RBC Global Asset Management

EM Unconstrained: Volatility behind and return ahead?

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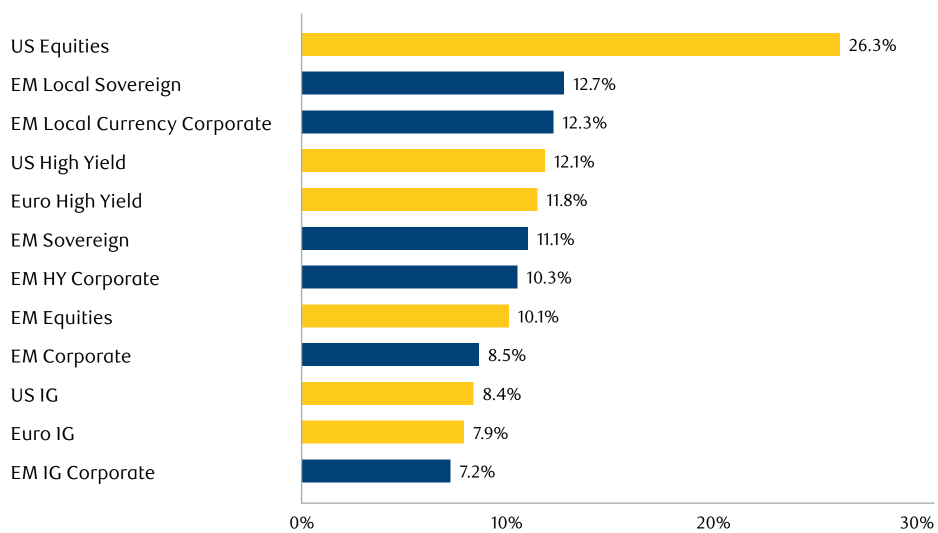
Markets ended the year on a strong note, on expectations that inflation will continue to trend lower, and with that, the Fed would soon begin to cut interest rates.

This led to a strong rally in core rates in December, reviving investor appetite for risk. In emerging markets ("EM") specific-news, Turkey inflation came in at 3.3% which was below expectations and a welcome surprise for the CBRT as it comes towards the end of its hiking cycle. On the other hand, Colombia and Hungary central banks cut rates in December, highlighting the divergent monetary policy that is already in play on in EM.

Meanwhile, in Argentina, the Milei administration took office with Finance Minister Caputo and BCRA president Bausili, two of the key figures responsible for implementing a shock-and-awe economic adjustment that seeks to tame the threat of hyperinflation and reset the multiple imbalances in the economy.

EM local currency assets outperformed hard currency credits in 2023



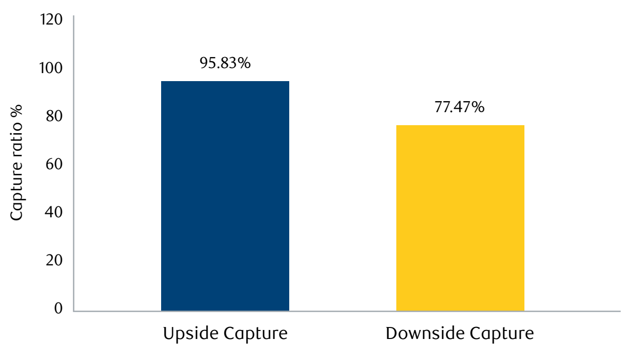
Source: Bloomberg, as at December 31, 2023.

Our EM unconstrained bond strategy did particularly well against a volatile market. During a very difficult 2022, the strategy returned -8.49% (compared to -14.74% in the reference blended index[1]), which is significant downside protection.

In 2023, the strategy generated 17.27% for the year. Latin America was the strongest region in December, and overall the year's winner, led by Colombia, Brazil and Mexico.

This return profile is consistent across various time periods and business cycles. On a trailing 3-year basis, which includes the period of Covid stress as well as market dislocation in 2022, the strategy has captured on average 95.83% upside, while capturing only 77.47% of the downside.

Upside/Downside Capture trailing 3 years



Source: RBC GAM, as at December 31, 2023. Inception date August 1, 2010.

The four strategic pillars

The strong performance of this strategy relates to the four key pillars of design.

1. Flexibility

The strategy is designed to be highly flexible with the ability to hold up to 100% in EM hard currency sovereign or local currency sovereign assets. More importantly, the strategy has the flexibility to be 'net short' EM FX if we expect the market to sell off and the US dollar to strengthen.

