The Next Chapter in EMD: Static vs. Dynamic Allocations

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- Emerging markets debt is a vast, global sector consisting of several different asset types across dozens of countries, each with its own governance structure, fiscal policy, monetary policy, and sovereign yield curve. While this diversity provides a compelling opportunity set and value proposition, it can also create confusion for investors considering the optimal allocation to EM debt.

- The dynamic between opportunity and confusion is a critical one to address in The Next Chapter for Emerging Market Debt. This installment of our series takes a sequential approach to providing our perspective on achieving optimal EMD exposure. We start by unpacking the performance attributes of the individual asset classes and then demonstrate the rationale for shifting allocations between these asset classes based on their respective characteristics.

- With the attributes and rationale in hand, assessing the performance of individual asset classes and blended allocations through specific market cycles—while also identifying a "benchmark" period for forward-looking context—provides additional context for strategies aimed at delivering optimal risk-adjusted performance.

ASSET CLASS ATTRIBUTES

There is no one best performing asset class of EM debt with the performance of hard currency sovereigns/corporates, local rates, and currencies varying widely throughout historical market cycles. As Figure 1 demonstrates, the return dispersion between hard currency and local currency, as well as between investment grade and high yield returns, within EM is often meaningful.

Figure 1: Annual gross performance—EM provides a wide universe for diversification and alpha generation (%)

EM provides a wide universe for cross-asset diversification and alpha generation.

2003-2010								2011-2020										2021-Present			
'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19	'20	'21	'22	'23	YTD '24
55.8	26.0	34.3	32.5	39.7	5.4	78.9	19.2	7.3	18.6	-0.6	7.4	1.3	11.8	37.8	0.7	18.8	18.8	0.9	-7.1	12.7	2.3*
22.2	23.0	10.2	15.2	18.1	-3.8	34.9	15.7	4.5	17.4	-2.0	5.0	1.2	10.2	15.2	-1.7	15.0	7.1	-1.8	-8.8	11.1	2.1
16.9	14.8	7.3	12.3	16.0	-5.2	29.8	13.1	2.3	16.8	-2.3	3.1	-2.2	9.9	11.5	-3.3	13.5	6.1	-2.3	-11.7	10.2	2.1**
16.2	11.6	6.3	9.9	6.2	-12.0	22.0	12.2	-1.8	15.0	-4.2	-2.0	-7.6	9.7	10.3	-4.3	13.1	5.3	-3.1	-12.3	9.1	0.2
15.8	10.3	6.1	7.2	5.0	-15.9	11.7	8.6	-5.2	8.9	-5.3	-5.7	-14.6	4.7	8.0	-6.2	9.1	2.7	-5.5	-17.8	8.4	-1.1
5.5	7.7	3.2	6.5	3.9	-53.2	5.2	5.7	-18.2	7.5	-9.0	-7.0	-14.9	3.5	4.6	-14.3	5.2	1.7	-8.7	-19.8	7.5	-2.1

■ ELMI+
(JPM ELMI Plus Composite Index)

■ Local currency—hedged
(JPM GBI-EM Global Diversified Index—USD hedged)

■ Hard currency sovereigns
(JPM EMBI Global Diversified Index)

■ EM FX local currency—unhedged
(JPM GBI-EM Global Diversified Index—USD unhedged)

■ Hard currency corporates
(JPM Corporate Emerging Markets Bond Index Broad Diversified)

■ EM equity
(MSCI EM Equity Index)

Source: JPMorgan, PGIM Fixed Income as of April 2024. *Spread return: 2.73%. **Spread return: 3.23%.

Against this backdrop, there are several observable attributes across the different EM asset types:

- **Hard Currency Sovereigns/Quasi Sovereigns:** These spreads tend to mean revert and perform well in "risk-on" markets and stable- to higher-rate environments. The universe is well diversified and higher-quality issuers tend to outperform in more volatile environments.
- **Hard Currency Corporates**: Typically, shorter in duration and more likely to outperform in more volatile rate markets. Corporate assets offer idiosyncratic opportunities and risks with attractive relative value prospects, but recovery values that are often much lower than those on sovereigns.
- **Local Rates**: EM rates (hedged from FX exposure) offer attractive real yields with steep curves and tend to perform well amidst slowing global growth.
- **EMFX**: Strongly influenced by the growth differential between emerging markets and markets. Uneven economic cycles and monetary dynamics can present relative-value and attractive carry opportunities.

With these characteristics in hand, we then group the asset classes by attributes pertaining to external (hard currency sovereigns and corporates) and local assets (local rates and FX).

HARD CURRENCY SOVEREIGNS AND CORPORATES

Hard currency sovereigns and corporates are very closely correlated (92% over the last 10 years) as sovereign spreads are the largest driver of corporate spreads, but there are some notable differences. Given that all but the highest-quality EM corporates tend to issue debt with maturities less than 10 years, the duration in EM corporates (4.2 years for the JPMorgan CEMBI Broad Diversified Index) is meaningfully lower than EM sovereigns (6.5 years for the JPMorgan EMBI Global Diversified Index). This difference in duration has been the largest driver in corporate outperformance relative to sovereigns over the last four years. Clearly this duration mismatch can be a benefit for each depending on the direction of core rates.

