Asset Management

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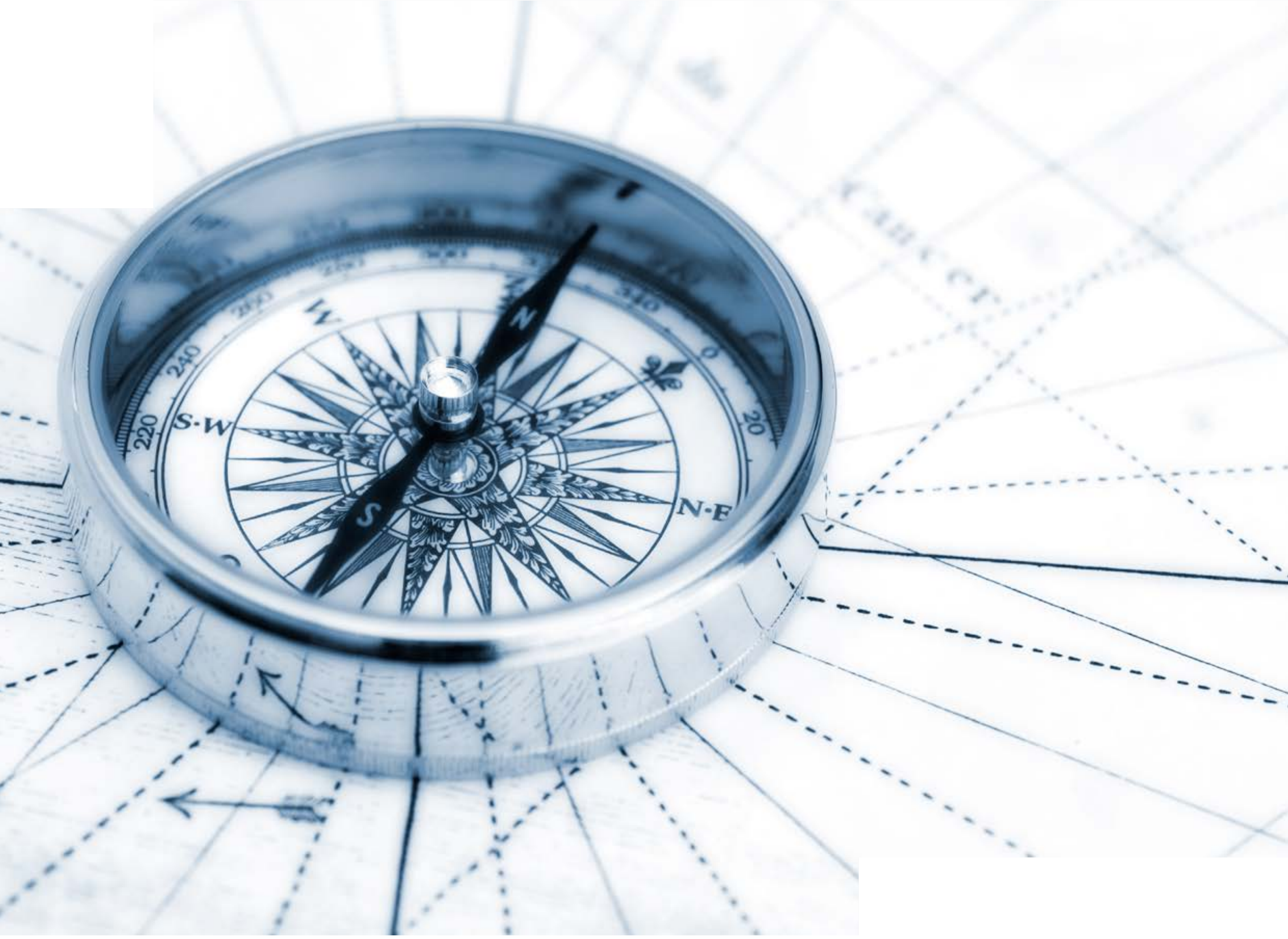
An introduction to emerging market corporate bonds



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Once considered risky and even crisis-prone, today emerging market bonds are viewed as an important asset class that encompasses investments from all over the world. This makes them interesting both on a stand-alone basis and in a portfolio context, especially as they can help diversify existing holdings. Credit Suisse Asset Management has a long history in this space and offers a number of solutions with solid track records.

