBB–/BBB–) and is a case in point for favoring corporates versus sovereigns. Moreover, as the competitive advantage of Suzano shows, emerging market corporates offer a broad variety of attractive investment opportunities compared to developed markets, as seen in Figures 21 and 22.

Figure 21: Suzano vs. Stora Enso (STERV): credit spreads vs. duration



Sources Bloomberg, Credit Suisse. Data as of 31.12.2020.

Figure 22: Suzano vs. Stora Enso (STERV): key figures

	Suzano	Stora Enso (STERV)
Country of domicile	Brazil	Finland
Market cap in USD mn	12,879	12,775
LTM* revenues in USD mn	6,204	9,870
LTM* EBITDA in USD mn	3,500	2,039
Net debt/EBITDA	4.5×	1.7×
Rating S&P/Fitch/Moody's	BBB–/BBB–/Ba1	n.a./BBB–/Baa3

* LTM = Last twelve months.

Source Bloomberg. Data as of 19.11.2020 (market capitalization and rating) and as of 30.09.2020 (revenue, EBITDA, net leverage).

Case study 2: Saudi Arabian Oil Company (Saudi Aramco) versus Exxon Mobil
This example shows the link and impact between a strategically important company and the specific country where it is located. It shows that the country risk premium can make up a substantial part of the overall credit risk premium. This can create interesting opportunities in times of distress relative to developed corporates, particularly when one considers underlying credit metrics.

From a pure ESG perspective, with an MSCI ESG rating of BB, Saudi Aramco is only slightly lower rated than Exxon Mobil at BBB. If we put our focus purely on emission intensity, Saudi Aramco has slightly better figures than Exxon.

Saudi Aramco is a Saudi Arabian multinational petroleum and natural gas company based in Dhahran, Saudi Arabia. It has the world's second-largest proven crude oil reserves and the largest daily production of all oil producing companies. The company was fully owned by the Kingdom of Saudi Arabia until it sold a 1.5% stake in an IPO in 2019. While the government stake remains very high at 98.5%, this IPO meant that the company moved from the EM Hard Currency Sovereign Index (JP Morgan EMBI) into the EM Corporate Index (JP Morgan CEMBI). This is a good example of a company that is majority owned by the state and is likely to benefit from implicit state support if needed, but is part of the emerging market corporate universe because it is not 100% owned by the government.

The COVID-19 pandemic in 2020 led to a sharp collapse in the oil price. While Saudi Arabia has relatively solid country fundamentals, which are reflected in its A1 rating by Moody's, its heavy fiscal reliance on oil revenues meant a sharp adjustment in the country risk premium. As a result, credit spreads of Saudi Aramco widened substantially also relative to other oil producers like Exxon Mobil (see Figure 24). The interesting point here is revealed by a pure credit fundamental perspective. As shown in Figure 23, Aramco has clearly better credit fundamentals than its US counterpart. The lower rating is only due to the government ownership providing a rating ceiling.

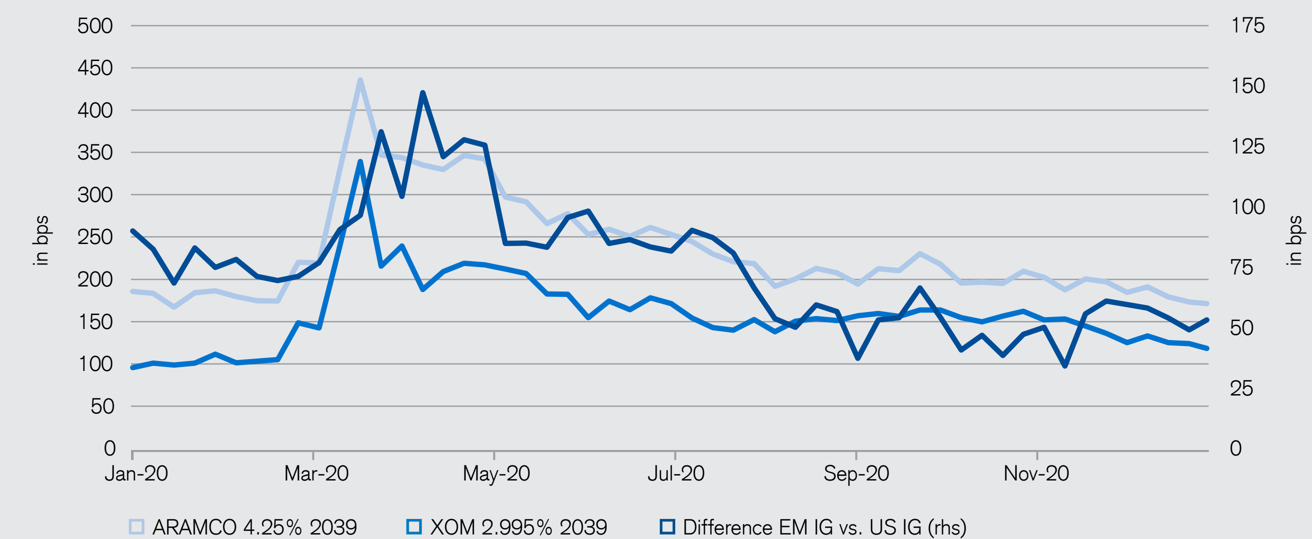
From a pure business perspective, Aramco has some of the world's lowest oil extraction costs, reflected in the much higher EBITDA margin versus Exxon Mobil, and thus has a much more viable business model even with very low oil prices. As can be seen in Figure 24, despite this, the relative pickup versus Exxon Mobil at the height of the market sell-off was almost 150 bps. These types of distortions can happen during severe market stress and the relationship usually normalizes when the market recovers.

