RBC Global Asset Management

Why Emerging Market Debt for absolute return investing?

February 2025

Polina Kurdyavko
Head of Emerging Markets,
Senior Portfolio Manager

Anthony Kettle
Senior Portfolio Manager

BlueBay Fixed Income Team

> "The EM hard currency sovereign and corporates universe alone is over USD4 trillion (approximately 2-3x the size of the US HY market)."

As we head into 2025, the macro backdrop looks uncertain, with volatility showing no signs of abating. Yet for investors focusing on absolute return, this volatility can be integral to achieving strong risk-adjusted returns.

We believe the EMD universe provides a fertile opportunity set for a long/short investment strategy for the following reasons:

- **A vast – and growing – universe:** the EM hard currency sovereign and corporates universe alone is over USD4 trillion (approximately 2-3x the size of the US HY market)[1]. It is also an under-researched and evolving asset class. A universe of this size can have up to USD1 trillion of new issues each year, and these provide ongoing new opportunities.
- **A diverse opportunity set that offers return dispersion:** the 80-plus countries within the EMD universe have significant variance in economic cycles, political regimes and social make-ups, as well as a multitude of companies and sectors. The diversity of this opportunity set providesregular idiosyncratic stories with diverging and often asymmetric risk profiles. These opportunities are often best captured via long or short positions that give access to a directional view, often alongside another offsetting position. Structuring positions like this allows one to hold high conviction positions through the expected EMD volatility, ultimately giving investors more chance of success.

A summary: why long/short investors should look at the EM universe

Large, diverse opportunity set	Regular idiosyncratic stories with asymmetric risk profile
Inefficiencies in market, with frequent mis-pricing	Volatility can come from credit specific events, flows or external shocks
De-link from beta of asset class	Ability to implement physical shorts to construct trades capitalising on asymmetry
Potential to have an 'edge'	Requires significant resources and meaningful size supporting strategy

[1] Bank of International Settlements (BIS) Debt Securities Statistics, JPMorgan.

- **The EM sovereign space offers additional features not as readily available in developed markets:** due to the availability of longer dated (and therefore higher duration) bonds in the EM universe, the opportunity for larger price movements during periods of market volatility can be more meaningful. This can provide long/short investors with a multitude of ways to capitalise on alpha opportunities, by constructing directional and non-directional (or curve) trades.

  Additionally, because of the rules surrounding index inclusion in the sovereign benchmarks, even when countries are in default, they remain in the index. This continued inclusion allows for liquidity in particular issuers to remain intact, as investors explore the potential credit implications of a default story and, likewise, the potential recovery values following restructuring. For long-short investors, the ability to play these stories, which can often offer asymmetric risk-reward profiles, can be very compelling, with potential for significant price movement.

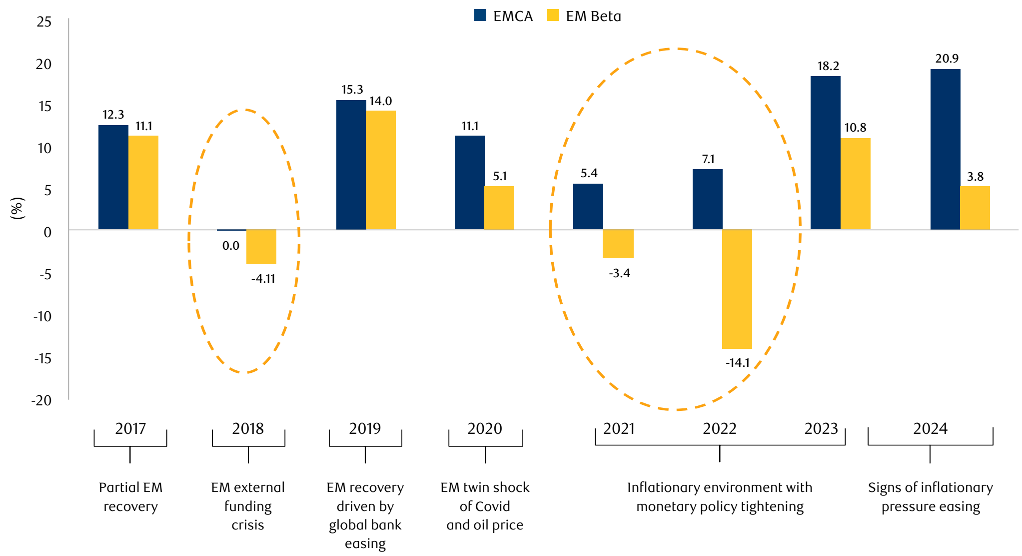
- **The ability to implement physical shorts:** derivative instruments, such as CDS, are a useful instrument for protecting positions but may not be available or have sufficient liquidity for some credits.