> **"The strategy is designed to be highly flexible with the ability to hold up to 100% in EM hard currency sovereign or local currency sovereign assets."**

A. Top-Down Asset Allocation: In 2023, we correctly forecasted that the EM sovereign asset class was past its peak in default risk. As a result, we felt relatively constructive on the stressed and restructuring candidates, knowing that most of the bad news was in the prices. In countries such as Turkey, which is subject to high political volatility, we purchased low cash price long-dated bonds but hedged them with short-dated CDS ahead of the general election in May. This strategy worked out as we came into May and June last year. The vast majority of the EM sovereign credit allocations performed very well during this period.

Top 10 issuers: EM Hard Currency Contribution

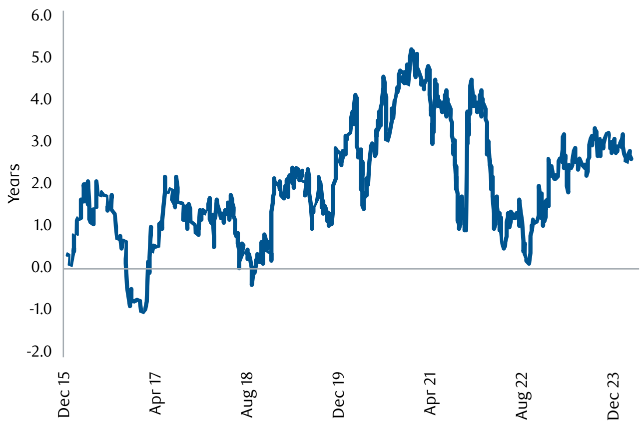
Country	Total (bps)
Venezuela	244.56
Argentina	202.26
Ukraine	163.94
El Salvador	112.30
Brazil	110.25
Tunisia	92.08
Mexico	90.15
Pakistan	88.10
Romania	66.84
Colombia	64.80

Source: Pi, an internal RBC GAM system, as at December 31, 2023.

[1] The blended reference index is 50% JPMorgan EMBI Global Diversified Index and 50% JPMorgan GBI-EM Global Diversified Index.

B. Local currency interest rate duration: We had particularly high conviction in local rates during this period. This was due to EM central banks being ahead of the curve in terms of following an orthodox monetary policy framework, which saw inflation either stabilising or starting to come down in a number of countries. In the portfolio, we took EM local currency rates exposure to the highest level in over a year, as can be seen from the below chart. This bias to long local rates duration contributed in excess of 670 basis points (bps) for FY 2023.

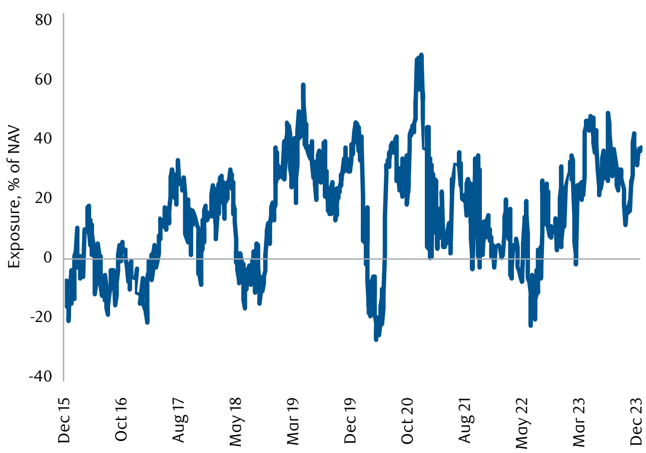
Local interest rate duration (years)



Source: Bloomberg as at December 31, 2023.

C. EM FX: We have managed to remain highly tactical in EM FX and this has worked well for the portfolio. As can be seen from the chart below, we were briefly 'net short' EM FX during August 2022, and this helped protect some downside as EM suffered from a loss of confidence from investors. Coming into this year, however, we increased FX exposure but then took profits. FX allocations contributed to in excess of +100bps to portfolio performance for FY 2023.

FX delta (+1%) (exposure, % of NAV)



Source: Bloomberg, as at December 31, 2023.

2. Systematic hedging in the portfolio

Due to a reasonably constructive view on the asset class, we had a relatively limited amount of macro hedges in the portfolio. Some of these, especially the put options on equity indices were used as a tail risk hedge, which detracted slightly from performance. Many of our hedges were idiosyncratic and implemented through CDS such as in Argentina or Turkey.

