

# The benefits of EM Investment Grade Spread Optimization

Vontobel Fund – Emerging Markets Investment Grade

Fixed Income Boutique

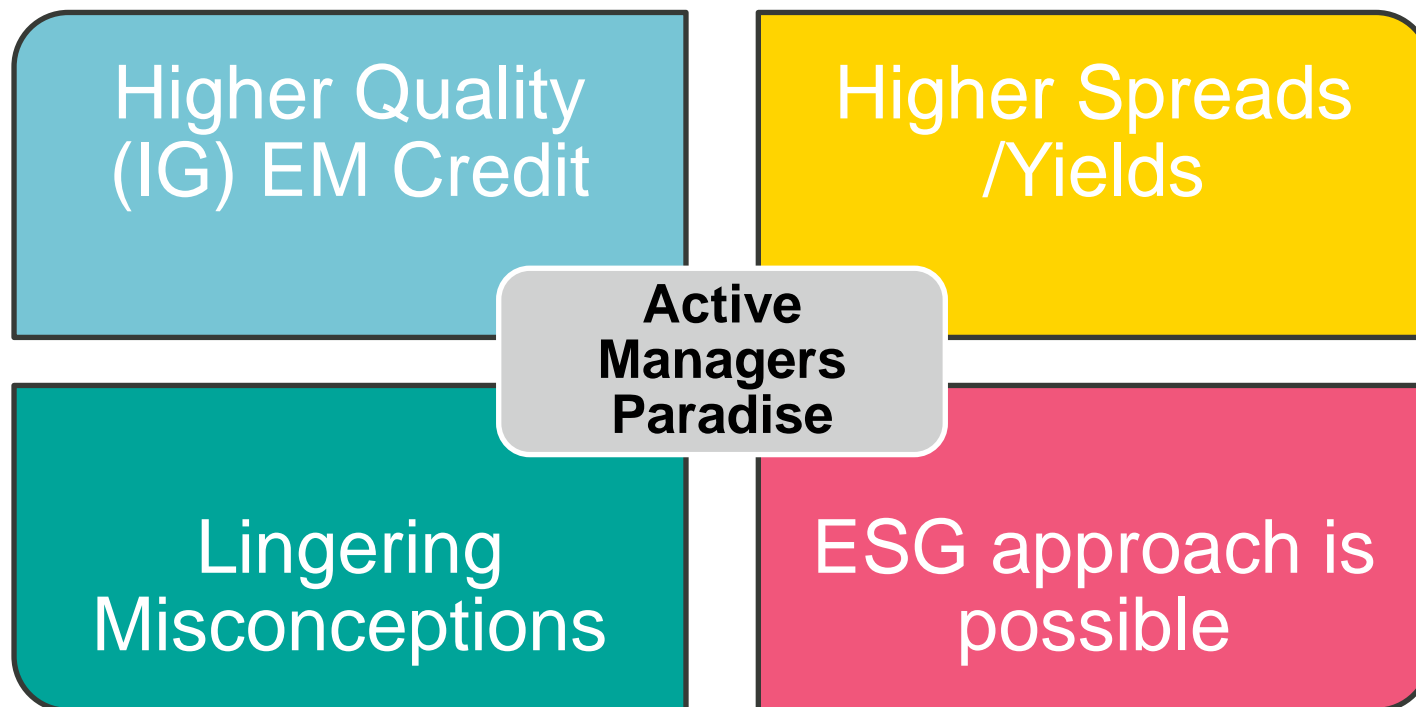
**Nuria Jorba**

Senior EM Corporate Bonds Analyst

11<sup>th</sup> May 2022

## Why are we here?

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# Emerging Markets Debt: a \$7.7bn, and growing, franchise

Overview of the open-ended EM FI fund strategies classified by ESG integration (SFDR Art. 6) or sustainability approaches (SFDR Art. 8). Mandates also available.