Fundamentals are equally important as cycles of improving and deteriorating sovereign and corporate fundamentals have become less correlated over the last four years. While EM sovereigns suffered meaningfully in 2020 and 2021 from debt accumulation and lower tax revenues, EM corporate fundamentals improved as leverage neared historic lows and profit margins remained high (before compressing slightly as inflation became harder to pass through). However, we expect these cycles to become more correlated given the enhanced credit quality of EM corporates relative to sovereigns. Indeed, the overall credit quality within corporates is slightly higher (BBB- for the JPMorgan CEMBI Broad Diversified Index vs. BB+ for the JPMorgan EMBI Global Diversified Index), due largely to a different country composition. For example, a few very high-quality countries are included in the CEMBI BD while some of the weaker countries are excluded due to a lack of corporate issuers within those weaker countries.

LOCAL RATES AND EMFX

Local assets have two distinct return streams—local rates and FX. Local rates have exhibited the lowest volatility of any asset class within EM while producing reasonably high information and Sharpe ratios (click here for detailed returns and Sharpe ratios). Conversely, EMFX has produced the worst information and Sharpe ratios over the last decade with moderate volatility. Given the wide dispersion between local rates and EMFX, as well as the different drivers of performance, we view the two as completely different asset classes and manage them independently of each other.

Local markets present an opportunity to generate significant alpha from both overweight/long or underweight/short positioning. Static allocations to local have led to underperformance and higher volatility over the long term, but there have been many periods where local is the best performing asset class. As a result, being tactical within local markets has proven to be the best way to manage exposure. Therefore, we prefer to maintain the flexibility to manage both local rates and EMFX in all of our EM debt portfolios—regardless of benchmark (e.g., in hard currency strategies where an allocation to local markets would be out of index as well as in blended and dedicated local strategies).

HISTORICAL PERFORMANCE AND TOP-DOWN EXPECTATIONS

Given both their historical performance and expected trajectories going forward, we believe that hard currency should be a strategic allocation while allocations to local markets should be more tactical. Hard currency spreads tend to mean revert and, as EM economies continue to converge toward DM economies, should compress over time. We believe over the next decade, average spreads and spread ranges within hard currency EM debt (both sovereign and corporate) will be tighter than where they are today.

The same cannot be said for local markets, where spreads do not mean revert and performance tends to be more cyclical. Inflationary dynamics will determine the directionality of local rates while EMFX can remain unanchored for long periods of time. That said, given the extreme strength of the U.S. dollar from 2012 through today, we do believe there will be value in EMFX over the next few years. However, over a longer period of time, our confidence is lower in currencies than it is in spreads.

Additionally, we believe returns going forward should be most similar to the period between 2012-2019 given that it was the most normalized—but not without hurdles from the 2013 taper

Given their diverse attributes, static allocations to specific sectors can lead to underperformance versus dynamic allocations.

tantrum, the 2014/2015 commodities crash, the 2016 U.S. elections, and the 2018 overtightening by the Fed—in emerging markets (Fig. 2).[1]

Figure 2: Trailing returns, volatility, and Sharpe ratios

	Annualized returns (%)						Volatility (%)						Sharpe ratio					
	1-year	3-year	5-year	10-year	End 2011-end 2019	Since end of 2011	1-year	3-year	5-year	10-year	End 2011-end 2019	Since end of 2011	1-year	3-year	5-year	10-year	End 2011-end 2019	Since end of 2011
Hard currency sovereigns																		
EMBI Global Diversified	9.2	-2.6	0.0	2.6	6.1	3.6	9.0	10.9	11.8	9.2	8.2	8.9	0.39	-0.52	-0.18	0.12	0.72	0.27
EMBI GD Investment Grade	3.0	-4.9	-0.8	2.0	5.8	2.7	9.6	10.4	10.0	7.9	6.7	7.8	-0.24	-0.78	-0.30	0.06	0.84	0.19
EMBI GD High Yield	15.8	-0.2	0.7	3.0	6.5	4.7	9.0	12.4	15.7	12.1	11.3	11.4	1.04	-0.26	-0.10	0.12	0.56	0.30
Hard currency corporates																		
CEMBI Broad Diversified	9.3	-0.3	2.2	3.5	6.2	4.4	5.1	7.0	8.5	6.5	6.0	6.2	0.69	-0.48	0.01	0.30	0.99	0.51
CEMBI BD Investment Grade	6.5	-1.9	1.0	2.7	5.6	3.5	5.5	6.7	7.1	5.5	4.8	5.3	0.17	-0.74	-0.16	0.21	1.15	0.43
CEMBI BD High Yield	13.5	1.8	3.9	4.6	7.2	5.9	4.8	8.0	11.1	8.8	8.6	8.3	1.53	-0.16	0.15	0.34	0.81	0.54
Local currency sovereigns																		
GBI-EM Global Diversified	0.7	-3.3	-1.3	-0.9	1.9	0.3	9.0	10.5	11.4	11.2	11.8	11.4	-0.52	-0.61	-0.30	-0.21	0.16	-0.08
Local rates GBI-EM GD—USD Hedged	3.8	-1.3	0.5	1.6	3.3	1.8	3.7	5.1	4.7	4.2	3.9	4.2	-0.43	-0.86	-0.35	0.02	0.85	0.15
EM currencies EMLI+	2.9	-1.1	-0.1	-0.4	0.9	0.3	5.3	6.6	6.7	6.6	6.7	6.6	-0.47	-0.63	-0.34	-0.28	0.13	-0.14
Blended indices																		
50% EMBI GD / 50% GBI-EM GD	4.9	-2.9	-0.6	0.9	4.0	2.0	8.9	10.4	11.3	9.7	9.5	9.6	-0.07	-0.58	-0.25	-0.06	0.42	0.08
75% EMBI GD / 25% GBI-EM GD	7.0	-2.7	-0.3	1.8	5.1	2.8	8.9	10.6	11.4	9.3	8.7	9.1	0.16	-0.55	-0.22	0.03	0.57	0.17
33% EMBI GD/GBI-EM GD/CEMBI BD	6.4	-2.0	0.3	1.8	4.8	2.8	7.5	9.1	10.2	8.5	8.1	8.3	0.11	-0.56	-0.18	0.04	0.57	0.19
50% EMBI GD / 50% CEMBI BD	9.3	-1.4	1.1	3.1	6.1	4.1	7.0	8.8	10.0	7.7	7.0	7.4	0.50	-0.51	-0.10	0.20	0.85	0.37
PGIM Fixed Income portfolio (composites)																		
Hard Currency Sovereign	11.0	-1.7	0.6	3.5	7.6	4.9	8.7	11.1	13.8	10.8	10.8	10.8	0.62	-0.38	-0.05	0.23	0.68	0.34
Local Currency Sovereign	1.1	-2.0	-0.4	-0.1	2.6	1.0	8.3	9.4	11.9	11.8	13.1	12.2	-0.49	-0.50	-0.16	-0.07	0.19	-0.01
Blended 50% HC / 50% LC	6.7	-1.1	0.7	2.1	5.5	3.5	8.5	10.2	13.0	11.1	11.8	11.3	0.16	-0.36	-0.05	0.11	0.45	0.20