3. High conviction, high concentration portfolio construction

In a previous paper we had argued that one of the key shortfalls of a total return strategy managed on a more 'benchmark proxy' basis is that it systematically falls short in capturing the upside fully in a rallying market and indeed struggles to outperform during strength. Constructing a high conviction portfolio with larger positioning helps mitigate against this issue, albeit introducing slightly higher portfolio volatility as a result.

This was particularly evident in our positioning in Ukrainian warrants where we had felt the large dislocation was overdone, as well as in Tunisia where we maintained a very high conviction despite markets losing confidence. The positioning in each of these high conviction names was around 3.3-4.7%.

Key long credits

Romania
Argentina
Ukraine
Ghana
Egypt

Key 'synthetic shorts' in credit

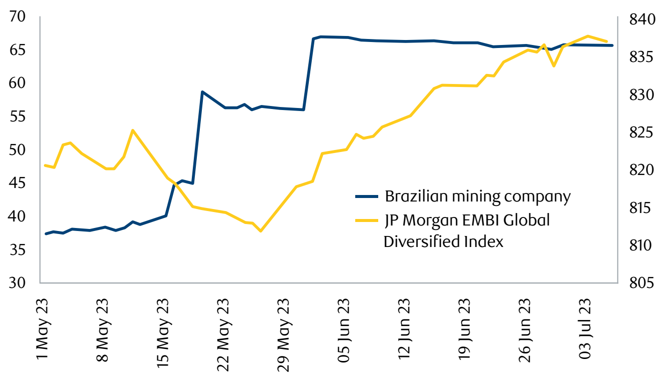
Argentina
Egypt
South Africa
KSA

Source: RBC GAM, as at December 31, 2023.

4. Idiosyncratic sources of return

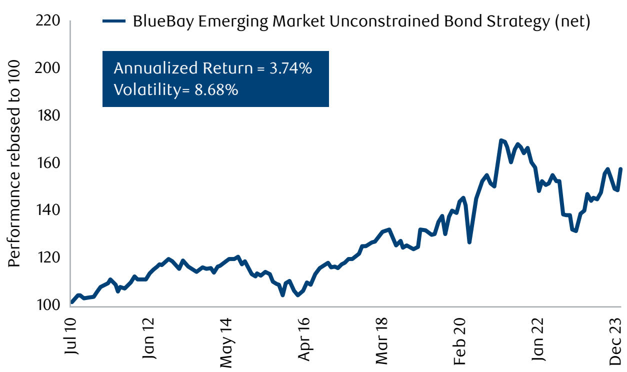
As we are active across the whole spectrum of EM fixed income, we can often find and incorporate idiosyncratic sources of return. One recent example of such a trade is a Brazilian mining compan – a distressed asset which has been suffering from poor market sentiment and had been trading in the low 30s for a while. Based on our engagement with management of the company and our assessment of recovery value, had high conviction that this trade will perform well. Coming into early May 2023, the restructuring proposal was unveiled and the bond prices rose by more than 50% in a short period of time. Notable, that during that period, the broader asset class, measured by the EM hard currency sovereign index, were actually in decline, thus the position offered uncorrelated alpha to the portfolio.This approach clearly works, not only in the short term but also in the long term.

Brazilian mining company price action against broader market



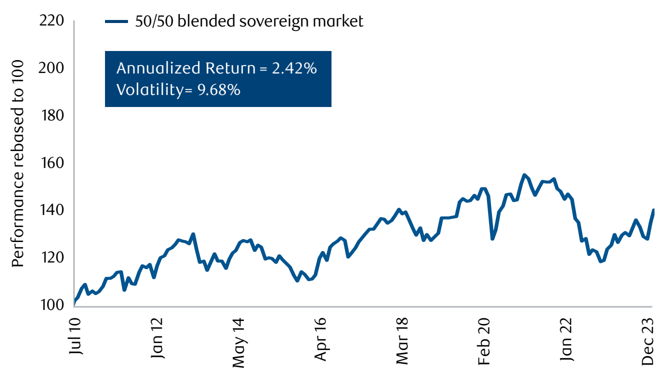
Source: Bloomberg as at June 30, 2023.

