Morgan Stanley

INVESTMENT MANAGEMENT

Emerging Markets Debt Outlook

Surviving Outside the Tent

FIXED INCOME | GLOBAL FIXED INCOME TEAM | MACRO INSIGHT | MAY 2020

In the first quarter of 2020, COVID-19 spread across the globe, wreaking havoc on the global health system and prompting an unprecedented closure of vast segments of the global economy. The recalibration of global growth and employment prospects fractured market confidence, sparking a sharp rise in volatility, and a historic decline in the value of global debt and equity markets.

In the ensuing panic, as Developed Market (DM) authorities, including the U.S. Treasury, U.S. Federal Reserve and European Central Bank (ECB), strategized stimulus measures, familiar narratives began to circulate regarding the downfall of Emerging Markets (EM). Despite standing outside the "tent" pitched by the Fed and other DM financial institutions to shelter developed markets, we contend that the imminent demise of EM has been greatly exaggerated. In this note, we review the current crisis in the context of EM, examining its impact on a diverse array of economies, their response to the shock, our response in our portfolios and the outlook for asset prices.

COVID-19 pandemic now hitting Emerging Markets

EM countries are at an earlier stage in the virus progression than DM, with the peak in cases projected to be weeks away (as of the writing of this article). Since COVID-19 appeared in China in early 2020, governments around the world have enacted measures to reduce the spread of the virus.

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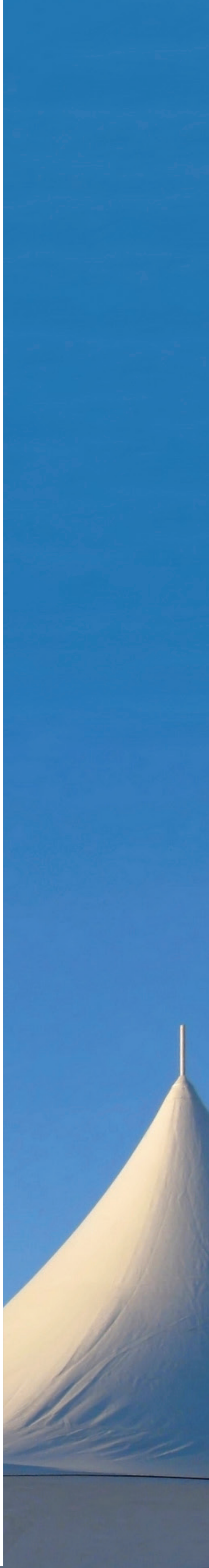
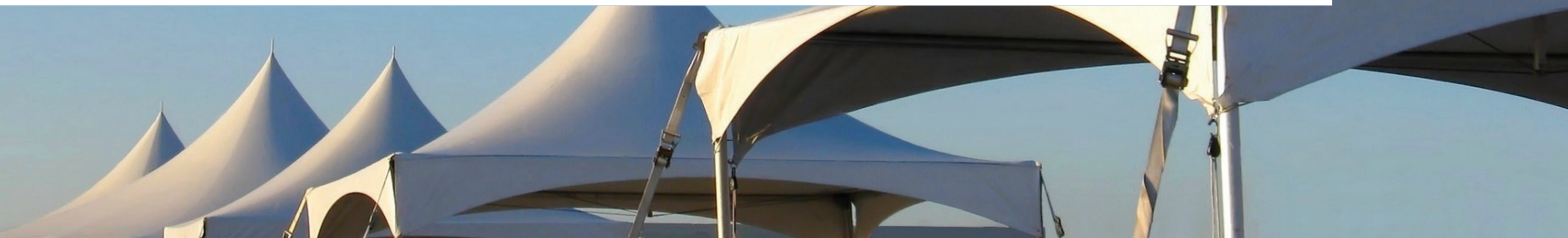
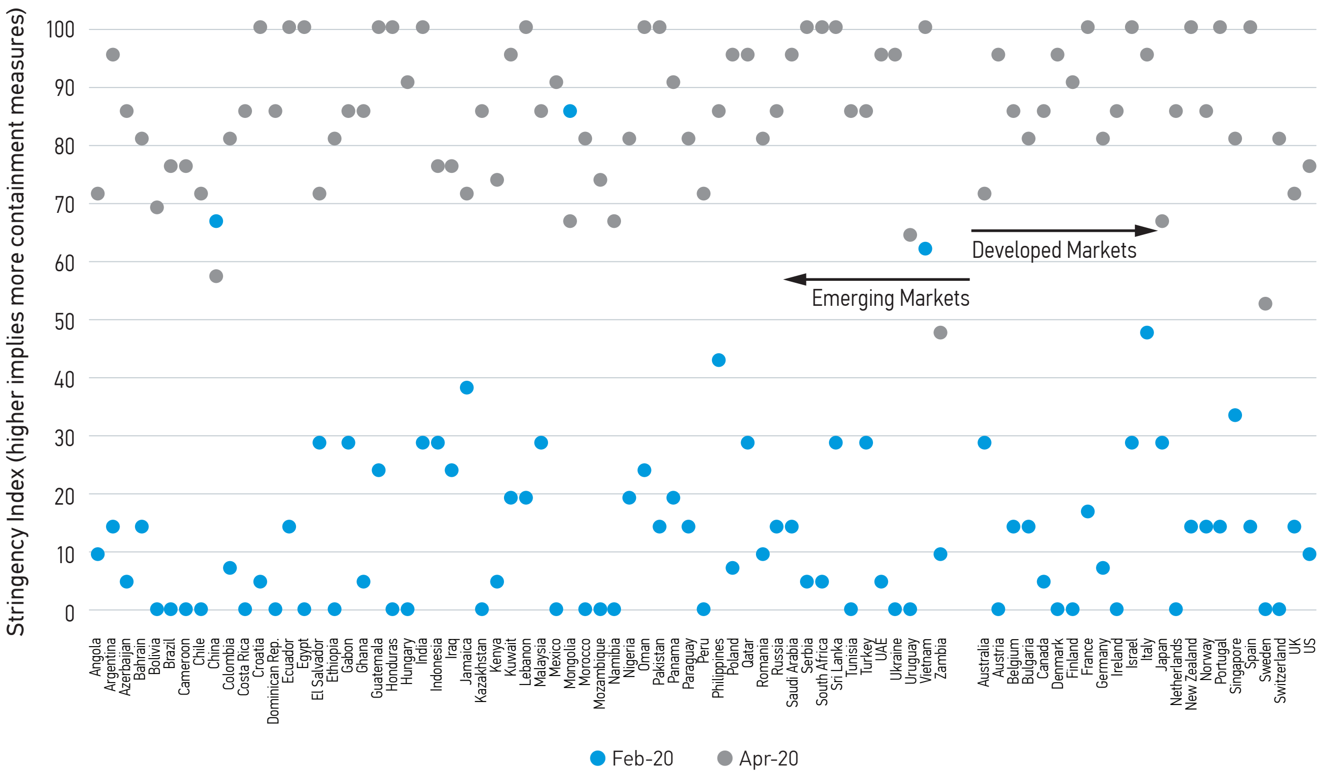