  Therefore, being able to implement physical cash short positions means a broader set of trades can be constructed to protect performance, as well as to capitalise on market inefficiencies or the asymmetries that often arise. Such trades can be implemented across the curve of a single credit, between credits or through outright shorts in names that are likely to deteriorate significantly or run into distress.

- **Volatility is likely to continue creating dispersion and potential mispricing of assets:** in addition to sources of dispersion and volatility within the EM universe, the global geopolitical backdrop in 2025 could also pose new questions for some EM issuers and opportunities for others. In the near term, markets are focusing on the potential implications of the agenda of President Trump's new administration. Volatility could arise due to shifts in trade dynamics, fiscal priorities, or geopolitical developments, as well as other forces, such as credit-specific events or asset flows. For those investors who are able to invest in long/short strategies, this volatility could be a key ingredient driving return dispersion and market inefficiencies, and contributing to an ongoing, attractive opportunity.

Our Emerging Market Credit Alpha Strategy

Delivering performance through the credit cycle, irrespective of market direction



Performance analysis (net of fees)	
1 Year	20.94
5 Year annualised	12.35
10 Year annualised	10.02
Net annualised returns since inception (%)	9.08
Annualised volatility since inception (%)	8.91
Sharpe ratio	0.85

Source: RBC GAM, as at 31 December 2024. Past performance is not indicative of future returns. Performance is based on net returns of the class D GBP shares of the EM Credit Alpha Fund ("Fund") (assuming a perfect hedge into USD) from 1 November 2011 to February 2012 and net returns of the class A USD shares of the Fund from March 2012 onwards. D shares are not subject to standard management and performance fees. A shares currently carry a 1.25% management fee and 20% performance fee, which until 31 March 2017 was 2% management fee and 20% performance fee. Therefore, to provide representative comparison for a typical investor, performance figures from 1 November 2011 have been modified from the historical performance figures to reflect the net returns of class A USD shares. In addition, returns from 1 January 2014 have been reinstated to include a 40bps cap fee, which came into effect from 1 August 2017. Returns from 1 November 2011 to 31 December 2013 remain unchanged as expenses remained below the 40bps cap level. The application of the expense cap was intended to allow the reader to assess the historical performance had the 40bps expense cap been applied for the entire performance period of the Fund, not just on or after the 1 August 2017, when the modification will come into effect. All historical performance, applying old fee structures, can be made available upon request. No representation is being made that the Fund will or is likely to achieve performance similar to that shown for the Strategy.

EMCA: an EM macro and credit long/short strategy for all stages of the market cycle

Our EMD long/short strategy is designed to generate positive returns irrespective of the underlying market environment. Through a skilled management team with longstanding expertise in the asset class, the strategy has successfully harnessed the volatility frequently found in the EMD opportunity set to deliver a long track record of positive absolute returns.

Key features of the strategy:

- A 'best ideas' portfolio, exploring dislocations in both corporate and sovereign EM credit, based on bottom-up due diligence.
- Alpha is targeted through a diversified set of opportunities, including relative value, new issues, event driven, and stressed trades, across the liquid EM universe.
- The team can adjust to changing market conditions due to the breadth of the investment universe, complementary set of sub-strategies, and flexible risk allocation.
- The strategy typically holds approximately 60 diversified, high conviction long or short positions.
- Focus is primarily on hard currency bonds but the strategy can also take advantage of attractive idiosyncratic opportunities in local currency markets.
- Opportunities are captured via three main alpha sources: macro, credit, and special situations/distressed investments, with a strong emphasis on liquidity and capital preservation, as well as consideration of ESG risks.

Why now?

Given the current economic and market themes, we believe the EM opportunity set is particularly compelling from a long/short perspective, as portfolios can not only benefit from tailwinds but also take proactive short views to position for some of the potential headwinds.

With volatility likely to feature in the markets in the coming months, a long/short approach to investing provides flexibility to generate positive returns regardless of market direction. Given its depth and breadth, as well as inherent inefficiencies, the EMD landscape provides the ideal environment for long-short investors to source alpha-generating opportunities.

Against this backdrop, an absolute return approach within EM credit can offer attractive returns, as well as an uncorrelated return stream for broader portfolios.

