



Why Emerging Markets Debt?

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Emerging markets debt is an under-researched and under-owned asset class, creating the potential for returns and diversification. In this discussion with Institutional Investor's Mike Corcoran, William Blair's Jared Lou provides his take.

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Mike: Hi, everybody. I'm Mike Corcoran with Institutional Investor. I'm joined today by Jared Lou. Jared is a portfolio manager with William Blair's emerging market debt team.

Jared, lots of opportunity in emerging market debt right now. I'm wondering if you could sort of just paint large for us why should investors be thinking about emerging market debt as an asset class.

Jared: Yeah, we like emerging market debt right now because we think it's under-owned, under-researched, and misunderstood.

Historically, emerging market debt sovereigns have defaulted about 1%, frontier markets about 1.5%, and median recovery values have been north of 50 cents on the dollar. Therefore, we think that you're more than compensated to own emerging markets debt.

Part of the reason this is the case is that emerging markets debt sovereigns benefit from a lender of last resort in the form of multilaterals and the International Monetary Fund (IMF).

This is unlike any other asset class that's out there. Not only is there a lender of last resort that could help you with financial assistance when you're in your darkest hour, but they can also help you with technical assistance to make you a better, stronger, more robust economy in the future.

I once had an old head of fixed income who told me—many, many years ago—he said, “I would never invest in a place where I couldn't bring my children on vacation.” I was a bit taken aback when he said this. I didn't know what to say. But upon reflecting upon this, many years later, I'm very thankful to having heard this because it made me realize that there are so many people that think like that.

It provides lots of opportunities for experienced fundamental investors like us to actually look at the real investment risks and returns and not be clouded by these emotions, judgments, etc. about what living in a frontier economy may be like.

Mike: So, Jared, there are some interesting opportunities in the sort of sub-asset classes of emerging markets debt—like frontier opportunities and some others. I wonder if you could talk about those a little bit.

Jared: Yeah. One of the most interesting parts of the sub-asset classes of emerging markets debt is many of them have shown similar or greater returns than global equities over the last 15 years or so with a fraction of the volatility. Frontier markets, in particular, have one of the higher Sharpe ratios out there.

Mike: Great. So let's talk a little bit about your approach at William Blair. What do you think sets you apart? What are some of the key differentiators for you when you're looking at and working with investors regarding emerging markets debt?

Jared: Our bias is to be overweight more of the high-yield part of the universe. What differentiates us from most of our competitors is we do this in a much more diversified fashion. Diversification is key to our strategy. You are more than compensated to own this part of the universe given the historically low default rates and high recovery rates.

We also incorporate a corporate overlay into our strategy. Our strategy can own up to 15% emerging markets debt corporates. What differentiates us here from the competition is the systematic and repeatable way in which we invest in emerging markets debt corporates using our spread over-the-sovereign framework, which is more disciplined than many of our peers and helps protect us from excess credit losses.

Jared Lou, CFA, is a hard currency portfolio manager on William Blair's emerging markets debt (EMD) team.

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