Source: JPMorgan, PGIM Fixed Income as of June 30, 2024.

While the longer-term performance of the EMBI Global Diversified Index (hard currency) has produced greater total returns and information ratios than the GBI-EM Global Diversified Index (local currency), this is heavily influenced by the period from 2012-2015 (Fig. 3).

Figure 3: EMD Returns and volatility through different market cycles (%)

	EMBI Global Diversified		CEMBI Broad Diversified		GBI-EM Global Diversified	
	Annualized return	Volatility	Annualized return	Volatility	Annualized return	Volatility
2003-2007	11.9	6.3	8.5	4.7	15.8	8.2
2008-2011	8.3	11.9	7.0	12.7	7.1	15.3
2012-2015	4.9	6.6	5.0	4.5	-3.9	11.5
2016-2019	7.5	5.5	7.1	3.3	7.8	10.8
2020-present	-0.8	12.1	-2.4	11.6	1.6	8.7

Source: JPMorgan, PGIM Fixed Income as of June 30, 2024.

PERFORMANCE ATTRIBUTES IN PRACTICE

Given the diverse attributes across EMD asset classes, static sector allocations can lead to underperformance versus dynamic allocations. When demonstrating the benefits of shifting

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[1] *We see 2020, 2021, and 2022 as unique years given the collective rate-hiking cycles by global central banks. 2022 was the worst total return year for EM debt on record.*

allocations across individual asset classes, we'll reference the period from 2020 to today as an example.

During this period, allocations in our blended strategies changed multiple times to capitalize on volatility, pricing inefficiencies, and other cross-sector opportunities in an effort to generate alpha. The positioning changes, within and across sectors, were primarily generated from bottom-up analysis, in the context of our top-down view. This involves dynamically exploiting various sources of returns, including issuer quality, fundamental expectations, and duration considerations in hard currency sovereign and corporate debt. In EM local and FX, sources of return can include monetary policy cycles and other relative value considerations including regional, fundamental, and thematic developments, such as the recent China/Asia underperformance, the Russia/Ukraine conflict, and global inflation.

Following the initial COVID shock in March 2020, we concluded that higher-quality hard currency issuers offered strong total return potential given their significant spread widening and the tendency for spreads in the asset class to mean revert and recover. Therefore, in our blend portfolios, we executed a strategy of purchasing bonds at the long end of these curves. Given the growth and fiscal shock, as well as our view that these headwinds would remain for the foreseeable future, we also reduced positions in lower-quality issuers whose funding sources may have been imperiled. We were careful not to sell issuers that could recover at the bottom and instead reduced or exited credits where our conviction waned.

Figure 4 shows a significant increase in investment grade exposure in early 2020, corresponding with a decrease in high yield exposure. The scope of the reduction in HY exposure is somewhat obscured by a tactical shift that reduced single-B risk in favor of double-B risk with the view that fundamentals of the latter cohort would remain intact (Fig. 5). As the year progressed and valuations of our high-beta, hard currency holdings recovered, we reduced positions in instances where valuations rebounded too sharply.