Figure 23: Saudi Aramco vs. Exxon Mobil: key figures

	Saudi Arabian Oil Company	Exxon Mobil Corporation
Country of domicile	Saudi Arabia	United States of America
Market cap in USD bn	1,879	295
Revenues in USD bn	294.77	213.86
EBITDA margin	65.6%	10.7%
Net debt/EBITDA	–0.09×	1.55×
EBITDA to interest expense	147.0	38.5
Rating S&P/Fitch/Moody's	n.a./A/A1	AA/n.a./Aa1

Source Bloomberg. Data as of 31.12.2019.

Figure 24: Saudi Aramco vs. Exxon Mobil: credit spreads



Sources Bloomberg, Credit Suisse. Data as of 31.12.2020.

Why invest?

We believe all investors should consider emerging market corporate bonds as part of their fixed income asset allocation. As shown in this paper, the landscape has changed significantly over the years. The asset class has matured and many emerging markets are no longer emerging – they have emerged. By ignoring emerging market corporate bonds, we believe investors will miss a broad and attractive opportunity set for their portfolio. This is true for investors who only have a sovereign emerging market allocation (either in US dollars or local currency) as well as developed market credit investors.

The fundamental development and importance of emerging markets has been substantial, and today many countries that still fall into the emerging market category no longer fit the initial criteria. The asset class itself has grown considerably and has been transformed into a much better diversified universe. A reflection of this is the significantly lower volatility for investment grade rated emerging market corporate bonds compared to earlier years, as well as attractive risk-adjusted returns in recent years.

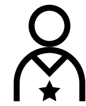
While investing in emerging markets does have additional risks relative to developed markets, particularly with regard to corporate governance and its institutional framework, emerging market corporates do offer a higher credit spread to reflect this. This is even more pronounced if we adjust for the often lower net leverage of emerging market corporates relative to developed market corporates in the same rating category. Additionally, many emerging market corporates still benefit from partial government ownership, and thus implicit government support.

Our team and solutions

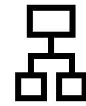
At Credit Suisse Asset Management, we can offer investors a broad exposure to different emerging market corporate bond strategies, with a focus on hard currencies. Focusing on global emerging markets, as well as specific regions such as Latin America and Asia, the strategies have strong track records against both the benchmark and peer group. Our highly experienced 15-person investment management team, based in Zurich, Singapore, and Hong Kong, follows a disciplined investment process that combines top-down and bottom-up analysis to deliver portfolios that are well diversified across regions, countries, and sectors.

To find out more about our EMD capabilities, please speak to your local Credit Suisse representative.

Profit from our EMD expertise



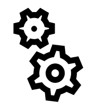
Experience
Long history of investing in EMD since 2005



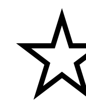
Team
Highly experienced management team based in Zurich, Singapore, and Hong Kong

Approach
Combination of a top-down macro strategy with intense bottom-up security selection

Risk
Active monitoring and risk management



Solutions
Broad spectrum of EMD opportunities with AuM of more than USD 15 bn[9]



Performance
Five-star ratings from Morningstar for flagship products[9]

[9] Data as of 31.12.2020.

For more information, please contact your relationship manager.

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