Performance EM unconstrained bond strategy



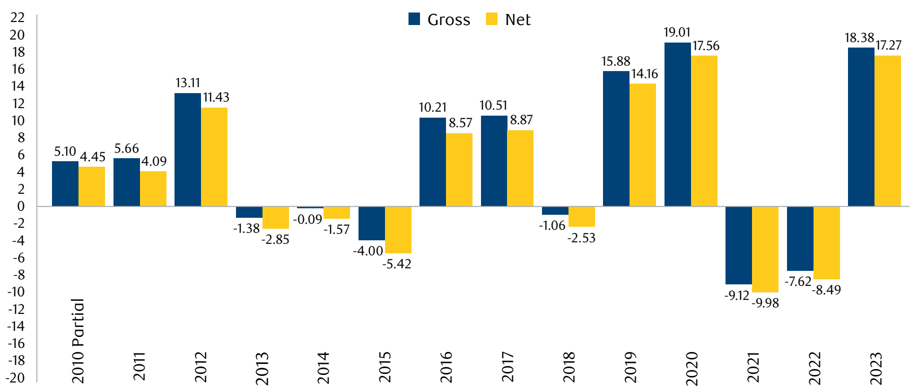
Source: RBC GAM and Bloomberg as at December 31, 2023.
This strategy is considered to be actively managed and does not have a benchmark to define the portfolio composition of the strategy or as a performance target.

50/50 blended sovereign market (monthly data series)



Source: Bloomberg, as at December 31, 2023.
The blended sovereign market is 50% JPM EMBI Global Diversified Index and 50% JPM GBI–EM Global Diversified USD unhedged Index.

Emerging Market Unconstrained Bond Strategy: annual performance (%)[1]



Past performance is not indicative of future results. The return on your investment may increase or decrease as a result of currency fluctuations if your investment is made in a currency other than that used in the past performance calculation. Fees and other expenses will have a negative effect on investment returns. For example, if there was an annualised return of 10% over a 5-year period then the compounding effect of a 0.60% management fee and a 0.20% performance fee would reduce the annualised return to 9.32% (figures used are only to demonstrate the effect of charges and are not an indicator of future performance).

Source: RBC GAM, as at December 31, 2023.

Note: [1] Strategy inception date: August 1, 2010. This strategy does not have an official benchmark and is actively managed.

Alpha sources

The return and volatility achieved over the longer period are also broadly consistent with the product design of this strategy.

Alpha source	Alpha range
Sovereign/ Corporate Credit	0-75%
Local Currency Rates	0-50%
Currency	0-50%
Term Structure	0-30%

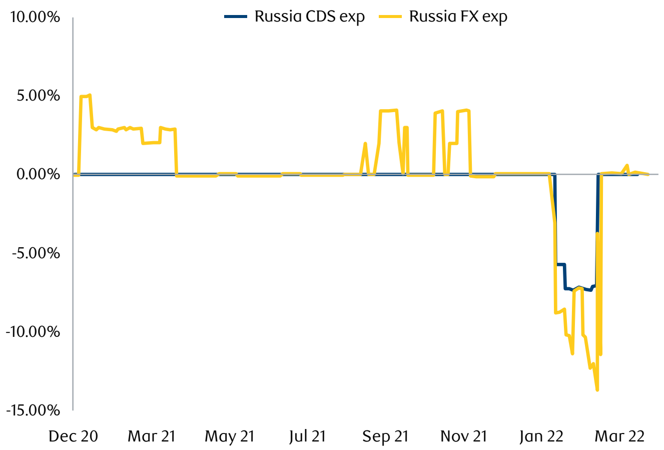
Source: RBC GAM, as at December 31, 2023.

ESG in the portfolio

This is an Article 8 strategy and therefore excludes a number of controversial issuers, including some carbon-intensive issuers, the full details of which can be found in our newsletters. In addition, the strategy also limits the amount of assets it can hold in 'very high risk' ESG issuers. However, given the total return nature of the strategy, if we have material concerns about an issuer, we tend not to hold that asset at all.

One example of this comes from the Russia-Ukraine war, which started in Q1 2022. As we had scored Russia very negatively on the ESG front, we had no Russian credit in the portfolio but instead hedged the portfolio using CDS and FX. This proved to be the right approach in terms of downside protection.

Russian portfolio exposure



Source: Bloomberg, as at June 30, 2023.