DISPLAY 1

Both Developed Markets and Emerging Markets have enacted aggressive measures against the virus

A higher value of the Stringency index implies stricter containment measures



Sources: Hale, Thomas, Sam Webster, Anna Petherick, Toby Phillips, and Beatriz Kira (2020). Oxford COVID-19 Government Response Tracker, Blavatnik School of Government. Data use policy: Creative Commons Attribution CC BY standard. Morgan Stanley Investment Management, as of April 2020.

By February 22, only six countries had implemented fairly aggressive containment policies, including the closure of non-essential businesses and schools (though all avoided full lockdowns). By the end of April, close to 136 countries were in quarantine. The Stringency Index[1] *(Display 1)*, tracking the varying degree of governments' coronavirus responses, shows that EM virus containment policies have broadly been as strict as those implemented in the DM world.

DM and EM will see weakening balance sheets, but EM will face more challenges

Given the synchronous nature of the COVID-19 shock, and the commonality of strategies deployed to fight its spread, it is not surprising that the projected economic performance of EM and DM in the next years will not materially differ. The simultaneous supply and demand shock from the COVID-19 outbreak is expected to reduce domestic and external demand and disrupt supply chains. According to the IMF,[2] DM GDP growth is expected to plummet to -6.1% in 2020, compared to a 1%

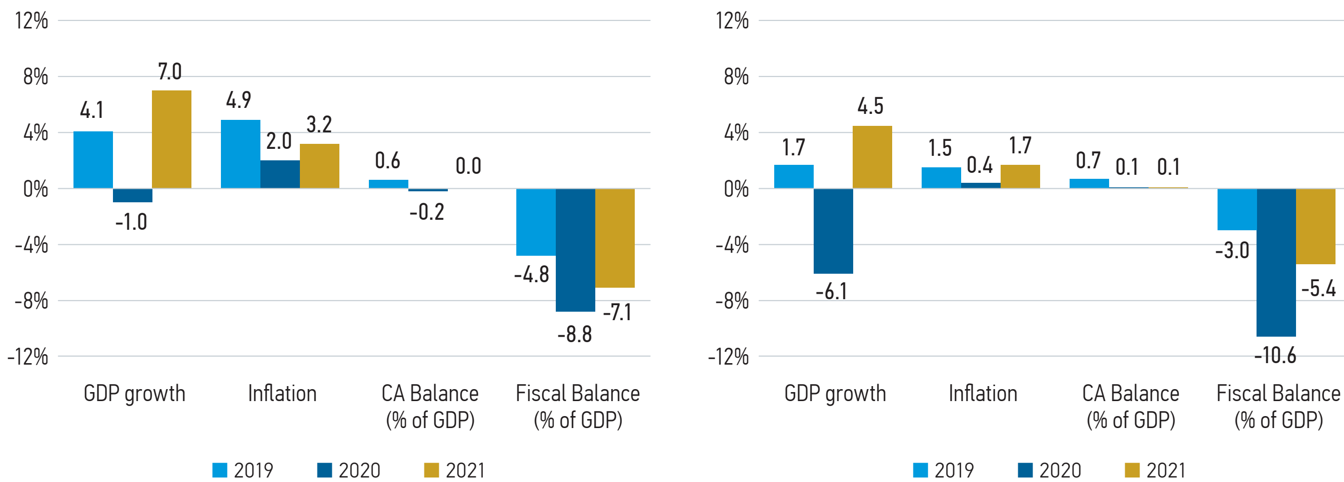
[1] The index tracks stringency of government response to COVID-19 across time. It combines the following indicators to measure containment and closure policies: school closing, workplace closing, cancellation of public events, restrictions on gathering size, public transport closures, stay at home requirements, restrictions on internal movement and international travel, and public information campaigns. The index ranges from 0 to 100 with 100 meaning completely lockdown.

[2] IMF's World Economic Outlook, April 2020.

DISPLAY 2

Lockdowns to weigh heavily on EM and DM fundamentals

Emerging Markets: Selected Macroeconomic Data *Developed Markets: Selected Macroeconomic Data*



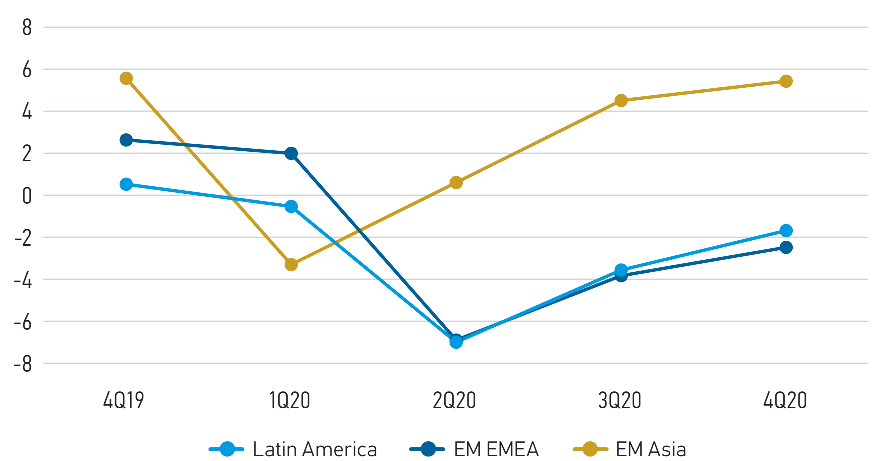
Source: Haver, IMF World Economic Outlook, MSIM as of April 2020.

contraction in EM, though from much higher growth rates in previous years *(Display 2)*. Policymakers across the world have deployed relief packages via aggressive fiscal and monetary policy easing in order to lessen the potential long-term economic damage associated with corporate defaults and high unemployment. The main difference between EM and DM is that the latter exhibit, in general, more solid economic fundamentals, stronger financial positions, and a wide array of tools to finance the economic relief measures. In contrast, many EM countries entered the COVID-19 crisis with 'pre-existing conditions,' and are likely to see a sharp deterioration in their fiscal positions and debt trajectories which, in more extreme cases, will ultimately require painful macroeconomic adjustments.