Figure 4: The increase and decrease in IG and HY exposures, respectively, during COVID's onset (active duration contribution in years)
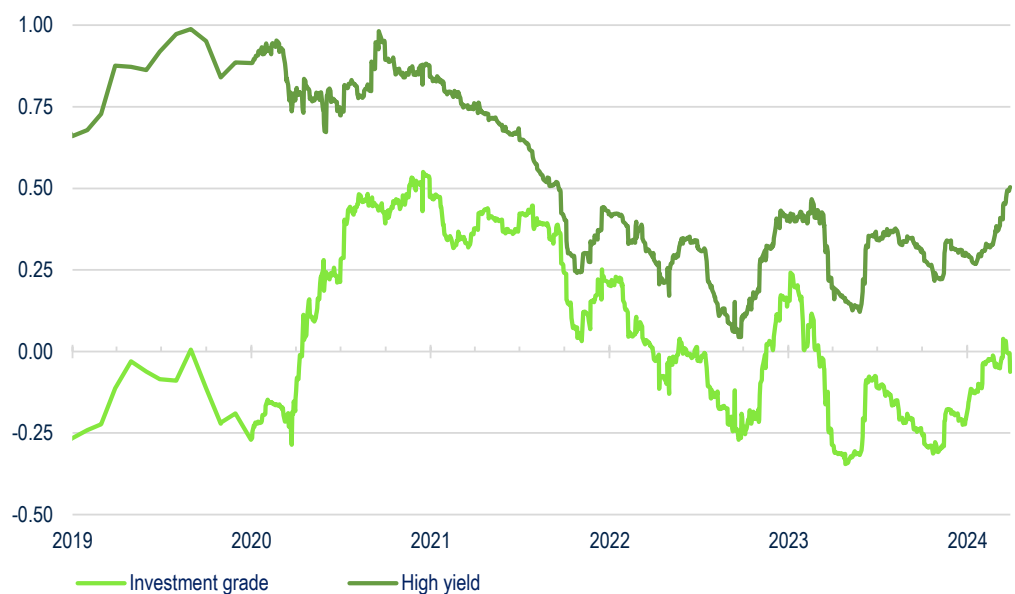
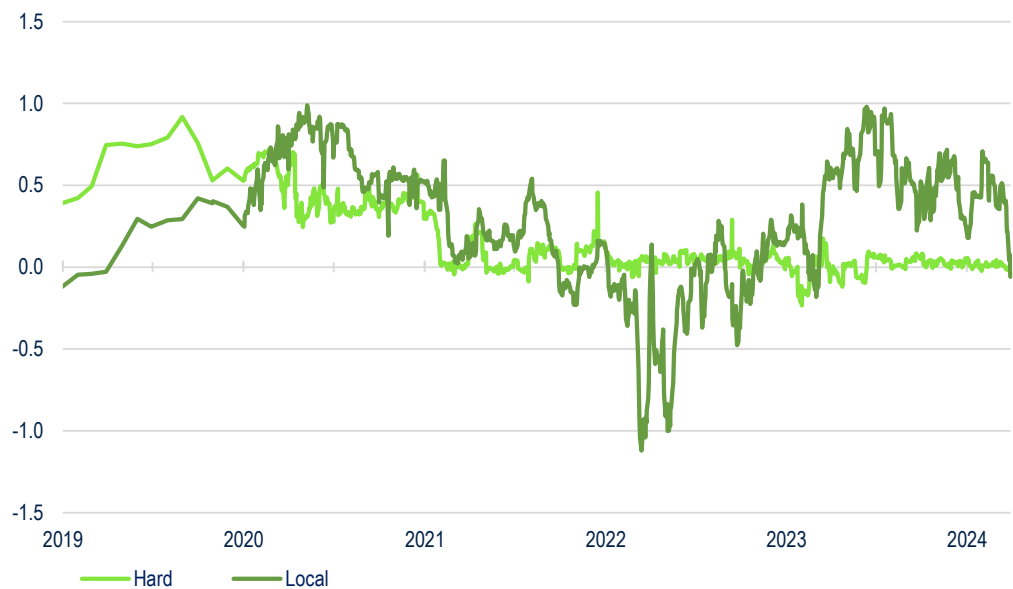Source: PGIM Fixed Income as of March 31, 2024.

Figure 5: The respective increase and decrease in BB and B exposures during COVID's onset (active spread duration by ratings in years)
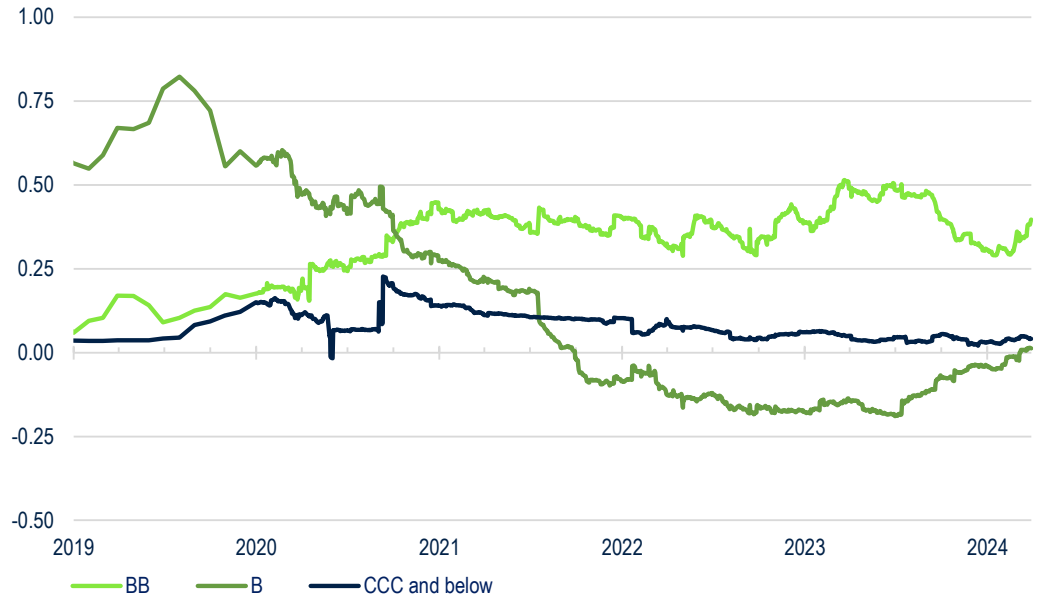
Source: PGIM Fixed Income as of March 31, 2024.