	Hard Currency Sovereign	Hard Currency Corporates	Local Currency
<b>ESG Integration</b>  <b>Art. 6</b> <b>SFDR</b>	VF - Emerging Markets Debt	VF - EM Corporate Bond VF II - Fixed Maturity Emerging Markets Bond 2026	
	Allocation Solutions		
		VF - Emerging Markets Blend VF – EM Investment Grade	
<b>Sustainable</b>  <b>Art. 8</b> <b>SFDR</b>	VF - Sustainable Emerging Markets Debt		VF - Sustainable Emerging Markets Local Currency Bond

# Deep & experienced Emerging Markets Debt Team

## FIXED INCOME BOUTIQUE



**Simon Lue-Fong**  
Head FI/Member of FIO  
Investment Committee (31)

## GLOBAL FI BUSINESS



**Rémi Casals**  
Global Head (23)

## CLIENT PORTFOLIO MANAGEMENT (4-Person Team)



**Adrian Bender**  
Head CPM (31)

## MACRO STRATEGY PLATFORM (5-Person Team)



## EMERGING MARKETS (12-Person Team)



**Luc D'hooge**  
Head EM/PM (33)



**Wouter van Overfelt**  
Head EM Corp/PM (20)



**Sergey Goncharov**  
PM/Analyst (13)



**Thierry Larose**  
PM/Analyst (32)



**Carl Vermassen**  
PM/Analyst (29)



**Cécile Sati**  
PM/Analyst (11)



**Dario Scheurer**  
PM/Analyst (5)



**Carlos de Sousa**  
PM/Strategist (13)



**Cosmo Zhang**  
Analyst (26)



**Nuria Jorba**  
Analyst (22)

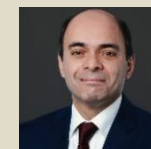


**Fouad Fenianos**  
Analyst (20)



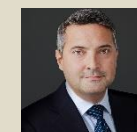
**Kenny Lee**  
Analyst (12)