EM unconstrained in a broader portfolio context

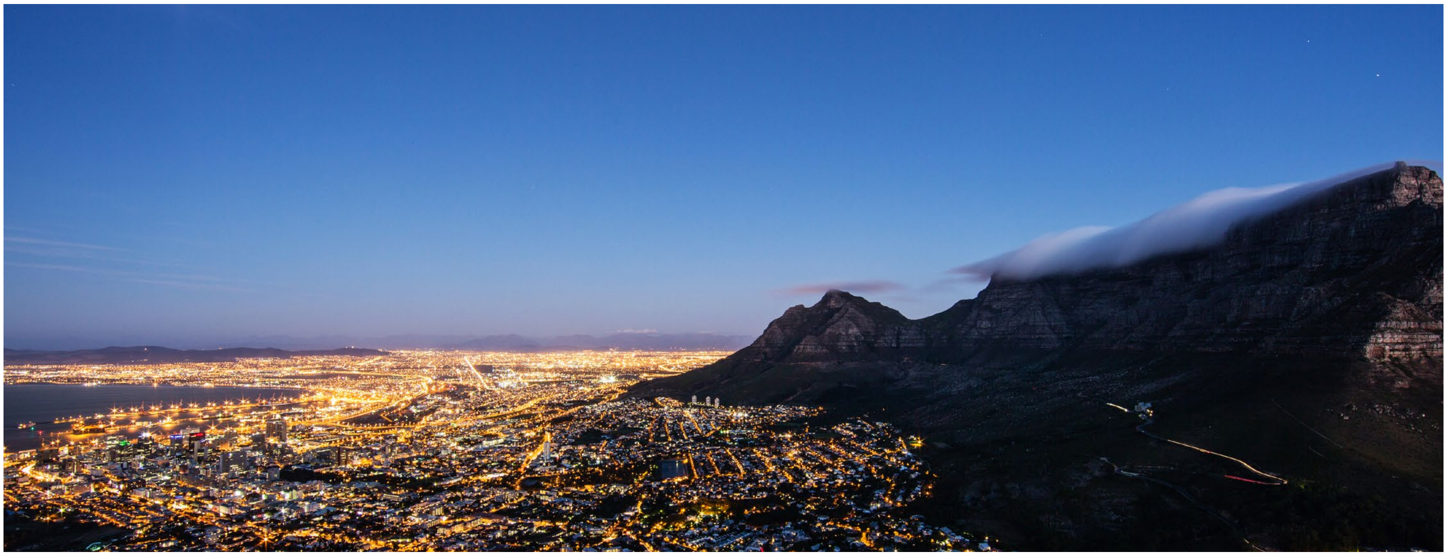
The higher return profile combined with slightly lower volatility increases the Sharpe ratio for this portfolio, which makes it a suitable allocation against other allocations in investors' portfolios.

Correlation to major indices shows that the strategy maintains a reasonably low (0.5) correlation with global government and aggregate bond indices, thus making it particularly suitable for addition in broader portfolios. It also retains a lower correlation with broader equity indices. The strategy's correlation with major EM fixed income indices runs between 0.73 to 0.78.

Correlation to major indices (since inception)

	EMU
BlueBay Emerging Market Unconstrained Bond Strategy	1.00
EM Local Currency Sovereign Index	0.75
EM Hard Currency Sovereign Index	0.78
EM Hard Currency Corporate Index	0.73
S&P 500	0.58
MSCI EM Equity Index	0.69
Barclays Global Aggregate Index	0.52
JPM Global Bond Index	0.39
MSCI World Equity Index	0.64

Source: Bloomberg, GAM, as at December 31, 2023.



The effect of adding the Emerging Market Unconstrained strategy to a portfolio

The table shows average annualised returns, volatility and inter-asset correlations over the last 13 years, based on monthly data.

Annualised returns, volatility and inter-asset correlations (%)

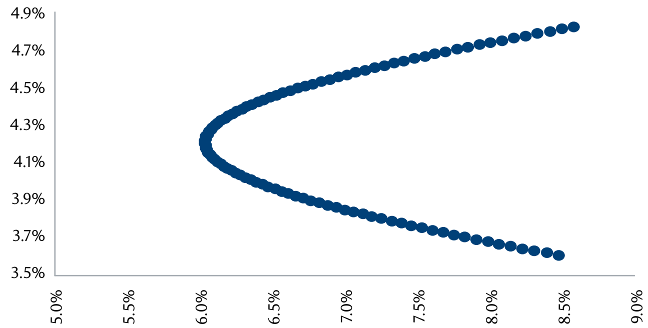
	Emerging Market Unconstrained	EMBI Global Diversified	GBI-EM Global Diversified	CEMBI Diversified
	Correlation	76.5	72.1	72.2
Volatility	9.68	8.65	11.69	6.65
Returns	3.74	3.92	0.83	4.27

Source: RBC GAM, as of December 31, 2023.
For the full performance track record since inception please refer to the charts on page 4.