From a local rates perspective, due to the disinflationary nature of the COVID shock, we anticipated that EM central banks would embark on an aggressive rate-cutting cycle and positioned the portfolios accordingly. EM local rates performed relatively well through the volatility, and when it appeared that EM central banks were nearing the end of their rate cutting cycles, we reduced our local interest-rate exposures (Fig. 6).

Figure 6: The shift in local rate exposures along with the prospects for changing monetary policies (active duration contribution in years)

Source: PGIM Fixed Income as of March 31, 2024.

As conditions evolved by late 2020, we began adding emerging market currencies as we believed G-10 currencies, as well as higher-quality Asian and European currencies, would outperform considering that the U.S. real yield advantage disappeared (Fig. 7).

Figure 7: The USD underweight in late 2020 demonstrates the tactical nature of EMFX exposure (% underweight in representative portfolio).
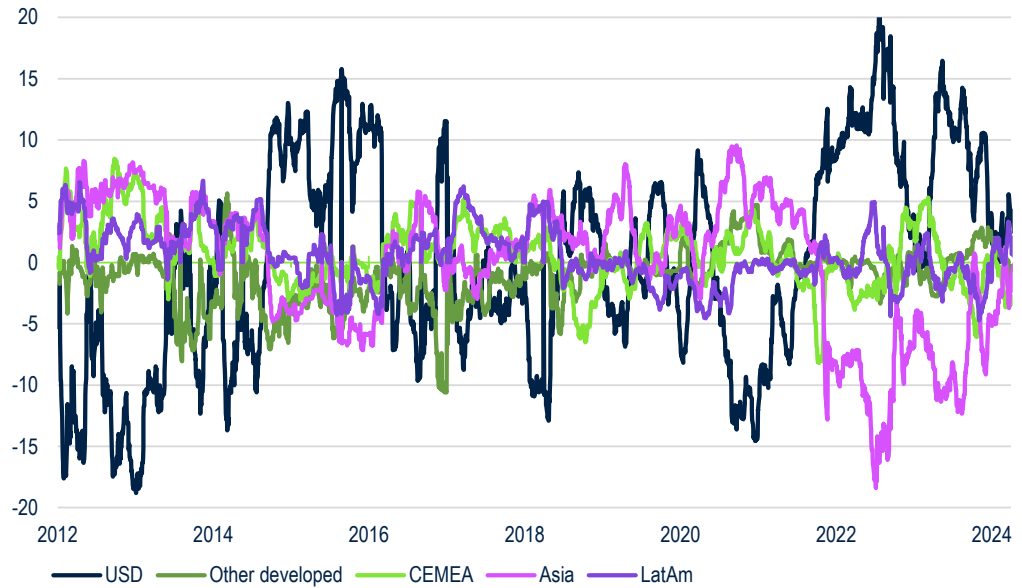
Source: PGIM Fixed Income as of March 31, 2024. Representative portfolio.

When allocating, we evaluate the expected returns within the entire opportunity set, and then construct our portfolios with the best combination to generate optimal risk-adjusted returns.

The market environment shifted again in 2021 and 2022. EM inflation was already higher than DM levels (Fig. 8), and then food and energy prices—which hold a larger weight in EM CPI baskets—surged following Russia's invasion of Ukraine (Fig. 9). As a result, EM central banks took an orthodox approach due to several factors (overall levels of inflation, concerns of passthrough to currencies etc.) and started their hiking cycles a year earlier (or more in some cases) than the Federal Reserve.

Figure 8: EM vs. DM inflation (EM = GBI−EM, ex-China weighted average %; DM = GBI Global weighted average %)
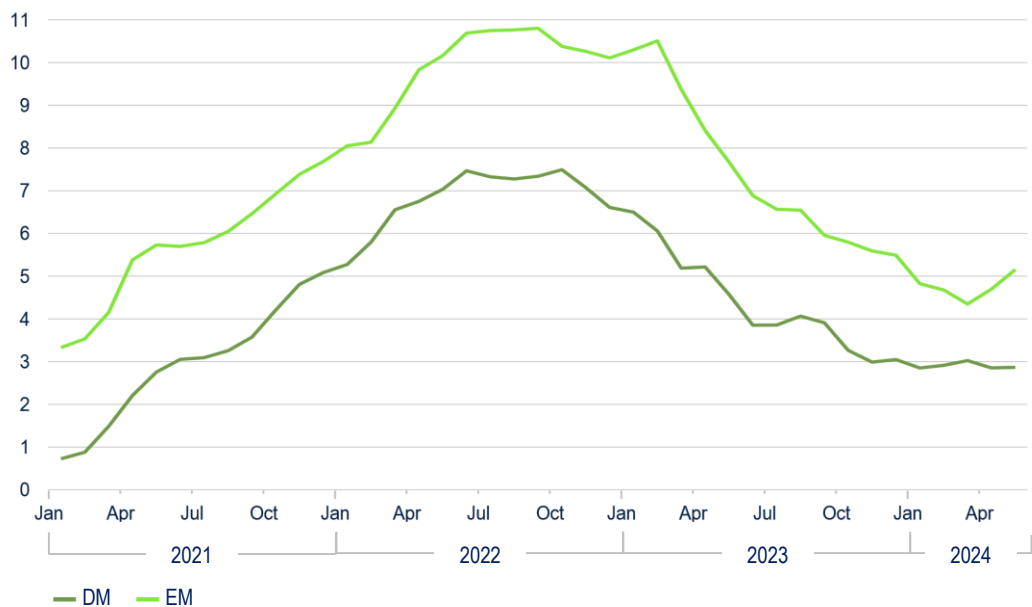
Source: Macrobond as of May 2024.

