

Investors have fled Emerging Market Debt (EMD)

We believe a compelling investment opportunity remains.

Recent outflows from EMD may be attributed to recession fears, the U.S. dollar's extended rally and global geopolitical tensions. Despite these headwinds, we view EMD as an exceptional investment opportunity. EMD's strong fundamentals, appealing valuations and the diversification it offers within a portfolio make it a compelling consideration for investors.

What can EMD offer investors?

EMD can offer a yield pick-up relative to developed market bonds, and it can provide strong diversification benefits relative to traditional investments due to its low correlation with global equities.

Structurally, the outlook for EMD is improving. Many emerging market central banks are now more independent and responsive to inflation, with some well underway in the rate-cutting cycle. Additionally, banks in these regions have strengthened their balance sheets and have adopted stronger macroprudential frameworks. From a valuation perspective, emerging market corporate leverage is considerably lower than in the U.S., yet spreads remain wider, presenting attractive opportunities.

EMD recently has stronger fundamentals and more attractive yields than its U.S. counterpart

	Investment Grade			High Yield		
	Leverage ratio	Yield to Worst (%)	Spread (bps)	Leverage ratio	Yield to Worst (%)	Spread (bps)
EMD	0.9x	5.11	153	2.3x	7.54	422
US	2.7x	4.72	89	3.4x	6.98	303

Sources: Leverage ratios: J.P. Morgan, Bloomberg Finance L.P., CapitalQ as of December 31, 2023 (excludes 100% quasi-sovereigns, financials, real estate and defaulted companies). U.S. Yield to Worst and spread data: Credit Suisse Indices, UBS, Bloomberg, ICE BofA Merrill Lynch as of September 30, 2024. EMD Yield to Worst and spread data: J.P. Morgan as of September 30, 2024.

Investing in EMD is not straightforward, with some opportunity sets shrinking and certain regions becoming less attractive in terms of valuations. However, significant opportunities remain within EMD, particularly for specialist managers with extensive regional expertise. These managers can bypass “tourist investors” and can access exclusive deals that only long-term relationships and local knowledge provide. In practice, this approach led to one of our preferred regional specialists securing a refinancing deal with a top regional airline before international investors were able to participate.¹

Where should investors focus today?

In today’s market, we believe investors should focus on tapping into skilled EMD managers who can identify value that will drive long-term performance. Given that certain areas of EMD are becoming increasingly crowded, we advocate for a barbell strategy that balances risk and return. This involves investing in

highly skilled regional EMD specialists alongside broader core EMD exposures, allowing us to seek opportunities across both hard and local currency markets. We remain highly selective with local currency exposure due to the additional volatility and challenges it can present.

In a time of outflows from EMD, our specialist approach stands out. It is less impacted by “tourist investors” and allows us to access exclusive and often overlooked opportunities within EMD. This targeted strategy helps us uncover more compelling investment stories to navigate the credit market effectively.

To learn more about credit capabilities at WTW please contact us [here](#).

¹This is a sample representation of our work with an investment manager. Outcomes may vary and there can be no guarantee of similar results.

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