

# THE CASE FOR EMERGING MARKETS CORPORATES

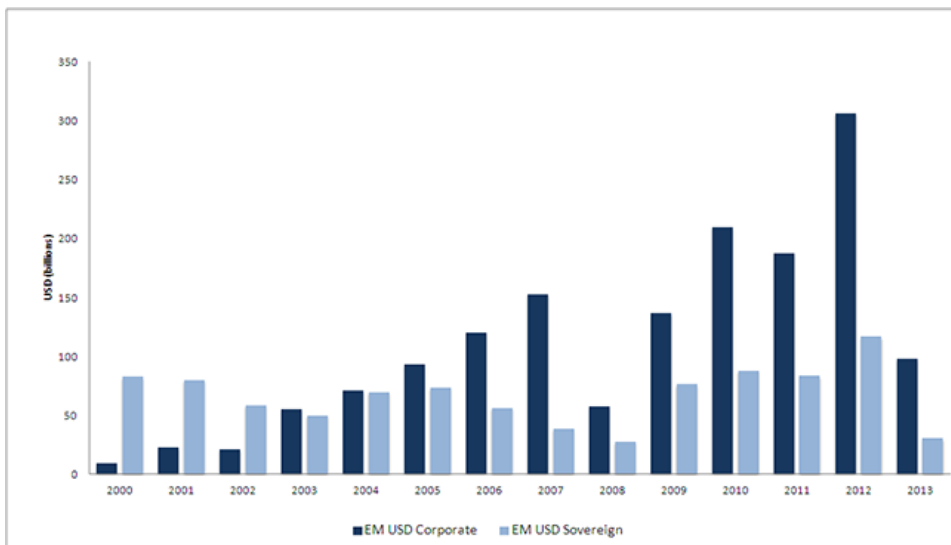
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If bond investing was a specific major available at colleges and universities, the curriculum could start with a 101 class on U.S. Treasuries. That would serve as the prerequisite for moving on to more advanced fare, such as corporates, municipals, high-yield and international bonds. Until recently, an investor’s basic bond education could be deemed “complete” without any knowledge of emerging markets corporates.

That is changing, and that could be a good thing. Given the popularity of [emerging markets \(EM\) sovereigns](#), both the dollar-denominated and the local currency variety, it might be a stretch to think developing world corporate bonds could become an even more attractive asset class. At the very least, dollar-denominated EM corporates represent a larger asset class than their dollar-denominated sovereign counterparts.

In 2012, over \$300 billion in dollar-denominated EM corporates were issued, or nearly triple the amount of dollar-denominated EM sovereign debt. That trend is continuing this year, with nearly \$100 billion in dollar-denominated EM corporates being issued in the first quarter alone – more than triple the amount of dollar-denominated sovereign bonds.<sup>1</sup>

U.S. dollar Denominated Emerging Market Debt Issuance



Source: JP Morgan. As of March 2013.  
 EM USD Sovereign represented by JPMorgan EMBI Global Index.  
 EM USD Corporate represented by JPMorgan CEMBI Broad Index.  
 Past performance is not indicative of future results.

## Higher Yields, Lower [Duration](#)

Average yields on emerging markets corporates are attractive—4.62% as of late March, up from 4.55% at the end of 2012 and far superior to what investors will find with the [Markit iBoxx USD Liquid Investment Grade Index](#).

Boilstering the case for developing world corporate bonds are lower durations compared to government debt. The average duration of emerging markets government debt, a measure of sensitivity to interest rate movements, was 7.05 years, compared with 5.23 years for

corporate securities, according to Bank of America.<sup>2</sup>

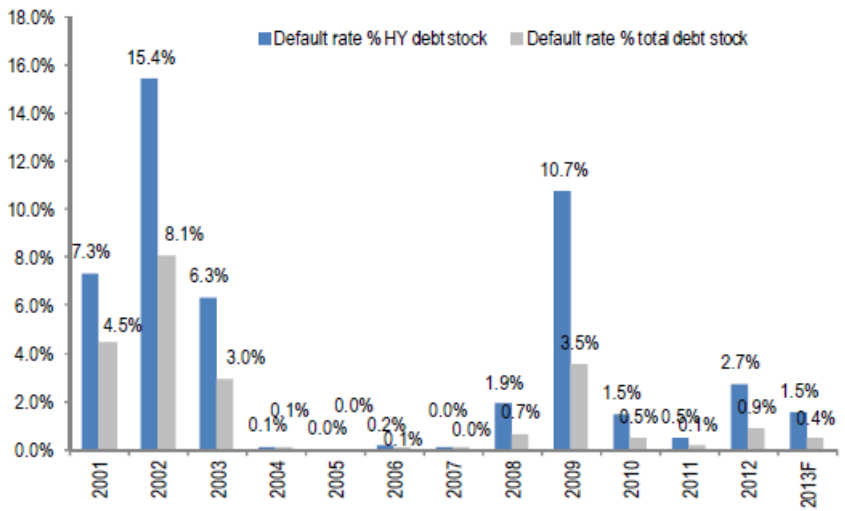
**Defaults: Not What One Might Expect**

Surely the alluring combination of low durations and high yields must come at a cost, for example, increased default risk, right? Not necessarily. As the chart below indicates, the number of emerging markets corporate bond defaults among financial services issuers, both investment-grade and junk, have dwindled since the financial crisis.

At the regional level, Asia, which saw a spike in corporate defaults in 1998–1999 due to the region’s debt crisis, may now look attractive. In 2011, there was not a single default by an Asian EM corporate issuer. In fact, the only region that saw corporate defaults that year was EEMEA (Eastern Europe, Middle East and Africa).<sup>3</sup>

Believe it or not, emerging markets corporates usually have lower default rates than their developed world equivalents. Last year, the corporate default rate in emerging markets rose from 0.33% to 1.43%, but the overall trend is lower and a reversal of that trend should be seen this year due to transformed credit quality at the corporate and sovereign levels along with improved corporate fundamentals.

**EM Corporate Default Rate History**



Source: J.P. Morgan estimates  
Past performance is not indicative of future results.

Ultimately, emerging markets corporates are not just a growing asset class, but they are also of growing importance to investors looking to establish well-rounded fixed income portfolios while maintaining exposure to potentially higher yields and tempering duration risk.

<sup>1</sup>Source: JP Morgan. As of Mar 2013. <sup>2</sup>Source: Bloomberg, “Emerging Market Debt Posting Worst Start Since 1995,” 3/28/13. <sup>3</sup>Source: Standard & Poor’s 2011 Inaugural Emerging Markets Corporate Default Study and Ratings Transitions.

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## DEFINITIONS

**EM USD Sovereigns**: Debt denominated in U.S. dollars issued by emerging market governments.

**Duration**: A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

**Markit iBoxx USD Liquid Investment Grade Index**: Designed to provide a balanced representation of the USD investment-grade corporate market and to meet investor demand for a USD-denominated, highly liquid and representative investment-grade corporate index.

**Investment grade**: An investment grade is a rating that signifies a municipal or corporate bond presents a relatively low risk of default.

**Junk Bond**: A high-yield or non-investment grade bond. Junk bonds are fixed-income instruments that carry a rating of 'BB' or lower by Standard & Poor's, or 'Ba' or below by Moody's. Junk bonds are so called because of their higher default risk in relation to investment-grade bonds.