The rise of the emerging markets as a force to be reckoned with for the world economy and in investing really started at the turn of the 21st century. From Asia to Latin America to emerging Europe, governments were increasingly able to stabilize their institutions and currencies, thereby creating the space for companies to flourish and to partake in the international debt markets – i.e. to issue bonds. It was about at that time as well that the large indices were launched, which are used today to track this market and which became the cornerstones for many solutions in emerging market bonds.

A historic rise

Over the last two decades, emerging market countries have grown to represent almost 60% of global GDP, and they continue to grow faster than their developed peers. It stands to reason that an asset class built on this base is broad and highly diverse. It includes everything from Mexican auto-parts manufacturers to Indonesian banks and Russian commodity giants. It contains pure corporate bonds as well as papers issued by governments or so-called quasi-sovereign entities – firms with significant government ownership. Finally, a broad range of credit qualities is represented in emerging market bonds, allowing for both high-quality investments as well as opportunities in higher-yielding but riskier segments.

We believe all investors should consider emerging market corporate bonds as part of their fixed income asset allocation. 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. While investing in emerging markets does have additional risks relative to developed markets, particularly with regard to corporate governance and the institutional framework, emerging market corporates 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. Covering 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 15-strong and highly experienced investment management team, based in Zurich, Singapore and Hong Kong, follow a disciplined investment process that combines top-down and bottom-up analysis to deliver portfolios that are well-diversified across regions, countries and sectors.

Join the conversation: terms and concepts

Emerging markets: A historically evolving and imprecise term – countries classified as emerging markets can vary greatly, including commodity importers and exporters, or ones with current account (trade) deficits or surpluses. There is no single definition. For investors, it therefore becomes vital to understand regions and countries separately.

Emerging market bonds: Also called emerging market debt (EMD). These are bonds issued by entities (companies, governments, etc.) domiciled in emerging markets, i.e. the countries defined as such in regions such as Asia, Latin America and elsewhere.

Corporate, sovereign, quasi-sovereign: Corporate bonds are issued by corporations, sovereign bonds by national governments. In between, so to speak, are quasi-sovereign issuers, which play an important role within the emerging market universe. A useful definition is an issuer where the government owns more than 50%. 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 in the oil & gas, metals & mining, utilities or financial sectors.

Credit spread: 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. Emerging market investment grade (see below) corporates have generally provided an attractive yield pick-up, especially considering their high rating.

Currency – local versus US dollar: An important choice for investors is 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. While corporate emerging market bonds used to be predominantly in local currency, the USD-denominated corporate EMD market now exceeds its sovereign equivalent.

Rating/rating agencies – also, investment grade versus high yield: The big rating agencies rate bonds by quality, i.e. the likelihood of default. The greater this likelihood, the worse the rating, and the higher the yield. The two basic categories, which many funds explicitly target, are investment grade (safer, lower yield) and high yield (more volatile, higher yield). The agencies also rate countries as a whole, and the country rating usually puts a cap on company ratings in that country, which can create interesting investment opportunities in high-quality companies hailing from weaker countries.

Regions: Asia and Latin America are the two biggest regions in the EMD universe, and there are indices and solutions concentrating specifically on these. Asia's dominance has increased as China's bond market has recently opened up and is now part of the asset class. Middle East, Europe and Africa are also represented.

Sectors: An often-heard take on EMD investment is that it boils down to a bet on commodities, since this sector supposedly dominates. This is no longer true. While natural resources (particularly oil & gas and metals & mining) remain well represented, reflecting the natural resources richness of many emerging economies, the financial sector makes up the largest share in the universe.

Risks: 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. Within emerging markets, differences can be very large and investors need to assess if the risk premium offered is large enough. Bonds carry the risk of default. If the issuer defaults or goes into liquidation, investors may lose some or all of their invested capital.

Read our white paper to learn more about emerging market corporate bonds

The market for emerging market corporate bonds has transformed from a niche into a mature, diverse and stand-alone asset class full of opportunities. To provide more information on this attractive investment category, Credit Suisse Asset Management published a detailed white paper for customers in March 2021. 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 being led by sovereign debt to a space where corporate bonds are now front and center. We also examine in detail the changing risk/return profile of corporate bonds and their correlation to other asset classes. The paper is meant to serve as a starting point for a discussion on how to integrate this asset class into your portfolio.

Download the white paper

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