We can see that the strategy has produced the highest average annualised returns (since inception). However, this has not been achieved by using higher risk, and in fact, the strategy is a volatility dampening product relative to local currency, producing comparable volatility to EM hard currency sovereign. EM corporate shows the lowest volatility. This is typically due to the slightly higher quality of the asset class, combined with lower duration. However, it is less liquid when compared to the other asset classes.

Efficient frontier between the strategy and EM hard currency sovereign

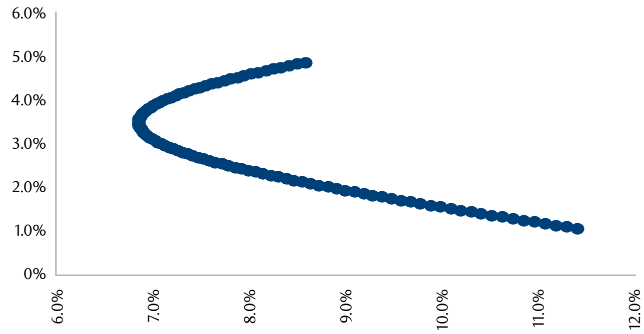
If a client only has an EM hard currency sovereign allocation at present, the chart shows that adding up to 45% of the strategy will cut volatility by nearly 25% from the 8.5% level, while boosting returns by 65bps (annualised).



Source: RBC GAM, as at October 31, 2023.

Efficient frontier between the strategy and EM local currency sovereign

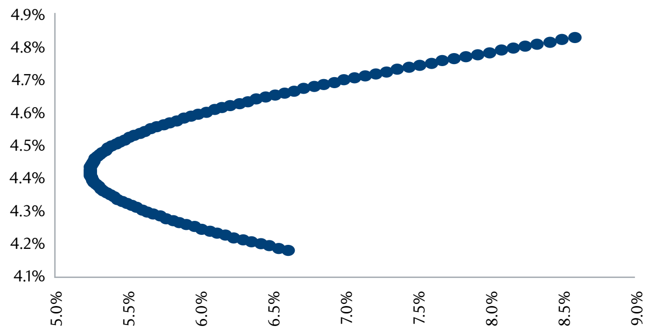
If a client only has an EM local currency sovereign allocation at present, the chart shows that adding up to 60% of the strategy will cut volatility by nearly 40% from the 11% level, while boosting returns by 200bps (annualised).



Source: RBC GAM, as at October 31, 2023.

Efficient frontier between the strategy and EM corporate

If a client only has an EM corporate allocation at present, the chart shows that adding up to 35% of the strategy will cut volatility by nearly 20% from the 6.5% level, while boosting returns by 20bps (annualised).



Source: RBC GAM, as at October 31, 2023.

Thus, we can see that the strategy is most beneficial for reducing overall portfolio volatility, if a client has either EM hard or local currency allocations.

Emerging market outlook

December proved to be another very strong month for risk assets, as core rates continued to rally sharply on market bets that inflation would continue to trend lower, and with that, the Fed would soon begin to cut interest rates. Equities also benefitted with mid-single digit gains for many indices including the S&P and the Nasdaq.

In EM-specific news, in Turkey, inflation came in at 3.3% which was below expectations and will be a welcome surprise for the CBRT as it comes towards then end of its hiking cycle. Meanwhile, in Argentina, the Milei administration took office with Finance Minister Caputo and BCRA president Bausili two of the key figures responsible for implementing a shock-and-awe economic adjustment that seeks to tame the threat of hyperinflation and reset the multiple imbalances in the economy.

"In the local markets, the index posted strong gains of 3.2% with the rates component out-performing."

In the credit space, EM credit markets were up approximately 3.1% in corporates and 4.8% in sovereigns. The rally in core rates provided a tailwind for investment grade credit, while the stronger risk tone fuelled the rally in high yield credit. In sovereign credit, the top performers were Argentina, along with sub-Saharan Africa and Egypt, while Ukraine and Venezuela continued to give back some of their recent gains. For the strategy, long positioning in Argentina was one of the main performers over the month, along with longs in Romania and Poland.

In the local markets, the index posted strong gains of 3.2% with the rates component out-performing. Latin America was the strongest region, followed by Asia which benefitted from the strong core rates rally. Top performers at the country level were Colombia, Peru and Turkey. For the strategy, our key call to be received in rates and in particular in Latin America was one of the key contributors thematically, along with long FX positions in Brazil and Mexico.

