INVESTMENT FUNDAMENTALS

Emerging markets debt.

Emerging markets (EM) debt refers to fixed income securities (bonds) issued by developing countries. In purchasing EM debt, investors essentially lend money to corporations or governments in developing regions in exchange for interest payments that are often notably higher than those offered in developed markets. Nevertheless, there are unique risks specific to emerging markets debt in addition to standard fixed-income investment risks.

When investor purchase debt securities, they are effectively lending money to a company or government agency with the expectation of receiving full repayment of the original amount loaned plus interest over a stated period. Emerging market debt is issued either by corporations, government agencies, or governments of developing countries, such as Brazil, Russia, India, China, Mexico, South Africa, among others.

Why is EM debt attractive?

Emerging market debt offers potentially higher returns due to the greater level of risk associated with investing in rapidly growing and sometimes politically unstable countries. Moreover, its performance is not typically tied to other traditional asset classes, so investing in it may help to diversify portfolios.

What are the risks?

With any investment, there is a trade-off between risk and reward. Many people consider debt securities (also known as “fixed-income” investments because they pay a fixed rate of interest) to be safer than equity securities (stocks) because the bond market has historically not experienced as much volatility as the stock market. However, a broad risk spectrum does exist in this asset class, with debt securities ranging from very safe (U.S. Treasury bonds) to moderately risky (investment-grade corporate bonds) to highly-speculative (high-yield bonds, also known as “junk” bonds). Emerging market debt falls between investment-grade corporate bonds and high-yield bonds on the risk spectrum.

Investing in any type of bond carries some risk, such as interest-rate risk and inflation risk. However, there are additional risks specific to emerging market fixed-income investments. These include but are not limited to:

- **Political risk** — Political instability is common in developing nations as governance systems tend to be immature.
- **Liquidity risk** —Emerging market debt securities may be difficult to buy and sell quickly as the market for them is more limited when compared to developed markets.
- **Corporate credit risk** — Financial reporting and regulatory oversight can be less transparent and reliable in developing countries. Accordingly, companies may unexpectedly fold and default on debt obligations.
- **Currency risk** — Investment returns may be affected by changes in the value of both U.S. currency and emerging-market currency.

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Hard vs local?

Emerging market debt can be issued in two forms. Hard-currency debt is denominated in the widely accepted currency of a highly-developed country, such as the U.S. dollar, the euro or the British pound. Hard-currency debt is sensitive to trends in credit ratings because default is more common in this form of emerging market debt. It also offers greater access to corporate bond markets in emerging countries.

Local-currency debt is issued in a particular emerging market country's own currency, such as the Brazilian real or the Chinese renminbi. Typically issued by more advanced emerging market countries, it's driven more by inflation and monetary policy than hard-currency debt. It tends to have shorter maturities and shorter durations and is therefore less sensitive to changes in interest rates. Local-currency debt is generally more liquid and tends to have limited corporate-bond exposure.

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Important information

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice and is intended for educational purposes only. There are risks involved with investing, including loss of principal. Information provided by SEI Investments Management Corporation, a wholly owned subsidiary of SEI Investments Company. Neither SEI nor its subsidiaries is affiliated with your financial advisor.

There are risks involved with investing, including loss of principal. Bonds and bond funds will decrease in value as interest rates rise. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from social, economic or political instability in other nations.

Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume.

Diversification may not protect against market risk. There is no assurance the objectives discussed will be met. Past performance does not guarantee future results.

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