A differentiated approach to EM debt

Why EM Debt?

Emerging markets (EM) debt offers a broad and differentiated opportunity set, with sources of risk and return that are underrepresented in a typical asset allocation mix. The asset class spans a wide variety of instruments from countries at vastly different stages of economic and political development. Idiosyncratic, country-level dynamics can matter as much as broad market forces, creating return opportunities that may be uncorrelated to traditional asset classes.

That heterogeneity also creates inefficiency. Each country brings its own political institutions, policy framework, economic structure and market dynamics. Information is often less plentiful and market access more complicated. For investors equipped to navigate that complexity, these inefficiencies can create mispriced risk and differentiated sources of alpha.

But capturing those opportunities, however, requires an investment process designed around the complexity and breadth of the asset class.

Our Approach

Start With the Opportunity Set. Our portfolios are not confined to the benchmark. The team canvasses 100+ countries for compelling investment opportunities. This broader universe allows the investment process to begin with where we see opportunity rather than where an index happens to allocate capital.

Understand the Fundamentals. Ideas are evaluated through bottom-up research focused on the relationship between fundamentals and valuation. The process is rooted in macroeconomic and political analysis to assess a country's policy set and direction in which it is headed. We remain alert to "policy moments", a catalyst that signal significant change in a country's economic potential.

Invest in Risk Factors. Developing a country view is only the beginning. We next ask which underlying risk factor – currency, interest rates, sovereign and corporate credit spreads – looks mispriced relative to the fundamentals. Only then do we determine which instrument provides the desired exposure and what accompanying risks should be hedged.

That distinction is central to our approach. By targeting the underlying macroeconomic drivers, investing in risk factors allows us to more precisely manage portfolio exposures while limiting unintended risks.

Turn Ideas Into Positions. The embedded trading team works alongside portfolio managers to translate investment views into positions. Traders also work to establish access to markets and securities that may involve more complex settlement or documentation requirements. This can also broaden the opportunity set by bringing less widely distributed investment opportunities to the team for evaluation.

Manage Risk Throughout. Risk management begins with the investment thesis and continues through implementation and portfolio monitoring. Portfolio exposures are evaluated and modeled from multiple perspectives to understand the different dimensions of risk embedded in the portfolio. The team also seeks to identify and hedge unintended exposures that could overwhelm the underlying investment thesis.

Why Active Management in EM Debt Matters

Not every approach to EM debt investing captures the asset class's full potential. We believe popular benchmarks exhibit structural flaws that obscure the characteristics that make the asset class attractive in the first place.

In our previous paper, *Seven Deadly Sins of Emerging Markets Debt Benchmarks*, the EMsights Capital Group explored seven benchmark constraints that have contributed to the asset class's checkered reputation. One of the most consequential is the persistent presence of non-EM risk.

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US interest-rate exposure provides a clear example. The hard currency benchmark has historically carried six to eight years of US duration, making developed-market rates a significant driver of performance. Over the last two decades, US duration accounted for 47% of the J.P. Morgan EMBI Global Diversified Index's 5.61% annualized return. Put differently, a substantial portion of the EM debt benchmark's historical return came from developed-market risk.

For investors seeking the differentiated return potential of EM debt, identifying these embedded exposures is critical. Isolating EM-driven risk from that of developed markets allows investors to more precisely target the risk factors they deem attractive while seeking to hedge out unintended exposures not central to the investment thesis.

Our Offerings

We apply this investment philosophy across three strategies designed to access different portions of the opportunity set.

Artisan Emerging Markets Debt Opportunities Strategy: An actively managed portfolio investing across sovereign and corporate credit, rates and currencies. Portfolio construction is bottom-up and benchmark agnostic with respect to investment positions, allowing the team to allocate opportunistically across risk factors.

The strategy seeks to outperform its benchmark over a full investment cycle while managing downside and unintended risks.

Artisan Emerging Markets Local Opportunities Strategy: An actively managed strategy investing primarily in local EM fixed income securities and currencies. Its investment universe extends beyond the J.P. Morgan GBI-EM Global Diversified Index, allowing the team to pursue opportunities outside the benchmark while seeking to outperform the comparator index with commensurate risk.

Artisan Global Unconstrained Strategy: A global long/short strategy investing primarily in non-US fixed income securities and currencies, with an emphasis on emerging markets. The strategy seeks incremental returns relative to the risk-free rate while maintaining low beta and correlations to broad market indices and traditional asset classes.

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