Looking forward, purely from an EM perspective, we can highlight three main trends which should support the ongoing spread compression and overall 'grinding tighter' narrative. Firstly, we note that a material dispersion is emerging between European economies and the US. Recent economic data has continued to indicate a slowdown in Europe, with inflation moderating more than expected in many parts, while the US has remained broadly stable. If European core rates rally, we could once again see a hunt for yield from European investors chasingthe high carry that EM assets offer.

Secondly, the technical factors are looking to be more supportive of the asset class, with materially lower issuance than the historical average, leading to a potential scarcity of bonds. This, combined with any positive inflow trends into the asset class, could lead to spreads holding stable, if not compressing. Thirdly, going into 2024, EM default rates are projected to come down from the high levels observed in 2022 and 2023 – in contrast with some other developed market asset classes. Moreover, in distressed assets such as Pakistan and Argentina, the likelihood of a positive outcome has increased.

Away from credit assets, however, we remain somewhat cautious on local currency assets in the shorter term. On the one hand, the rates component looks attractive in our view, especially given the monetary policy orthodoxy exhibited in many EM countries and moderation of inflation, combined with high nominal rates. However, at the same time, we think EM currencies could come under pressure sporadically in 2024 especially as it will be an election-heavy year. The US election could yet see Donald Trump returning as Republican frontrunner. This could lead to a strong US dollar and, once again, some volatility in EM currencies. Elections in individual EM countries, such as South Africa, also promise plenty of headlines which could keep currencies volatile. That said, we remain constructive on EM currencies on a medium to long-term basis.

Going into 2024, we think differentiation will be key – both from a top down asset allocation basis and a bottom up asset selection perspective. In many ways, 2024 may mirror 2023 in that returns overall will be positive, but not without material volatility.

A large, experienced team of EM sovereign and corporate specialists, with expertise spanning over two decades

Sovereign specialists

Portfolio Managers

Russel Matthews
Jana Harvey
Gautam Kalani
Gary Sedgewick
Christian Libralato
Som Bhattacharya
Anami Patel

Sovereign strategists

Graham Stock
Timothy Ash
Jo Morris
Zhenbo Hou
Malin Rosengren

Head of Emerging Markets

Polina Kurdyavko

Traders

Ben Thompson
David Watling
Deepe Raja
Mark Harrison

Institutional portfolio management

Bashir Farukh

Business operation & strategy

Ameneh Ziai

Corporate specialists

Portfolio Managers

Anthony Kettle
Brent David
Mihai Florian
Illya Zyskind
Malcolm Kane
John Shaw

Corporate strategists

Mark Agaiby
Matias Vammalle
Sven Scholze
Vanessa Stevenson
Vishal Iyer

21	**30**	**16**	**12**	**$10.7bn***	**98**
Years of track record in EM debt	Investment Professionals	Average years of experience	Unique EMD Strategies	Dedicated EM AUM* ($477m EM Unconstrained) AUM)	Research coverage countries

*As at December 31, 2023. Please note that numbers are unaudited and may be subject to change.

GIPS® Composite Report, as at December 31, 2023

Emerging Markets Fixed Income - Aggregate Unconstrained (USD)

Composite Code: BBEMB10
Benchmark: No Benchmark
Currency: USD
Inception Date: August 1, 2010

Annual returns

Year	Return, Gross Performance	Return, Net Performance	Benchmark Return	Number of Accounts at End	Dispersion of Account Returns, Equal Weighted	Composite 3 Year Standard Deviation	Benchmark 3 Year Standard Deviation	Composite Assets (millions)	Firm Assets (millions)
Aug 10 to end Dec 10	5.10	4.45	–	1.00	n/a	0.00	–	92.012	39419.237
2011	5.66	4.09	–	1.00	n/a	0.00	–	117.575	37156.560
2012	13.11	11.43	–	1.00	n/a	0.00	–	175.950	51759.755
2013	-1.38	-2.85	–	1.00	n/a	4.99	–	165.878	58393.382
2014	-0.09	-1.57	–	1.00	n/a	4.74	–	95.574	63070.579
2015	-4.00	-5.42	–	2.00	n/a	5.85	–	56.971	57228.229
2016	10.21	8.57	–	2.00	n/a	6.37	–	89.253	50154.895
2017	10.51	8.87	–	1.00	n/a	5.88	–	123.724	59472.366
2018	-1.06	-2.53	–	1.00	n/a	4.84	–	439.416	58834.614
2019	15.88	14.16	–	1.00	n/a	6.78	–	389.162	60821.937
2020	19.01	17.56	–	1.00	n/a	12.08	–	645.648	75100.000
2021	-9.12	-9.98	–	3.00	n/a	13.05	–	675.908	78000.000
2022	-7.62	-8.49	–	4.00	n/a	13.52	–	710.749	64300.000
2023	18.38	17.27	–	4.00	n/a	10.79	–	692.201	427022.837