## CORPORATE BONDS (10-Person Team)



**Mondher Bettaieb**  
Head/PM (29)

## FIXED INCOME OPPORTUNITIES (4-Person Team)



**Ludovic Colin**  
Co-Head/PM  
(24)



**Hervé Hanoune**  
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## GLOBAL & SWISS (5-Person Team)



**Anna Holzgang**  
Head/PM (26)

## TRADING (3-Person Team)



**Jean-Michel Manry**  
Head FI Trading (29)

## ESG ANALYSIS (4-Person Team)



**Marion Swoboda**  
ESG Analyst (27)

## FI SOLUTIONS (2-Person Team)

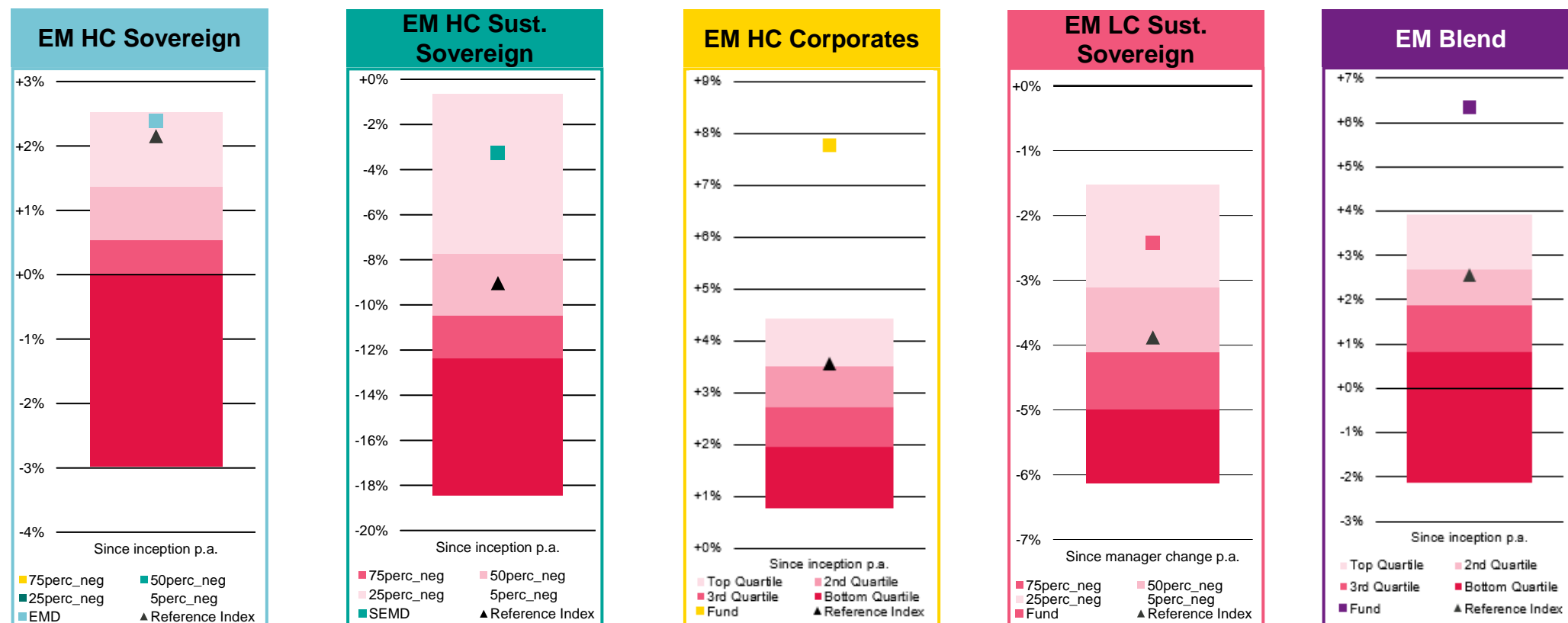


**Davide Petrella**  
Quant. Analyst (5)

# Why invest actively in EM debt with Vontobel?

## EM debt is very inefficient and provides rich pickings for active experts

Annual net performance since inception of our flagship funds versus benchmark and Morningstar peer group



Launch Date: 15.05.2013

Launch Date: 30.09.2020

Launch Date: 13.11.2015

Manager Change: 28.02.2018

Launch Date: 24.08.2015

**Robust relative performance versus market and peers across the suite of strategies.**

### Past performance is not a reliable indicator of current or future performance.

Performance data does not take into account any commissions and costs charged when shares of the fund are issued and redeemed, if applicable. The return of the fund may go down as well as up due to changes in rates of exchange between currencies. Source: Vontobel Asset Management, Morningstar Direct. From inception/manager date indicated above to 30.04.2022.

Left to right: VT Fund – EM Debt, VT Fund – Sust. EM Debt, VT Fund – EM Corporate, VT Fund – Sustainable EM Local Currency, VT Fund – EM Blend. I share classes.

# **Introduction**

Why EM IG?

Focus on ESG and Labelled bonds in EM

Conclusion

# Vontobel Fund – EM IG in a nutshell



Solution for investors seeking exposure to **Sovereign and Corporate EM IG**. Focus on excess spread generation

## Objectives

- **Well diversified exposure to exclusively EM IG rated sovereign, quasi sovereign and corporates**
- Generate **>50 bp excess spread** versus the BM with the same or similar average rating
- **Systematic overweight labelled bonds** as a market based solution to ESG questions

## Financial Approach

- **Spread optimization** (optimize spread for a given level of risk)
- **Contrarian** and **value** driven focus
- Focus on diversification to limit the (ex-ante) tracking error vs. benchmark

## ESG Approach

- **Systematic overweight labelled bonds** as a market based solution to ESG questions
- For non-labelled bonds, the “**Sustainable Waterfall**” approach (Exclusion & Inclusion):
  - Prioritize **Sovereigns** which have the most efficient use of resources\*
  - Focus on ESG impact of **sectors**
  - Invest in **Corporates** with the better managed ESG risks (NOT lowest risks)

Neither the fund, nor the Management Company nor the Investment Manager make any representation or warranty, express or implied, with respect to the fairness, correctness, accuracy, reasonableness or completeness of an assessment of ESG research and the correct execution of the ESG strategy. As investors may have different views regarding what constitutes sustainable investing or a sustainable investment, the fund may invest in issuers that do not reflect the beliefs and values of any specific investor.

\*Vontobel in-house model for measuring ESG of sovereigns. Sustainability model for measuring ESG of corporates. Stylistic illustration only: Subject to change, without notice, only the approved prospectus or comparable document of the fund will be legally binding. Source: Vontobel Asset Management

# What does EM IG spread optimization look like?

## Illustrative characteristics of the model portfolio

Key figures in USD (as of 13.04.2022)

	FUND*	REFERENCE INDEX**		
Yield to Maturity (% after Hedging)	4.9	4.1	←	Higher yield
Modified Duration (Years)	6.5	6.6	←	Similar duration
Number of Positions	151	850		
Spread (OAS in %)	2.3	1.5	←	Higher spread
Average Rating	BBB+	A-	←	Similar Financial rating
Labelled bonds (% of AuM)	13.1	4.4	←	Higher exposure to labelled bonds
MSCI ESG rating (Est.)	BBB	BBB		
Active Share (Country, Issuer, ISIN)	19%/70%/93%			

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<sup>1</sup>Vontobel Fund – Sustainable Emerging Markets Debt. <sup>2</sup>Vontobel Fund – Emerging Markets Debt.