DISPLAY 3

Asia will likely lead the way out of COVID-19 in 2020

Quarterly GDP growth, consensus forecasts (%)



Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass. Source: Bloomberg, MSIM as of April 30, 2020.

Asia likely to outperform, COVID-19 may cancel out the windfall from lower oil prices

Nonetheless, we expect to see some differentiation in growth patterns within EM, particularly favoring a few Asian economies, which entered the crisis earlier and responded promptly to tackle the spread of the virus *(Display 3)*. Another consideration when projecting EM growth this year is the interplay between the pandemic and lower commodity prices, particularly oil. In a normal situation, lower oil prices would be a boon to oil-importing economies. However, the adverse impact of COVID-19 on growth, remittances and tourism will deprive importers of the traditional benefits of lower oil prices, thus reducing differentiation between commodity importers and exporters.

In Asia, first-in-first-out China is in the process of gradually reopening its economy. Growth is likely to have troughed in the 1Q20, with a mild recovery expected to take place in Q2, aided by further fiscal/monetary stimulus. Meanwhile, densely populated countries, such as India and Indonesia, are in a more vulnerable position and will likely underperform. So will Asian economies heavily geared towards tourism, one of the sectors most adversely affected by the virus.

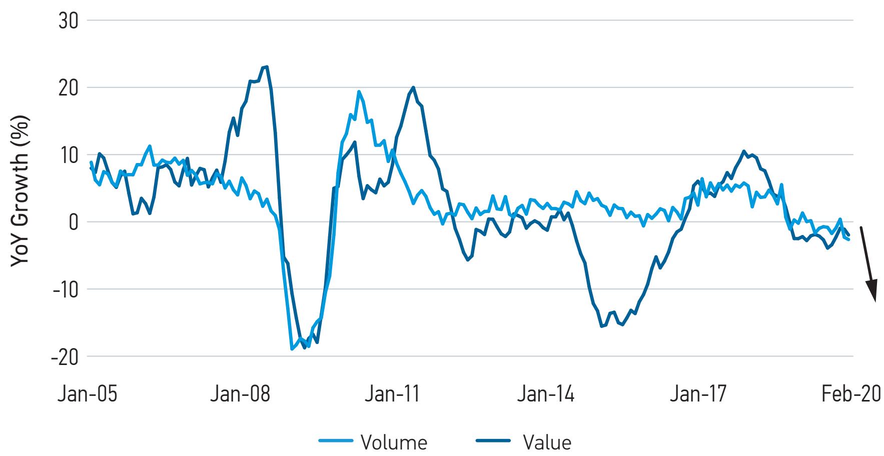
Latin America (LatAm) will likely suffer the most due to its reliance on commodities and structural 'pre-existing conditions.' The combination of the COVID-19 crisis and a collapse in oil prices is a toxic mix for the region. Moreover, the informal market accounts for more than 40% of the workforce in some countries, with long-term lockdowns taking a heavy toll on their economies. The region could contract by 5.4% in 2020, with growth below -5.0% for key regional economies (such as Mexico and Brazil). The Caribbean, a beneficiary of lower oil prices, but heavily reliant on tourism, will also be severely affected.

Europe, Middle East, and Africa (EMEA) will struggle, with GDP growth projected to fall by 5.5%. Oil importers in Eastern Europe will suffer due to strong trade linkages with a contracting Eurozone and/or a dependency on tourism, whereas subdued commodity prices will hurt oil exporters in EMEA.

DISPLAY 4

Challenging near-term outlook for global trade

Global Trade - Volumes and Unit Value



Source: Haver from Netherlands Bureau for Economic Policy Analysis, as of April 24, 2020.

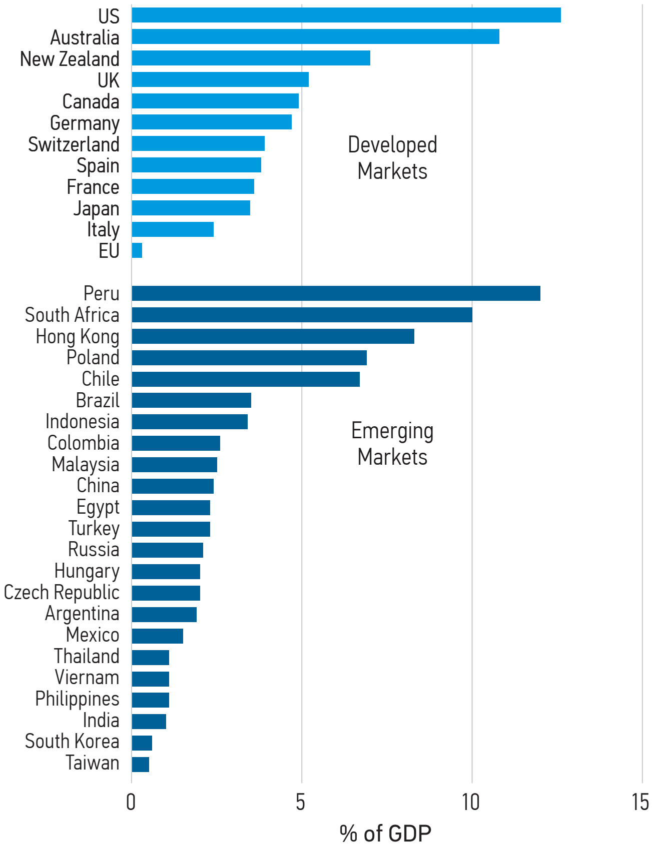
Global trade backdrop remains challenging

The World Trade Organization expects global trade to fall between 13% and 32% in 2020 due to COVID-19 related disruptions. The latest available data on trade volumes and values is from last February, thus not capturing the worst of the COVID-19 crisis *(Display 4)*. We expect a sharp fall in March global trade numbers, not far from Global Financial Crisis levels, exacerbating negative trends in place since the start of the U.S.-China trade war. Weaker external demand will worsen external balances across countries, particularly affecting those with large export sectors (manufacturing exports in selected Asian and Eastern European economies, and commodities in LatAm (ex-Mexico) and Africa).