Figure 9: How food and energy prices were affected by the war in Ukraine (lhs: USD/Bu) (rhs: USD/Bbl)

Source: Bloomberg, PGIM Fixed Income as of May 2024.

In this environment, the carry offered by EM hard currency is clearly attractive and our expected macro-scenarios bode well for forward looking returns.

Therefore, we reduced our local rates exposure in 2021 and increased our underweight meaningfully in 2022. We also implemented long positioning in the U.S. dollar with almost 100% of our FX risk budget allocated to short EMFX/long USD positioning as we believed the Fed's hawkish stance would prompt U.S. dollar outperformance versus other currencies (refer again to Fig. 7).

The time period examples above demonstrate that the allocation between hard/local and investment grade/high yield in our blend portfolios mainly stems from our country allocation and security selection (i.e., bottom-up issue selection). When allocating, we evaluate the expected returns within the entire opportunity set and then construct our portfolios with the best combination of hard currency and local assets with the goal of generating optimal risk-adjusted returns. In hard currency, expected returns are typically driven by a country's fundamental trajectory coupled with current valuations. In local currency, expected returns are typically driven by comparisons of how monetary conditions are evolving alongside inflation and output gaps (i.e., an indication of a central bank's need to increase/decrease real policy rates) and the extent to which these factors are reflected by current valuations.

FORWARD-LOOKING PROSPECTS

With the preceding empirical observations as context, we shift our view to current return prospects for the asset classes. While the near-term market context remains cloudy due to growth concerns, the cushion and carry offered by EM hard currency debt is more apparent.
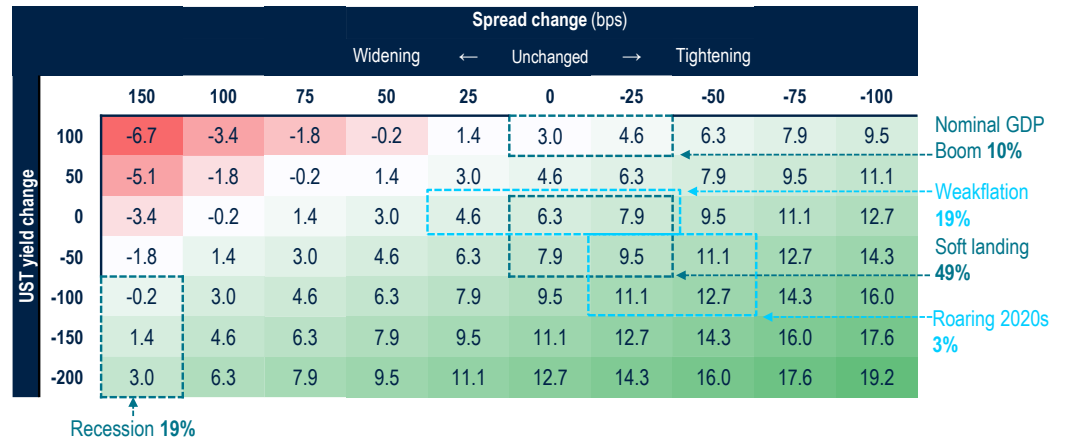
Current yields (actual cashflows generated) in hard currency sovereigns are near 6.25%. This provides a significant cushion for any near-term spread volatility or potential rise in U.S. Treasury yields. With a duration near 6.5 years, it would take over 100 bps of higher spreads/Treasury yields to erode that carry and result in negative total returns over a one-year period. Conversely, we believe just a realistic amount of spread tightening or Treasury yield compression would take EM hard currency returns into the double digits.

Importantly, our expected macro-scenarios bode well for forward looking returns. For EM, we assume a "global growth" scenario by taking a weighted average of the U.S. (35%), Europe (35%), and China (30%) to derive plausible economic scenarios that markets could price in over the next 12 months. Our base case for EM continues to call for "moderation" under which growth remains solid, inflation slowly declines, and the labor market gradually loosens. While there is wide distribution of the remaining economic scenarios, we expect returns for hard currency sovereigns to be highly positive under all but a small subset of our projected economic scenarios (Fig. 10; see our Q3 Outlook for our second-half rate expectations and economic scenarios).