Past performance does not guarantee future results. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

1 Ex-post risk statistics based on monthly frequency data. If not enough data points are available, risk stat will show as 0. Ex-post risk stats are based on gross performance, unless gross data is otherwise unavailable.

Performance Disclosure: The represented performance is hypothetical and does not represent the investment performance of an account or fund that an investor is able to invest in. No representation is being made that the fund available to invest in by an investor will or is likely to achieve profits or losses similar to those shown. There are frequently sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular investment or trading strategy. There are numerous other factors related to the implementation of any specific investment or trading strategy which cannot be fully accounted for in the preparation of hypothetical performance results and all which can adversely affect trading results. **Past performance is not indicative of future performance. Derivatives trading involves a substantial risk of loss.**

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Compliance Statement: RBC GAM claims compliance with the Global Investment Performance Standards (GIPS) and has prepared and presented this report in compliance with the GIPS standards. RBC GAM has been independently verified for the periods January 1, 2002 through December 31, 2021. The verification report(s) is/are available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

Verification: RBC Global Asset Management (RBC GAM) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. RBC Global Asset Management (UK) Limited has been independently verified for the periods March 31 2002 to December 31 2021. The verification reports are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's Policies and Procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

Calculation: Composite returns are calculated using the beginning market values of the underlying portfolios. For all periods greater than 1 month, returns are geometrically linked. Returns greater than 12 months are annualized. For further information the RBC Global Asset Management (UK) Limited. Pricing and Valuation Policy document is available upon request.

Dispersion: The composite dispersion of annual returns is indicated by the performance of individual accounts representing the equal weighted standard deviation of returns. Dispersion of returns is calculated for portfolios included in the composite for the full year. Dispersion of returns is calculated using gross returns. If the field contains "N/A", the composite dispersion is not presented as it is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

Gross of fees: Gross of fees performance returns are presented before management fees, but after administrative fees and all trading expenses. Returns are presented net of withholding taxes on dividends, interest income and capital gains where applicable.

Net of fees: Net of fees performance returns are presented after management fees, administrative fees and all trading expenses. Returns are presented net of withholding taxes on dividends, interest income and capital gains where applicable.

Derivatives: The underlying portfolios may use derivatives for hedging purposes, and may also use derivatives such as options, futures, forwards, and swaps for non-hedging purposes as a substitute for direct investments, as long as the portfolio's use of derivatives is consistent with its investment objectives. Currency hedging is used primarily as a risk management tool to limit the volatility of portfolio returns and may be used tactically to enhance returns. Currency hedge ratios can range between 0-100%, depending on asset class and mandate.

Leverage: No leverage has been used in any of the portfolios contained in the composite.

Composite description: The Emerging Markets Fixed Income - Aggregate Unconstrained (USD) Composite invests in emerging market fixed income securities denominated in USD and local currencies with at least 80% of the net assets will be exposed to bonds or debt instruments issued by emerging market issuers. The composite includes portfolios that include flexible allocations across all EM sub asset classes containing both long and short positions. The short positions are only permitted via the use of financial derivative instruments only.

Creation date: The Emerging Markets Fixed Income - Aggregate Unconstrained (USD) composite was created on 20 February 2015. A complete list and description of the firm's composites and performance results are available on request.

Composite fee: Net-of-fees returns are calculated by deducting a model management fee of 7.92bps, 1/12th of the highest management fee of 95bps, from the monthly gross composite return.

Benchmark: The Emerging Markets Fixed Income - Aggregate Unconstrained (USD) composite does not use a benchmark. We believe that no benchmark that reflects this strategy exists.

Reporting currency: All returns are shown in USD.

The investments discussed may fluctuate in value and investors may not get back the amount invested. You should read the prospectus carefully before investing in any BlueBay fund. Net performance figures reflect the reinvestment of all dividends and earnings, and the deduction of fees and expenses. A description of the specific fee structure is contained in the Fund's prospectus.

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