DISPLAY 5

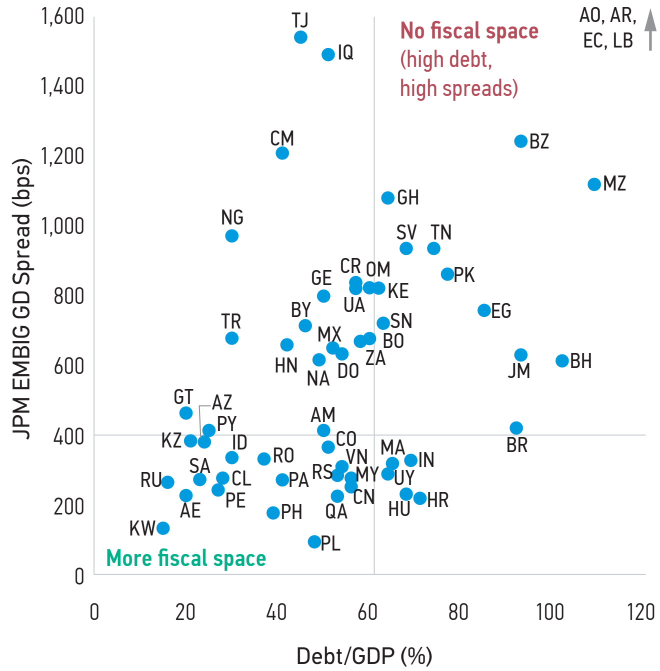
EM fiscal relief on a par with DM...

Fiscal response as a percentage of GDP



...despite more limited fiscal space

Gross debt as a percentage of GDP, JPM EMBIGD spreads



Sources: UBS, JP Morgan, IMF World Economic Outlook, Bloomberg, MSIM as of April 2020.

EM fiscal balances to deteriorate as a result of the lockdown

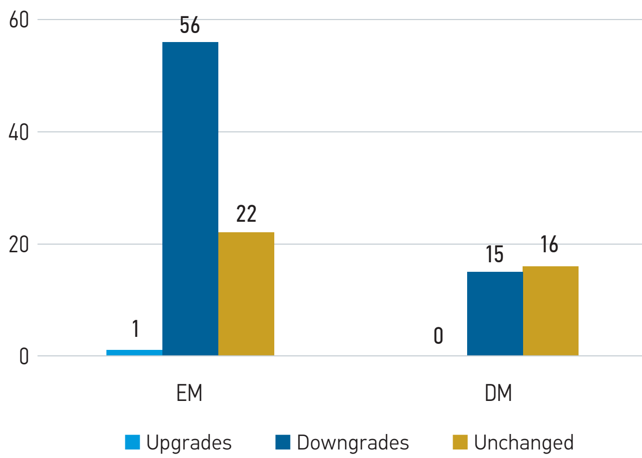
Countries with fiscal surpluses, low debt-to-GDP ratios, less reliance on external debt and large domestic markets have more room to absorb the extra burden of economic relief policies. Weaker economies, featuring high levels of government debt and no market access, are more constrained *(Display 5)*. Nevertheless, policymakers across EM have largely opted for aggressive relief packages, downplaying near-term budget constraint considerations, at the expense of heightened fiscal risks in the future.

Expect more sovereign downgrades in EM and DM, but limited "fallen angel" risk

The resulting deterioration in fiscal balances is putting pressure on both EM and DM credit ratings. Since the beginning of March, 56 countries in EM have been downgraded versus 15 countries in DM *(Display 6)*. We expect this downward trend in global ratings to continue as economic contraction weighs on credit metrics. However, it is worth pointing out, particularly for rating-sensitive EMD investors, that the "fallen angel" risk in EM sovereign debt is limited to a small set of countries (Colombia and Romania, most notably). Others are likely

DISPLAY 6

Rating Outlook Changes Since March 1, 2020

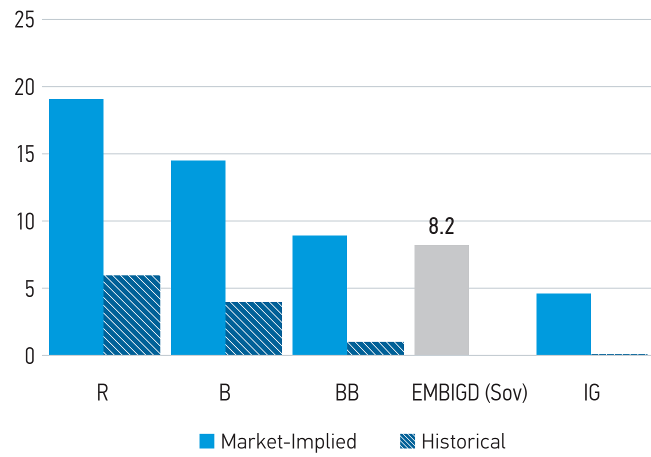


Source: Bloomberg and MSIM as of April 24, 2020.

DISPLAY 7

EM Sovereign debt prices in substantial default risk premium

YE21 Market-Implied vs. Historical Default Rates (%)



Note: Credit bucket R excludes credits already deemed in default per our model (i.e., Argentina, Ecuador, Lebanon, Suriname, and Zambia). Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

Source: MSIM and Moody's as of May 5, 2020.

to retain investment grade (IG) status thanks to sizable buffers. Finally, we note that close to 60% of EM hard currency debt is already rated as high yield (HY).

Market prices already reflect higher default probabilities

One of investors' concerns is the potential uptick in EM sovereign default rates, as higher fiscal deficits and governments' contingent liabilities weigh on debt dynamics and may force countries into debt restructuring. We argue that this fear is overstated. Market prices already reflect a higher default risk, so sovereign defaults in the months ahead do not necessarily imply a negative impact on returns. In fact, our empirical analysis[3] shows five countries[4] with current bond prices already reflecting 100% default probability until year-end 2021. Secondly, the market-implied default probabilities by credit bucket are much higher than those observed from historical data *(Display 7)*, suggesting that current bond prices offer compelling value and ample compensation for bearing default risk.

EM monetary policy: fighting the virus conventionally (and unconventionally)

In addition to the use of fiscal policy, many EM countries have implemented easier monetary policy, both in conventional and unconventional ways. The common (and, in our view, correct) assessment by central banks all over the world is that COVID-19, despite causing supply-side disruptions, is overwhelmingly a negative demand shock, warranting monetary policy accommodation. As a result, negative output gaps have a larger weight in central banks' reaction functions at the expense of inflation or financial stability considerations. Luckily for EM, most EM central banks have room to use conventional monetary tools, without hitting the feared effective zero bound,[5] and have done so in the last month. EM

[3] We estimated cumulative default probabilities for all sovereigns in the JPMorgan's EMBIG Diversified Index until year-end 2021, based on bond prices (For India, we used quasi-sovereign bonds). We assumed a recovery rate of 40%, in line with historical recovery rates as well as recently published sell-side research (see Moody's Sovereign Default and Recovery Rates, 1983-2018, April 8, 2020, and JP Morgan's EM Sovereign Repayment Risks, April 9 2020). Default probability estimates are robust to an alternative recovery rate of 25%, with the exception of a very limited number of credits trading at distressed levels. The index information is provided for illustrative purposes only and is not meant to depict the characteristics of a specific investment.