Figure 10: Hard currency one-year expect return analysis (%)

	Spread change (bps)										
		Widening		←		Unchanged	→		Tightening		
		150	100	75	50	25	0	-25	-50	-75	-100
UST yield change	100	-6.7	-3.4	-1.8	-0.2	1.4	3.0	4.6	6.3	7.9	9.5
	50	-5.1	-1.8	-0.2	1.4	3.0	4.6	6.3	7.9	9.5	11.1
	0	-3.4	-0.2	1.4	3.0	4.6	6.3	7.9	9.5	11.1	12.7
	-50	-1.8	1.4	3.0	4.6	6.3	7.9	9.5	11.1	12.7	14.3
	-100	-0.2	3.0	4.6	6.3	7.9	9.5	11.1	12.7	14.3	16.0
	-150	1.4	4.6	6.3	7.9	9.5	11.1	12.7	14.3	16.0	17.6
	-200	3.0	6.3	7.9	9.5	11.1	12.7	14.3	16.0	17.6	19.2

Nominal GDP Boom **10%**
Weakflation **19%**
Soft landing **49%**
Roaring 2020s **3%**
Recession **19%**

Source: PGIM Fixed Income as of June 2024.

Within local markets, our conviction is growing that more EM central banks will be cutting rates in the second half of 2024 (Fig. 11). The disinflation process is more mature in EM than in developed markets, and EM inflation has been surprising to the downside since early 2023 (Fig. 12).
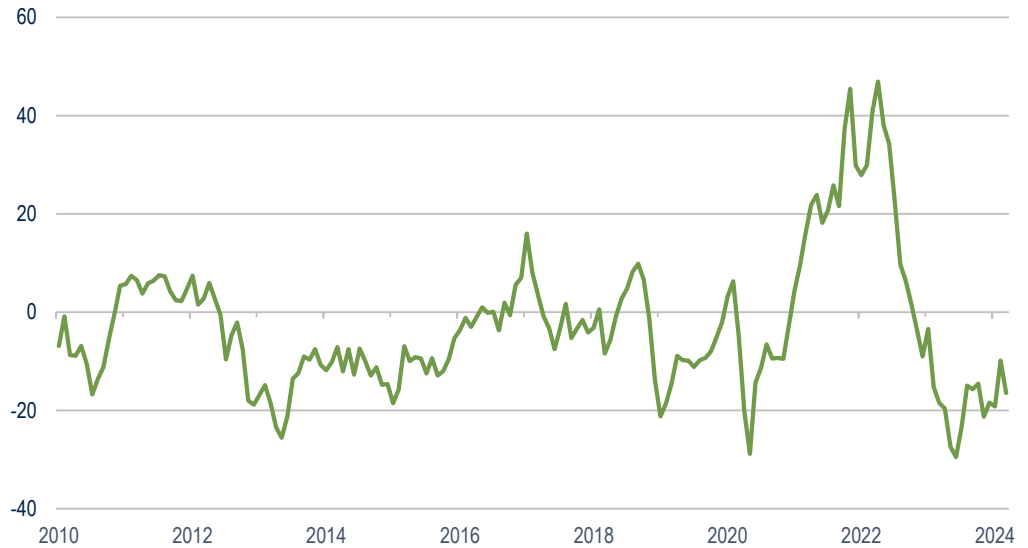
Within local markets, our conviction is growing that more EM central banks will be cutting rates in 2H2024.

Figure 11: EM central banks' policy rate decisions (number of central banks hiking, cutting, or keeping rates on hold per month; 28 total EMs)

■ Cuts ■ On hold ■ Hikes
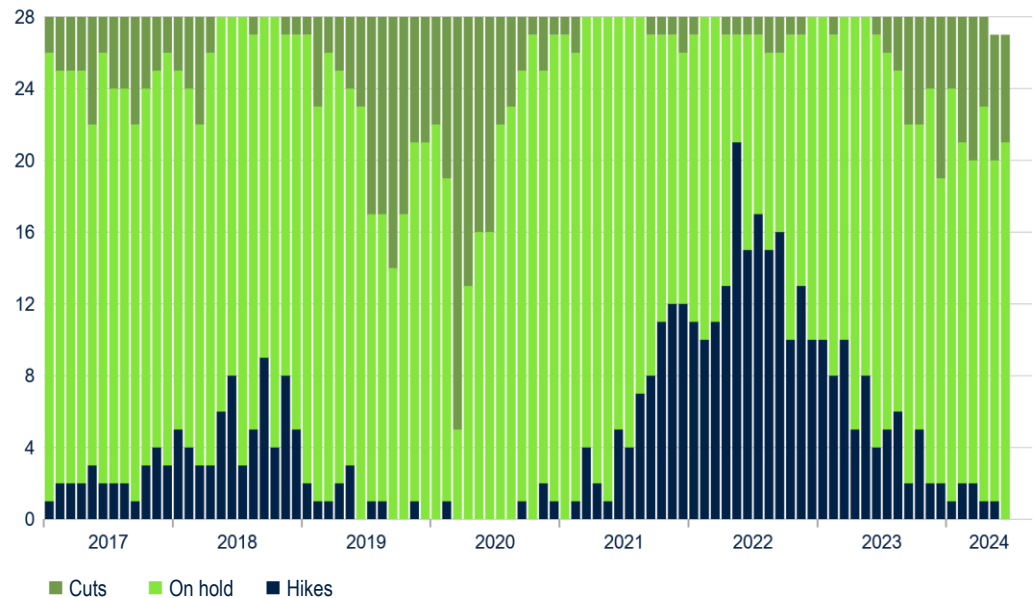
Source: Macrobond as of April 2024.

