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Chief Investment Office GWM
Investment Research

Demystifying emerging market bonds

Weekly - Regional View Emerging Markets

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UBS Trending: EM bond market provides opportunity? For more on our latest views on this topic, watch this short video.

Some investors still believe emerging market bonds are too risky, subject to a high likelihood of default and therefore unsuitable for buy-and-hold portfolios. While this view might have held true several decades ago—and might still apply to certain individual issuers today—the emerging market bond asset class has greatly matured and we think looks set to deliver attractive volatility-adjusted returns in the coming years.

Not your grandpa's asset class

The birth of the asset class can be traced back to the restructurings of 1970s-era commercial bank loans into modern-day bonds on the back of the Brady plan. When emerging market bonds were first issued in international markets in the late 1980s and early 1990s, not even 3% of the countries issuing such securities were rated investment grade; that number has since grown to over 50% (Fig. 1).

In addition, the investment universe has expanded dramatically in recent years, offering greater depth of choice to investors along with diversification benefits. Just two decades ago, a total of 30 emerging market countries had bonds outstanding in global markets of sufficient size and liquidity, but over 70 do today. Perhaps more impressively, just 53 companies domiciled in the emerging world issued large and liquid international bonds back then. The number has ballooned to over 700 since (Fig. 2).

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The domain of emerging market bonds is also distributed much better geographically nowadays. While 20 years ago most issuers came from Latin America and Asia, the representation of countries and companies from Europe, the Middle East, and Africa has grown substantially and investors today are able to allocate capital across regions with ease.

An investment portfolio workhorse

Hand in hand with the above-described evolution, the performance of US dollar-denominated emerging market bonds over the last 20 years has been solid—not just in total return terms, but also adjusted for volatility (Fig. 3).

Investment returns during the period have been supported by the asset class's spread over US Treasury bonds, and have accrued in the context of low-single-digit default rates in any given year as a percentage of outstanding notional, except for a brief spike to high-single digits during the COVID pandemic. Emerging market local currency bonds, in turn, are a less well-diversified asset class, and it can be argued have yet to reach the level of maturity of their US dollar counterparts. These lag in terms of investment performance during the same period.

Clipping the coupon

Emerging market USD-denominated bonds currently offer appealing interest rates of between 7% and 8%, as per the JPMorgan CEMBI and EMBI Diversified indices, which attempt to track the universe of corporate and sovereign bonds, respectively.

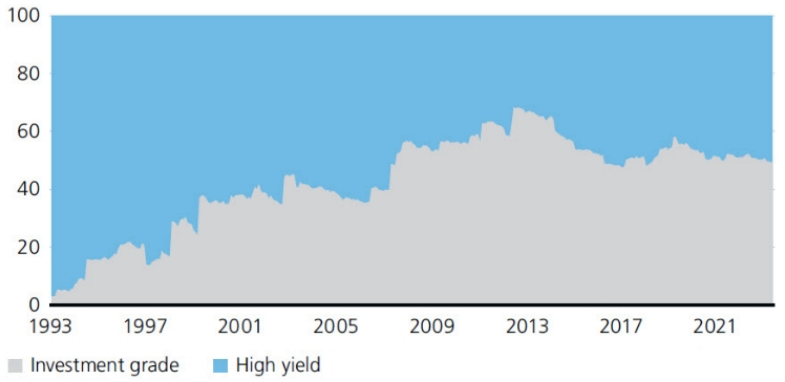
While yield levels are attractive, the spreads these bonds offer over US Treasuries are fair, in our view. We expect emerging market bond spreads to trend sideways over the next 6–12 months, allowing investors to collect high-single-digit returns during the period. Risks to the outlook include renewed US recession fears and a flare-up of geopolitical tensions.

For near-term opportunities within the asset class, Latin American corporate debt is a space worth highlighting. The issuers we cover include industry and sector champions of global scale, with sound credit metrics and strong corporate governance standards. We favor large industrial and agricultural commodity producers, geographically diversified steel and cement producers, logistics operators, telecommunication services providers with a continental footprint, systemically important banks, and aircraft makers.

Looking further out, we believe emerging market US-dollar-denominated sovereign and corporate bonds should be able to deliver average annualized returns of close to 6% over the next business cycle, with an annualized volatility of between 9% and 10%. This compares well to expected returns in developed markets' fixed-income segments and justifies a long-term allocation to the asset class, in our view.

Figure 1 - Majority investment grade

Share of emerging market sovereign bonds rated investment grade, %



Bloomberg, UBS, as of June 2024

Figure 2 - Very well diversified asset class

Number of countries and corporate issuers represented in each index

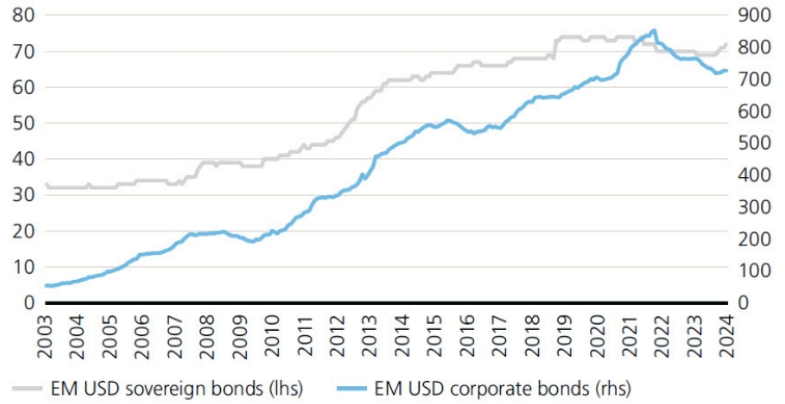


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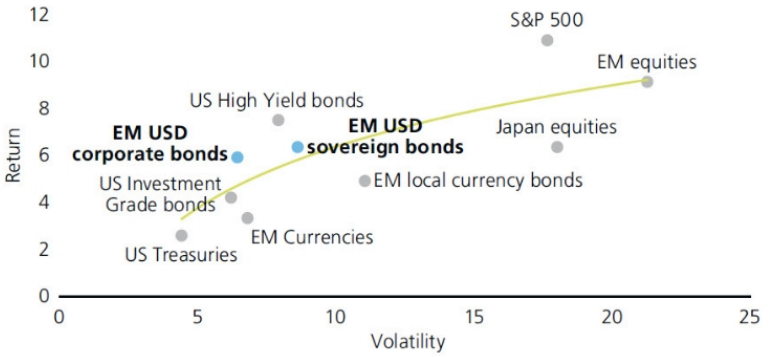
Figure 3 - Attractive risk-adjusted returns

Annualized return (vertical axis), annualized volatility (horizontal axis), 2003-today, in %



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