[4] Argentina, Ecuador, Lebanon, Suriname, and Zambia.

[5] Besides outright interest rate cuts, a wide array of central banks across the EM world have deployed other "conventional" tools, including: lowering reserve requirements, new or enlarged liquidity facilities to boost credit to corporations (or sometimes governments), regulatory forbearance, among other measures.

easing has thus led to a reduction of EM-DM real policy rates differentials which, as we discuss later, has strategy implications for emerging market currency *(Display 8)*.

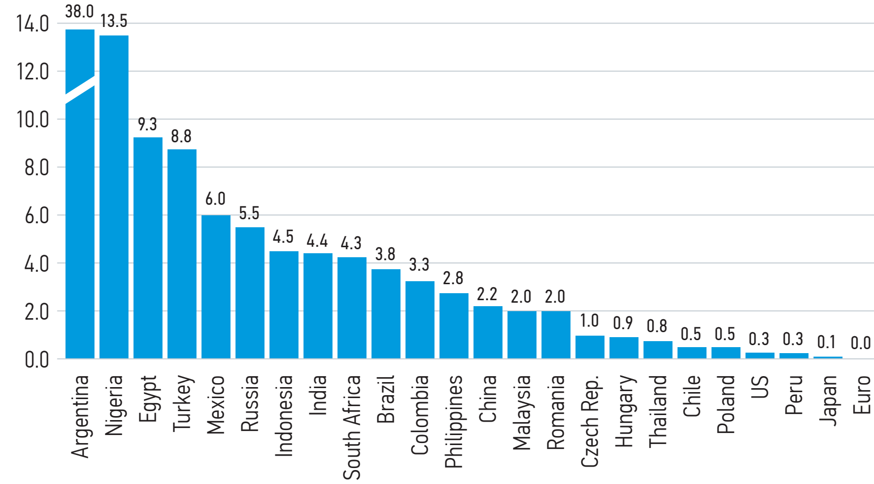
Perhaps the most notable innovation by EM central banks during the COVID-19 crisis is the use of unconventional monetary policy tools (i.e. Quantitative Easing or QE). Unlike QE in DM, which provides an alternative way of easing monetary policy when rates hit the zero bound, EM QE provides local Treasuries with an alternative source of fiscal-deficit financing.

Success of QE in EM is difficult to predict, but we argue that countries meeting the following criteria are more likely to succeed: (i) prudent fiscal policies and healthier debt stocks; (ii) access to diversified financing sources, (iii) ample stock of reserves to stabilize the FX, and (iv) trustworthy Central Banks that will keep long term inflationary pressures anchored during the QE program. We believe this puts CEE and Thailand's QE at an advantage over those announced in more (fiscally and/or externally) vulnerable economies such as Turkey, South Africa or Romania.

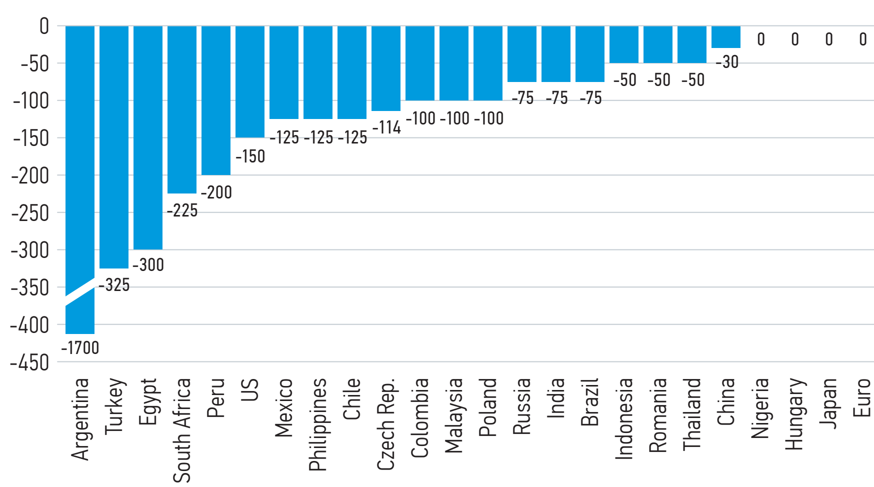
DISPLAY 8

EM policy rates far from hitting the zero bound, despite large cuts

Policy rates as of April 30, 2020 (%)



Policy rate cuts since January 2020 (bps)



Source: World Economic Outlook, Bloomberg, MSIM as of April 2020.

Limited EM backstops so far, but things may be improving

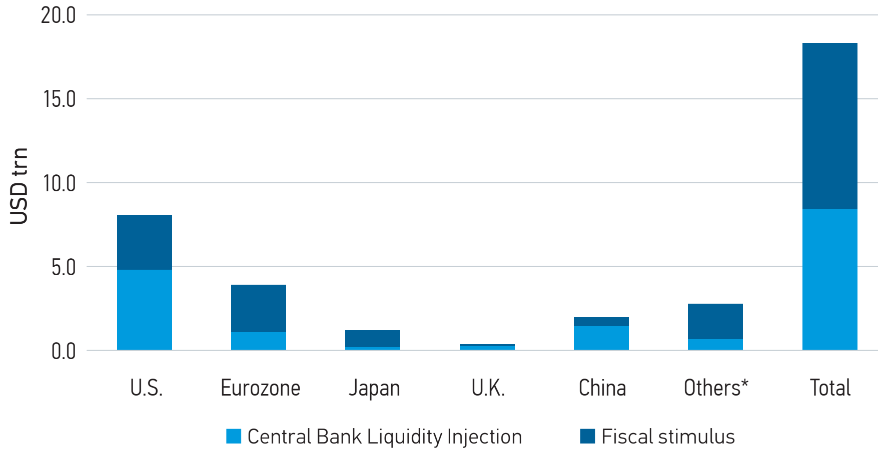
The dramatic spike in risk aversion due to COVID-19 caused even the most liquid markets to trade in a dysfunctional manner and prompted decisive action by policymakers in the developed world to restore proper functioning of financial markets *(Display 9)*. Their efforts were successful at stabilizing market sentiment, causing a significant relief rally in April.