Figure 12: Citigroup Economic Surprise Index: Emerging Markets

Source: PGIM Fixed Income, Citi as of April 2024.

Dynamic portfolios are better able to successfully navigate market cycles.

At a current level of 6.60%, the yield on the local rates benchmark is still near the top end of the year-to-date range of 6.10-6.65%. If the Fed cuts rates in the second half of the year, it could provide a tailwind to the asset class.

From a bottom-up perspective, widening fiscal deficits in most EM countries and recent election surprises in South Africa, Mexico, and India present some "country selection" challenges. Based on inflation trends, we see a wide dispersion among EM central banks' policies. Brazil, Chile, Czech, and Hungary are closer to ending their easing cycle, while Mexico, Colombia, and Peru have scope to continue their easing. Asian Central Banks and South Africa are likely to wait for the Fed before cutting rates.

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In EMFX, we remain cautious and maintain long positioning in the U.S. dollar (in portfolios that have the ability to short EMFX) as the Fed appears set to take a relatively gradual approach to rate cuts. However, over the medium to longer term, we see opportunity for EM currencies to generate strong returns against the U.S. dollar as many have meaningfully repriced since 2012 (Fig. 13).

Figure 13: Local currency one-year expected return analysis (%)

		FX return								
		-10	-7	-5	-3	0	3	5	7	10
GBI-EM yield change	100	-8.4	-5.4	-3.4	-1.4	1.6	4.6	6.6	8.6	11.6
	50	-5.9	-2.9	-0.9	1.1	4.1	7.1	9.1	11.1	14.1
	0	-3.5	-0.5	1.5	3.5	6.5	9.5	11.5	13.5	16.5
	-50	-1.0	2.0	4.0	6.0	9.0	12.0	14.0	16.0	19.0
	-100	1.5	4.5	6.5%	8.5	11.5	14.5	16.5	18.5	21.5

Source: PGIM Fixed Income as of June 2024.

OPTIMAL PORTFOLIO PERSPECTIVES

At certain points in time, such as 2021-2022, the ability for dynamic portfolios to navigate market cycles involved limiting the negative impact from local markets, resulting in performance

similar to the performance of stand-alone hard currency mandates. In other time periods this will involve fully benefiting from local markets when local performance is strong. Additionally, when given the ability to short local markets (e.g., buy U.S. dollar versus EMFX and short local rates), this approach provides another potential source of alpha from local markets. The ability to short local rates (i.e., pay rates with interest rate swaps) would also provide a meaningful lever for total return and alpha generation.

Without the flexibility to short EMFX or enough tracking error to be meaningfully underweight EMFX, we believe local market exposure should be kept at a lower weight (closer to 15% or possibly 25%) within a blended mandate to reduce volatility and increase information ratios.

Additionally, we believe that allowing room for corporates (potentially to 10-20% with an issuer cap under 1% for lower rated issuers) would also increase long-term returns and diversification.[2]

CONCLUSION

The diversity of emerging markets debt and the disparity of returns across market cycles present compelling opportunity sets for many investors. Yet, these same factors can also contribute to an exercise in confusion when seeking the optimal allocations to the sector.

Considering the potential questions, this installment of our emerging market series aims to chart a path for establishing or adjusting exposure to EMD. Our analysis of asset class attributes, experience of adjusting exposures depending on economic and market conditions, and identification of pertinent market cycles lends itself to a blended approach when allocating across EM debt, thus providing the needed flexibility to remain opportunistic while cutting through the confusion as the Next Chapter in EMD opens.

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[2] *We suggest an issuer cap on high yield corporates because, while they do have solid information ratios, recovery values in EM corporates tend to be lower than other markets. Therefore, a limit on high yield issuers is recommended to best keep downside under control.*

APPENDIX

While many readers will be familiar with emerging market debt asset classes, some will not. Therefore, we've included summary definitions of hard and local assets.

HARD CURRENCY

Hard currency sovereigns: debt issued by a sovereign government in a hard currency, mainly U.S. dollars and governed by the law of a foreign country–typically the U.S. Like any credit instrument, the return consists of a duration (or U.S. Treasury) component and interest payments, as well as potential for price appreciation or depreciation due to spread tightening or widening based on perceived credit risk. The most commonly used index to track hard currency sovereigns is the JPMorgan EMBI Global Diversified, which tracks the performance across 69 countries.

Hard currency corporates: debt issued by a corporation in a hard currency, mainly U.S. dollars and governed by the law of a foreign country–typically the U.S. Just like hard currency sovereigns, this is a credit instrument, and the return consists of a duration (or U.S. Treasury) component and interest payments, as well as potential for price appreciation or depreciation due to spread tightening or widening based on perceived credit risk. The most commonly used index to track hard currency sovereigns is the JPMorgan CEMBI Broad Diversified, which tracks the performance of corporates across 58 countries.

LOCAL CURRENCY

Local currency sovereigns: debt issued by a sovereign government in its own currency and typically governed by its own legal system. Similar to a U.S. Treasury Bond or German Bund, local currency sovereigns are interest rate products and carry the currency risk of the issuing government's currency–this risk can be hedged or not. The most commonly used index to track local currency sovereigns is the JPMorgan GBI-EM Global Diversified, which tracks local currency sovereign performance across 20 countries.

EM currencies (EMFX): currencies of emerging market countries. These are traded directly in the FX market, typically using currency forwards.

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