

# Emerging Market Debt: More Than Higher Yields

The merits of investing in emerging market debt have been firmly established in recent years and the asset class continues to attract significant interest and inflows. In this Q&A, Lyubka Dushanova, EMD portfolio strategist at State Street Global Advisors, considers the driving forces behind the sustained uplift in demand and what might lie ahead.

State Street Global Advisors is one of the largest managers of EMD globally with over \$38bn across hard and local currency debt and employs an indexed investment management approach.

## What has driven the growth of the EMD market in recent years? Is it more than just a search for yield?

The search for income has certainly been a factor in the increased interest in EM debt, given the ultra-low or negative policy rates in developed markets over much of the past decade. But it is more than that. The low correlation and higher growth factor exposures of EMD assets provide diversification benefits for global bond and equity investors. Furthermore, emerging economies, on average, offer stronger growth potential and lower debt burdens than their advanced counterparts.

## The active/passive debate has raged for years — what are your observations in relation to EM debt?

Traditionally, EM debt has been perceived as a complex and illiquid asset class which lends itself better to active management. However, the asset class has grown and developed significantly with liquidity notably improving. Index replication strategies have also evolved, allowing skilled managers like State Street Global Advisors to consistently track index performance. We have observed that EMD active managers haven't always delivered — indeed, underperformance versus benchmarks, inconsistency of performance and relatively poor downside protection are recurring issues.

The perception has changed — our assets in EMD have increased more than five-fold in the past five years, with the active-to-index rotation a key driver. Some of our investors have moved their entire EMD exposure out of active management, while others have allocated part to our index

strategies alongside their active managers — the two approaches can be complementary and are not necessarily mutually exclusive.

## What differentiates State Street Global Advisors from other passive managers?

We describe ourselves as an index manager because what we do is not passive at all — and our philosophy differentiates us from passive managers. Although we don't take active fundamental positions and we operate within tight risk limits, we can also add value by reducing the cost of implementation and exploiting the multitude of micro-inefficiencies that persist in these markets. Our Value-Added Indexing approach that we have refined over many years is built around these two objectives and has delivered consistent and reliable results.

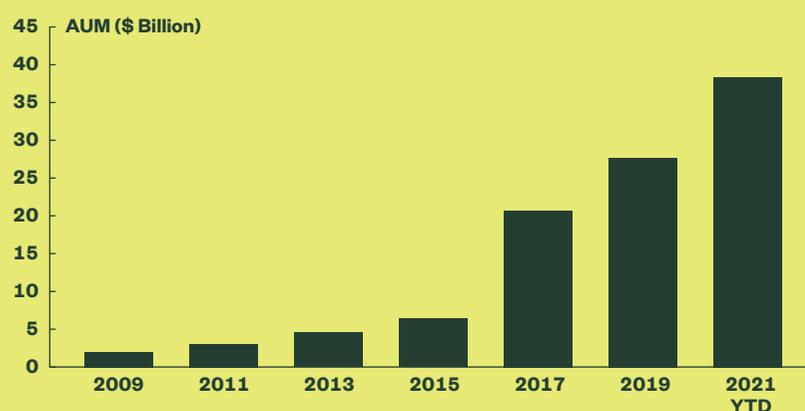
## ESG is increasingly on the radar of investors — what are the options for investors who want to integrate ESG into their EM Debt allocation?

Investors can invest in a strategy that follows an ESG benchmark, such as JP Morgan's JESG indices or opt for a bespoke solution. The benefits of following an ESG benchmark is that it provides a transparent, standardised, and ready way to integrate ESG in EM Debt.

The key benefit of taking a bespoke approach is the greater choice and control of the methodology. However, such solutions are typically more expensive, can take a long time to determine and in some cases can be less transparent — therefore it is typically the larger, long-term mandates that we see choosing a bespoke option. We believe that unless investors have very large allocations to EMD or very long investment horizons they may find that following an ESG benchmark approach is more suitable. In particular, we believe that index strategies that follow an ESG benchmark can offer the most effective and transparent way to integrate ESG in EM debt as, unlike active managers, an index manager does not have to choose between optimising the ESG score and optimising performance.

## \$38.2 Billion and Growing

State Street Global Advisors' EMD Assets Under Management



Source: State Street Global Advisors, as of 30 June 2021. Figures provided in USD.

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