The massive liquidity released by monetary authorities in the developed world should—with a lag, and to a lesser extent—spill over into other parts of the world, thus supporting EM assets. Just as in previous crises (absent a material, direct backstop for EM economies), EM as an asset class is on its own, standing outside the "tent" pitched by the Fed and other institutions to shelter DM markets.

However, the International Monetary Fund has pledged support for EM via several programs with reduced conditionality, and as of late, we are seeing actual disbursements. In particular, the IMF has doubled the size of its quick disbursement facilities[6] to $100 billion, initiated fundraising efforts ($1.4bn) towards granting debt relief and unveiled a Short-Term Liquidity facility available to countries with solid macroeconomic frameworks. *Display 10* shows that the IMF's COVID-19 approved lending so far has reached $15.6 billion, as of May 1. When adding standard IMF lending programs, the stock of funding already granted stands at $160 billion, versus available financing estimated at $1 trillion. Therefore, the financial relief to EM could be very significant if the IMF unleashes its full lending firepower.

DISPLAY 9

DM's big 'tent'



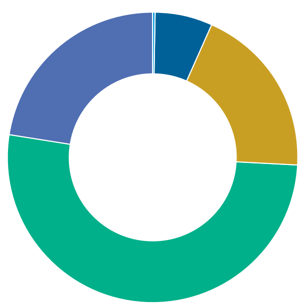
*Others include rest of the world, ADB, IMF and WB.

Source: MSIM based on Cornerstone Research.

DISPLAY 10

IMF lending to EM slowly picking up, expect more to come

IMF Emergency Financing Approved by Region in $ million (Total as of May 1, 2020: $15.6bn)



Asia and Pacific	51
Europe	1,020
Middle East and Asia	2,978
Sub-Saharan Africa	8,083
Western Hemisphere	3,483

Sources: IMF as of 05/01/2020. Total COVID-19-related IMF approved financing include funds from RCF/RFI facilities, augmentation of existing programs, and debt relief granted via CCRT.

[6] RCF (Rapid Credit Facility) and RFI (Rapid Financing Instrument).

Lack of backstops did not prevent EMD from rebounding after previous selloffs

Backstops directly aimed at supporting weak EM economies, though useful, are by no means a necessary condition for EM assets to rally following large selloffs. History shows that the asset class has been highly resilient and capable of staging robust recoveries, even in the absence of extraordinary support measures. *Display 11* shows that both EM sovereign and corporate hard-currency debt, after suffering large losses during the Global Financial Crisis, recovered strongly thereafter, delivering positive returns in the four subsequent years, three of them in double-digit territory.

DISPLAY 11

Hope after the storm: large drawdowns followed by strong recoveries

DOLLAR-DENOMINATED	2008	2009	2010	2011	2012
Sovereign	-12.0%	+28%	+12%	+8.5%	+18.5%
Corporate	-15.9%	+35%	+13%	+2.5%	+15%

This index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.** See disclosures for Index definitions. Source: Bloomberg, JP Morgan, Morgan Stanley Investment Management. This is the annual return for JP Morgan EMBIG Global Diversified and Corporate EMBIG Broad Diversified index for the respective years.

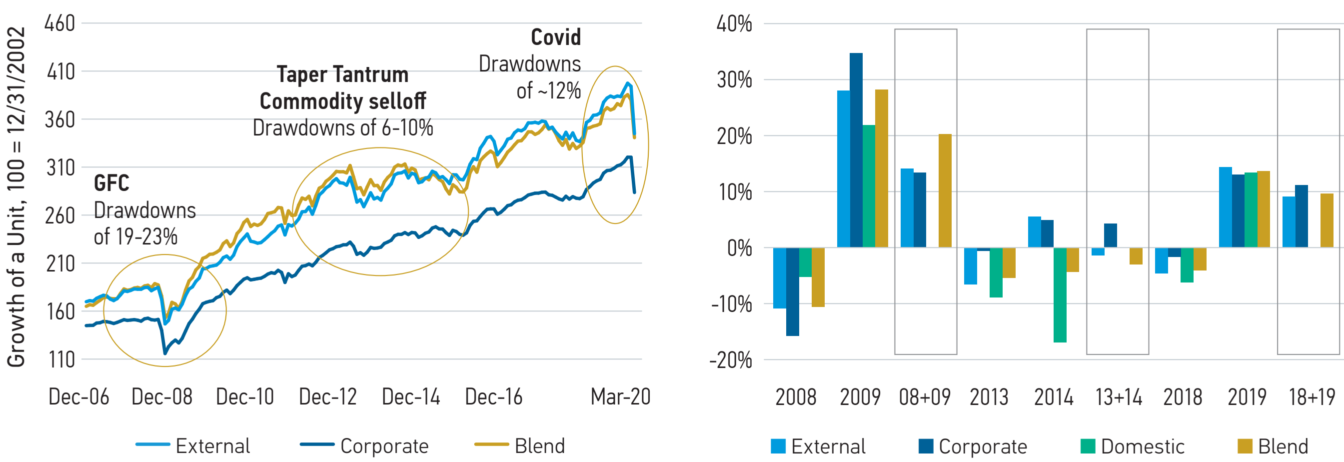
Display 12 shows a more detailed account of EM debt returns after selloffs. The main takeaways can be summarized as follows: drawdowns are typically short-lived, lasting 2-4 months on average, whereas recoveries are more protracted, typically averaging 6-9 months, with similar behavior across EMD strategies. Moreover, history indicates that consecutive years of negative returns have been rare and mostly limited to local-currency or blended strategies. While past performance, of course, does not guarantee future results, we believe these historical return patterns, as well as attractive valuations and clean positioning, combine to paint a supportive picture for the asset class.