Our EMD team: a strong track record of turning volatility into alpha

EMD can be an inefficient and misunderstood asset class; we believe that achieving attractive absolute returns requires a team with significant resources and asset class expertise.

The BlueBay team has been investing in the EMD space since our inception in 2002, with over USD11.8 billion in dedicated assets under management[2]. From the outset, the absolute return focus of firm has driven the investment approach and mindset of the team.

Lead managers Polina Kurdyavko and Anthony Kettle bring complementary portfolio management skillsets and have worked together for over 17 years. They are backed by a large dedicated wider EM team of 26 investment professionals, who have an average investment experience of 19 years and cover the full universe of EM sovereigns and corporates (both hard and local currency).

We spend a considerable amount of time on the ground in EM countries conducting research and meeting with key stakeholders. Our history and deep relationships provide direct access to a broad range of sources, including politicians, policymakers, central bankers, civil servants, trade unionists, and local market participants.

We also visit companies and their facilities, and engage with management teams, suppliers, and customers. The additional insight gained from these multi-faceted dialogues is instrumental when analysing investment opportunities, particularly within EM.

Ultimately, we apply a holistic 'mosaic theory' approach to our due diligence. This is based on our belief that well-informed investment decisions in EM require an astute understanding of the interplay between the macroeconomic and corporate developments in each country, from both the bottom-up and top-down perspectives. This is the premise for our investment process and provides the foundation for our team-based approach to investing, one that integrates sovereign and corporate expertise.

Furthermore, the fact that we have a dedicated repo team, and as one of Europe's large specialist credit managers, we are one of the largest lenders of corporate and sovereign bonds, means we are in a strong position to secure borrow on credits that we are looking to short. When relevant, this enables us to express negative views.

A large, experienced team of EM sovereign and corporate strategists:

11 regional and sector specialists	**19** years of average experience	**26** investment professionals
22 years of track record in EM debt	**3** dedicated specialist traders	**9** portfolio managers
300+ Issuers	**98** countries	**12** sectors

Source: RBC GAM, as at 31 December 2024.

[2] RBC GAM, as at 30 November 2024.

This document was prepared by RBC Global Asset Management (UK) Limited (RBC GAM UK), authorised and regulated by the UK Financial Conduct Authority (FCA), registered with the US Securities and Exchange Commission (SEC) and a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC).

In the United States, this document may also be provided by RBC Global Asset Management (U.S.) Inc. ("RBC GAM-US"), a SEC registered investment adviser. The entities noted above are collectively referred to as "RBC BlueBay" within this document. The registrations and memberships noted should not be interpreted as an endorsement or approval of RBC BlueBay by the respective licensing or registering authorities.

With respect to the investment performance presented, **past performance is not indicative of future performance**. Actual account performance may or will vary from the performance shown because of differences in market conditions; client-imposed investment restrictions; the time of client investments and withdrawals; tax considerations; economies of scale; portfolio turnover; the number, type, availability, and diversity of securities that can be purchased at a given time; differences in the underlying currency of the assets in the account, and other factors. Client assets managed using these strategies in separate accounts or different vehicles may be subject to restrictions, fees or expenses that are materially different than those found in the non-US funds.

Some of the statements contained in this material may be considered forward-looking statements which provide current expectations or forecasts of future results or events. Forward-looking statements are not guarantees of future performance or events and involve risks and uncertainties. Do not place undue reliance on these statements because actual results or events may differ materially from those described in such forward-looking statements as a result of various factors. Before making any investment decisions, we encourage you to consider all relevant factors carefully.

This document is confidential and, without RBC BlueBay's consent, may not be (i) copied, photocopied or duplicated in any form by any means or (ii) distributed to any person that is not an employee, officer, director or authorized agent of the recipient.

Information herein is believed to be reliable but RBC BlueBay does not warrant its completeness or accuracy. This document contains information collected from independent third-party sources. For purposes of providing these materials to you, neither RBC BlueBay nor any of its affiliates, subsidiaries, directors, officers, or employees, has independently verified the accuracy or completeness of the third-party information contained herein.

The information contained herein does not constitute investment, tax, accounting or legal advice. Recipients are strongly advised to make an independent review with their own advisors and reach their own conclusions regarding the investment merits and risks, legal, credit, tax and accounting aspects of all transactions. Any risk management processes discussed refer to efforts to monitor and manage risk but should not be confused with and do not imply no or low risk. No chart, graph, or other figure provided should be used to determine which strategies to implement or which securities to buy or sell.

RBC Global Asset Management (U.S.) Inc.
800.553.2143 | **rbcgam.com**