EMERGING MARKET FIXED INCOME: FOCUSING ON FLOWS

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2013 was not a good year for performance in emerging markets (EM), emerging market fixed income or fixed income in general, outside of U.S. high yield. Interest rates rose, EM currencies generally weakened against the U.S. dollar, and investors were more upbeat about prospects in the developed world than those in the emerging world. While we will provide a more in-depth analysis of specific emerging markets in an upcoming blog post, we thought it might be useful to put 2013 in context of money flows to potentially understand where the market is positioned at the beginning of 2014. Simply put, when there are more sellers than buyers, prices tend to fall. At the most basic level, flows can be a driver of asset prices. According to J.P. Morgan, in 2013 flows into emerging market fixed income occurred at the slowest pace since the global financial crisis. All told, only $9.7 billion flowed into dedicated emerging market fixed income strategies last year, well below the $40 billion historical average run rate[1]. On the WisdomTree front, the Asia Local Debt Fund (ALD), Emerging Markets Local Debt Fund (ELD) and the Emerging Markets Corporate Bond Fund (EMCB) had net inflows of only $84 million[2]. However, some interesting and noteworthy trends emerged in 2013 for the asset class. The wide-scale redemptions of emerging market debt generally occurred from retail investors ($9 billion in outflows), whereas many institutional clients took advantage of the increase in relative yields to reduce structural underweights to EM debt. All told, institutional accounts accumulated an estimated $20 billion of emerging market debt in 2013[3]. In spite of the disappointing 2013 performance, there were a few additional bright spots that emerged from the emerging markets. Emerging market corporations came to market last year with a new record annual issuance of $359 billion[4]. Again, it was predominantly institutional investors that were taking down this record supply. In a trend we noted previously, we believe that the emerging market corporate asset class is only in the very early stages of adoption for many fixed income investors. In our view, a large number of emerging market corporate issuers took advantage of some of the lowest borrowing rates in their history to lock in financing last year, putting them on a much stronger footing to start 2014. J.P. Morgan projects that in 2014, net financing needs for EM corporations will fall 39%, to $143 billion[5]. **Emerging Markets Fixed Income**

	JPM CEMBI Broad EM Corporates	JPM EMBI Global USD Sovereigns	JPM GBI-EM Global Diversified Local Currency Sovereigns
2013 Flows (USD billions)	$4.8	($6.1)	$11.0
Total Dedicated Assets Against Benchmark	$63.0	$293.0	$217.0
2013 Dedicated Asset Growth Rate	32.2%	0.0%	11.4%
Market Size (USD billions)	$716	$586	$930
Yield to Maturity (%)	5.87%	6.10%	6.85%
Duration (years)	5.32	6.82	4.62
Investment Grade % of Universe	69%	73%	91%
Trading Volume (2012)	750 billion	996 billion	3.726 trillion
Currency Denomination	USD	USD	Multiple

Sources: J.P. Morgan, WisdomTree; as of 12/31/13. Subject to change. Past performance is not indicative of future results. You cannot invest directly in an index.

EM corporate debt is proxied by the JPMorgan Corporate Emerging Market Bond Index – Broad, EM USD sovereign debt is proxied by the JPMorgan Emerging Market Bond Index – Global, and EM local currency sovereign debt is proxied by the J.P. Morgan Government Bond Index – Emerging Market (GBI-EM) Global Diversified.

Overview

For definitions of indexes in the chart, please visit our [Glossary.](#) Looking to the year ahead, we believe that many of the same elements that drove 2013's increased adoption of emerging market credits may hold. Namely, improving issuers' credit profiles, shorter duration than EM USD sovereigns and attractive yield levels (read previous blog post here). Even though U.S. interest rates are currently forecast to rise this year, positioning in emerging market corporate debt tends to be much lighter than other fixed income sectors[6]. We believe that as developed world growth continues, many of the large, multinational EM corporations will stand to benefit. From a valuation perspective, investment-grade-rated EM issuers now have yields more in line with single-B-rated issuers in the U.S. and Europe[7]. While total returns may be dampened on account of rising U.S. interest rates, we believe that EM corporates are currently attractively priced against other similar credit quality assets. [1]Source: J.P. Morgan, as of 1/8/14. [2]Sources: WisdomTree, Bloomberg; as of 12/31/13. [3]Source: J.P. Morgan. [4]Source: J.P. Morgan. [5]Joyce Chang, "Emerging Market Outlook and Strategy," J.P. Morgan, 1/8/14. [6]Source: J.P. Morgan, as of 1/8/14. [7]Sources: J.P. Morgan, Standard & Poor's; as of 1/8/14.

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You cannot invest directly in an index.

DEFINITIONS

Interest rates : The rate at which interest is paid by a borrower for the use of money.

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.

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

Single-B-credit rating : represents the middle level of a highly speculative credit risk according to Standard & Poor's and Fitch. This level represents borrowers that are more vulnerable than BB rated issuers, but still currently have the capacity to meet its commitments.