Shocks induce panic and uncertainty, but also reveal opportunities

In response to the unprecedented global demand shock, investors recalibrated the outlook for growth, inflation, and debt sustainability across the spectrum of Emerging Market sovereigns. Amidst that adjustment, which occurred under a backdrop of illiquid markets, MSIM identified some dislocations—in both hard and local currency—that

DISPLAY 12

EM Debt Return Profile: Short-lived drawdowns, extended recoveries



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Source (Left Chart): Bloomberg, MSIM. As of 03/31/2020, according to the primary index provider JP Morgan, which uses a middle rating approach of Fitch, Moody's, and S&P ratings. EM Equity represented by MSCI EM NR USD index, EMD "Blend" represented by an equal-weighted index of External Sovereign, External Corporate, and Domestic Sovereign debt represented by the JPM EMBI Global, CEMBI Broad Div., and GBI-EM GD Index (respectively). External=JPM EMBI Global Index, Corporate=JPM CEMBI BD Index. Source (Right Chart): Bloomberg, MSIM. As of 03/31/2020 according to the primary index provider JP Morgan, which uses a middle rating approach of Fitch, Moody's, and S&P ratings.

represented attractive opportunities. For example, in Peru, the team observed that rising local bond yields (in both level and curvature) had dislodged from a worsening growth outlook, and falling inflation expectations. Instead of rising, we believed that yields should have been in decline, especially given that the central bank had room to ease policy rates. Meanwhile, we viewed the fiscal impact of government spending to be manageable, and mitigated by a strong starting point (low debt/GDP) and existing buffers (Fiscal Stabilization Fund). As the initial panic subsided, and investors began to apply fundamental analysis to differentiate between countries and identify mispricing, Peruvian local debt yields swiftly normalized.

DISPLAY 13

High Yield Emerging Market Corporates screen cheap vs fair-value estimates

BASE	EXCESS SPREAD ASSUMPTION (BPS)			500
	DEFAULT RATE	RECOVERY RATE 20%	RECOVERY RATE 40%	RECOVERY RATE 60%
CEMBI HY Implied Spread to Worst (bps)	2%	660	620	580
	3%	740	680	620
	4%	820	740	660
	5%	900	800	700
	10%	1,300	1,100	900

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

Source: Bloomberg, JP Morgan, MSIM as of May 2020.

Value in EM credit and duration, EM FX may face near-term challenges

If we split the market's reaction to the crisis into two phases, then the first phase, which peaked in mid-March, was marked by discussions around big tail risks: 1) extreme funding market stress and illiquidity, 2) slow/inadequate policy responses and 3) fears of unmitigated global spread of the virus. As the market's perception of the distribution of risks normalized, EM asset prices, which had become severely dislocated from admittedly-worsened fundamentals, recovered a portion of the selloff losses, rewarding investors who 'bought the panic' in March. As we move into the second phase, the discussion shifts towards 'differentiation' and identifying which countries/credits are best equipped to absorb the still unfolding shocks.

In hard-currency sovereign debt, our sovereign spread valuation model points to EM debt being fairly priced versus their deteriorating fundamentals. However, we think that there are opportunities within this segment, primarily from attractive new issuance premium offered by high-quality sovereigns. We expect this trend to expand to sovereigns further down the credit quality spectrum, provided a more stable global market sentiment and supportive technical environment remains. For the time being, we remain cautious on HY sovereigns on the back of uncertain global growth prospects, preferring idiosyncratic stories with attractive valuations.

In local rates, we like duration in low-yielders. Several EM economies are facing strong disinflationary forces from lower oil prices and collapsing activity, while their solid fundamentals allow them to better withstand deteriorating fiscal trends. Some countries have announced QE programs that, if successful, should lead to the bull-flattening of yield curves. We also like duration in countries with high real rates and relatively prudent fiscal policies.

Despite being materially undervalued, EMFX is likely to face challenges in the near term due to an uncertain outlook for global growth and commodities, potential disruptions in market sentiment (which favors the USD, despite its richness), reduced EMFX carry attractiveness and the fact that EM FX plays a key role as a shock absorber. Finally, EM QE can lead to further weakening of currencies. As a result, we remain cautious on EMFX, waiting for potential support for this asset class from a faster than expected recovery in global growth and a stabilization in commodity prices.

For EM corporates, a supportive stance by IMF and multilateral lenders and fiscal/monetary stimulus implemented in some countries should mitigate any material systemic risk. The operating outlook remains challenging for various sectors and is likely to lead to a higher rate of default than previously expected. We note, however, that relative to previous crises, EM corporate issuers' balance sheet and liquidity profiles are generally in healthier conditions relative to previous crises to withstand the negative impact from the pandemic. We expect defaults to be mostly sector-specific/idiosyncratic and an increased number of 'fallen angel' issuers to be driven by sovereign rating downgrades rather than standalone credit reasons. This backdrop allows us to assess credits based on their merits in a recessionary environment and to look for opportunities to add relative risk in oversold assets, including HY where the current spread is cheap to our fair value estimation based on an expected default rate of 5% and recovery rate of 40% *(Display 13)*.

More specifically, we like sectors that benefit from policy frameworks (real estate in Asia), or from cash flow visibility due to resilient business models (Utilities, TMT) and favorable demand outlook (food and beverage, including protein exporters) where valuation remains attractive relative to more vulnerable sectors. We remain cautious and selective in commodities (energy, metals and mining) and have pared risks to the issuers that struggled to pass our stress test. Finally, we are avoiding sectors with material operational disruptions, such as airlines, lodging, etc. due to the impact of COVID-19.

Light positioning and better risk sentiment should be EMD supportive

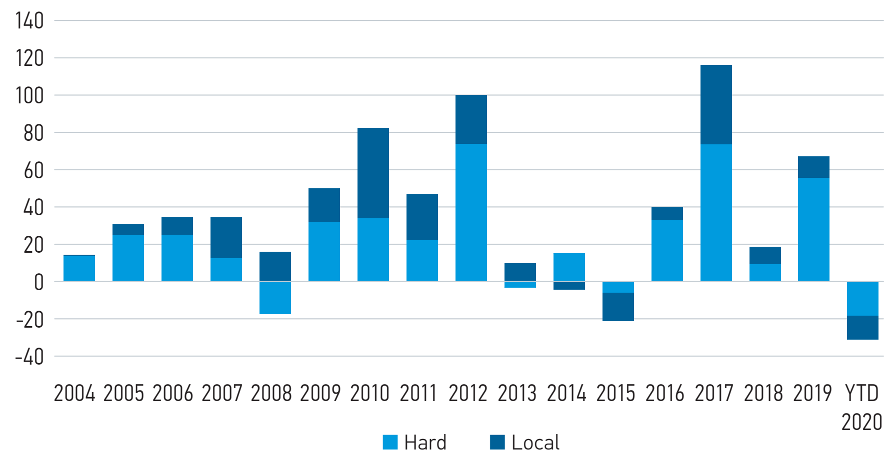
Flows out of the asset class in response to COVID-19 have been significant both in their magnitude and their speed, reaching an accumulated $31.1bn, in the year to April 23, 2020 (*Display 14*). Hard-currency-denominated EM debt has suffered the largest outflows, partially reversing the very healthy inflows seen last year. The exodus from the asset class has been led by volatile retail investors, whereas institutional investors' exposure to EM debt has been typically stickier, likely reflecting strategic asset allocation decisions.

Portfolio flows in and out of EM markets are sensitive to growth and monetary policy differentials, global financial conditions and dollar strength, among others. The first factor is not necessarily supportive of inflows into EM, as the symmetric nature of COVID-19 is likely to cause quantitatively similar economic contractions in both DM and EM. On the other hand, both real and nominal EM-DM interest rate differentials still look compelling versus zero or negative yields in the developed world *(Display 15)*. This should incentivize insurance companies or pension plans with defined benefits, for example, to try to boost portfolio yields via maintaining or increasing exposures to EMD.

Meanwhile, global financial conditions could provide a more constructive backdrop for portfolio flows into EM, as the ripple effects from massive liquidity injections by DM Central Banks spread to riskier assets. EM sovereign issuers have quickly taken advantage of more

DISPLAY 14

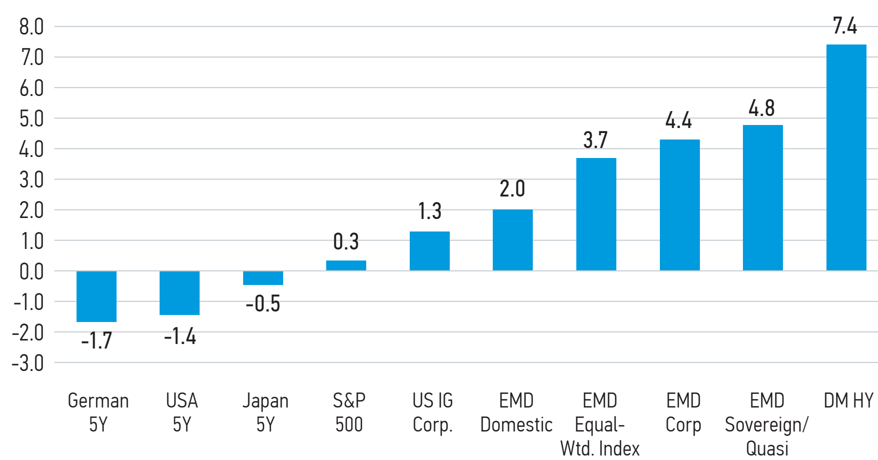
Lighter positioning in EM debt after fast and heavy outflows ($ bn)



Source: J.P. Morgan, EPFR Global, Bloomberg, as of April 30, 2020.

DISPLAY 15

EM-DM yield differentials still supportive of EM debt (%)



The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

Source: Bloomberg, Morgan Stanley Investment Management. Data as of April 24, 2020.

Foreign securities are subject to currency, political, economic and market risks. The risks of investing in emerging market countries are greater than investments in foreign developed countries. Investors should carefully review the risks of each asset class prior to investing.

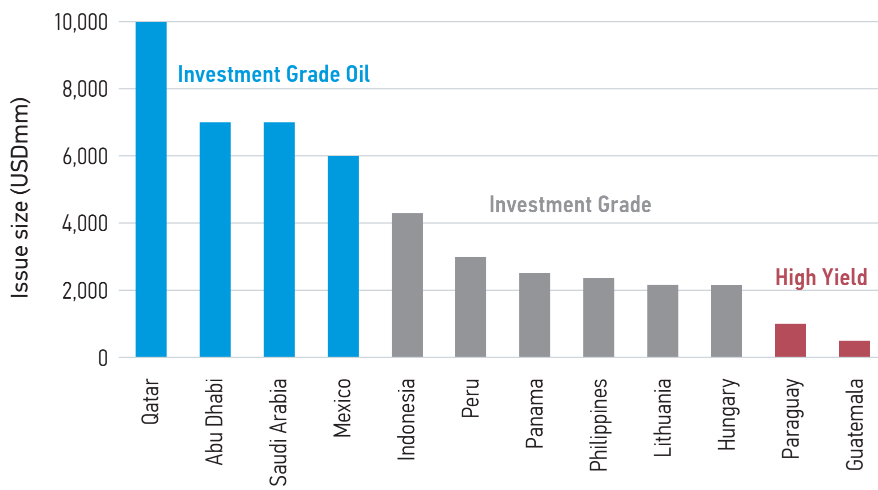
supportive global financial conditions, by tapping the Eurobond market. As *Display 16* shows, the market has been open not only for IG credits benefitting from lower commodity prices, but also to a number of high-quality oil exporters and HY countries with relatively prudent macroeconomic policies.

Finally, a reversal of flight-to-quality behavior could eventually lead to a weakening USD versus other currencies, though we acknowledge that EM FX could remain challenged in the near term as we gain more visibility on the impact of COVID-19 on economic growth. However, we note that the USD screens expensive as per our FX valuation models, which coupled with less attractive carry after the Fed slashed rates, could ultimately generate conditions for its depreciation and a resurgence of investment flows into EM.

DISPLAY 16

No lockdowns for Eurobond market

EM Sovereign Issuance over the last month



Sources: JP Morgan, MSIM as of April 28, 2020.

Conclusion

There is no denying that the synchronous shock from COVID-19 is unambiguously negative, not only for EM, but for DM as well. However, the global response by policymakers has been substantial and, so far, successful at stabilizing risk markets. DM has been the first to benefit given not only the wherewithal but also the speed at which institutions such as the Federal Reserve and the European Central Bank have responded. While we expect to see further consolidation of this trend providing continuing support for DM markets, we now see that EM may play catch up on evidence of increasing support by the IMF and other institutions directly targeted at EM. This could drive outperformance of EMD assets in the near term (with some caveats on EMFX). In our view, current pricing in EM appears to fairly reflect the obvious deterioration in fundamentals, but on a relative-value basis, EM now looks more compelling than DM, as it has lagged the latter on lack of a specific backstop. History has shown that after valuations become more attractive and positioning cleaner, drawdowns have tended to be short-lived, while rebounds have tended to be more protracted and typically have delivered positive returns. We think similar conditions are currently in place, and investors who are comfortable with the risks of emerging markets, should consider adding EM debt exposure into their portfolios while current dislocations prevail.

Risk Considerations

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this portfolio. Please be aware that this portfolio may be subject to certain additional risks.

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JP Morgan Corporate EMBIG Broad Diversified index is a global, liquid corporate emerging markets benchmark that tracks U.S.-denominated corporate bonds issued by emerging markets entities.

The **S&P 500® Index (U.S. S&P 500)** measures the performance of the large-cap segment of the U.S. equities market, covering approximately 75 percent of the U.S. equities market. The index includes 500 leading companies in leading industries of the U.S. economy.

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