<sup>3</sup>Non-ESG reference index – J.P. Morgan EMBI Global Diversified. <sup>4</sup>ESG reference index – J.P.Morgan ESG EMBI Global Diversified.

Source: Vontobel Asset Management.



# Portfolio construction: Investment Guidelines and vs Vontobel Fund – Emerging Markets IG

Long-Term Rating Scale		Our Focus	Product Characteristics																
<table><tr><td>AAA</td></tr><tr><td>AA+</td></tr><tr><td>AA</td></tr><tr><td>AA-</td></tr><tr><td>A+</td></tr><tr><td>A</td></tr><tr><td>A-</td></tr><tr><td>BBB+</td></tr><tr><td>BBB</td></tr><tr><td>BBB-</td></tr></table>	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-		<table><tr><td>A+</td></tr><tr><td>A</td></tr><tr><td>A-</td></tr><tr><td>BBB+</td></tr><tr><td>BBB</td></tr><tr><td>BBB-</td></tr></table>	A+	A	A-	BBB+	BBB	BBB-	<ul style="list-style-type: none"><li>– <b>Approach:</b> Spread optimization applied to labelled bonds and ESG best in class EM sovereigns &amp; corporates</li><li>– <b>Investment universe:</b> EM Corporates, quasi-sovereigns and Sovereigns.</li><li>– <b>Average rating:</b> Investment grade</li><li>– <b>Max 10% sub-investment grade bonds due to downgrades (sale if falls below BB-)</b></li><li>– <b>Base currency:</b> USD (non USD hard currencies to be hedged)</li><li>– <b>Benchmark:</b> 50% JPM EMBI GD IG, 50% JPM CEMBI BD IG</li><li>– <b>Country/corporate issuer caps:</b> 20% and 3% respectively</li><li>– <b>Duration:</b> BM +/-2.5 years</li></ul>
AAA																			
AA+																			
AA																			
AA-																			
A+																			
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BB+																			
BB																			
BB-																			
B+																			
B																			
B-																			
CCC+																			
CCC																			
CCC-																			

\*"First-Best" rating methodology applies. Additionally, the fund can hold a 3% 'below B-' passive quota that can be used to hold on to existing bond investments after a downgrade, and avoid forced selling of such positions if the fundamental credit picture can be sustained. If 3% is exceeded, the fund will reduce it back to below 3% within 3 months. Subject to change, without notice, only the current prospectus or comparable document of the fund is legally binding.

# Investment risks of the Vontobel Fund – Emerging Markets Investment Grade Debt

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- Securities with a lower credit quality means a higher risk that an issuer may fail to meet its obligations. The investment value may fall if an issuer's credit rating is downgraded.
- Using derivatives generally creates leverage and entails valuation risks and operational risks. Leverage magnifies gains but also losses. Over-the-counter derivatives involve corresponding counterparty risks.
- Asset-backed and mortgage-backed securities, and their underlying receivables are often intransparent. The sub-fund may also be subject to a higher credit and/or prepayment risk.
- CoCo-Bonds may entail significant risks such as coupon cancellation risk, capital structure inversion risk, call extension risk.
- The sub-fund also includes sustainability criteria in its investment process. This may mean that the sub-fund's performance is more positive or negative than a conventionally managed portfolio.
- Distressed securities have a higher credit and liquidity risk as well as uncertainty in any potential bankruptcy proceedings.
- Investments in emerging markets entail increased liquidity and operational risks as these markets tend to be underdeveloped and more exposed to political, legal, tax and foreign exchange control risks.
- The sub-fund's investments may be subject to sustainability risks. The sustainability risks that the sub-fund may be subject to are likely to have an immaterial impact on the value of the sub-funds' investments in the medium to long term due to the mitigating nature of the sub-fund's ESG approach. The sub-funds' performance may be positively or negatively affected by its sustainability strategy. The ability to meet social or environmental objectives might be affected by incomplete or inaccurate data from third-party providers. Information on how environmental and social objectives are achieved and how sustainability risks are managed in this sub-fund may be obtained from [vontobel.com/sfdr](https://vontobel.com/sfdr).

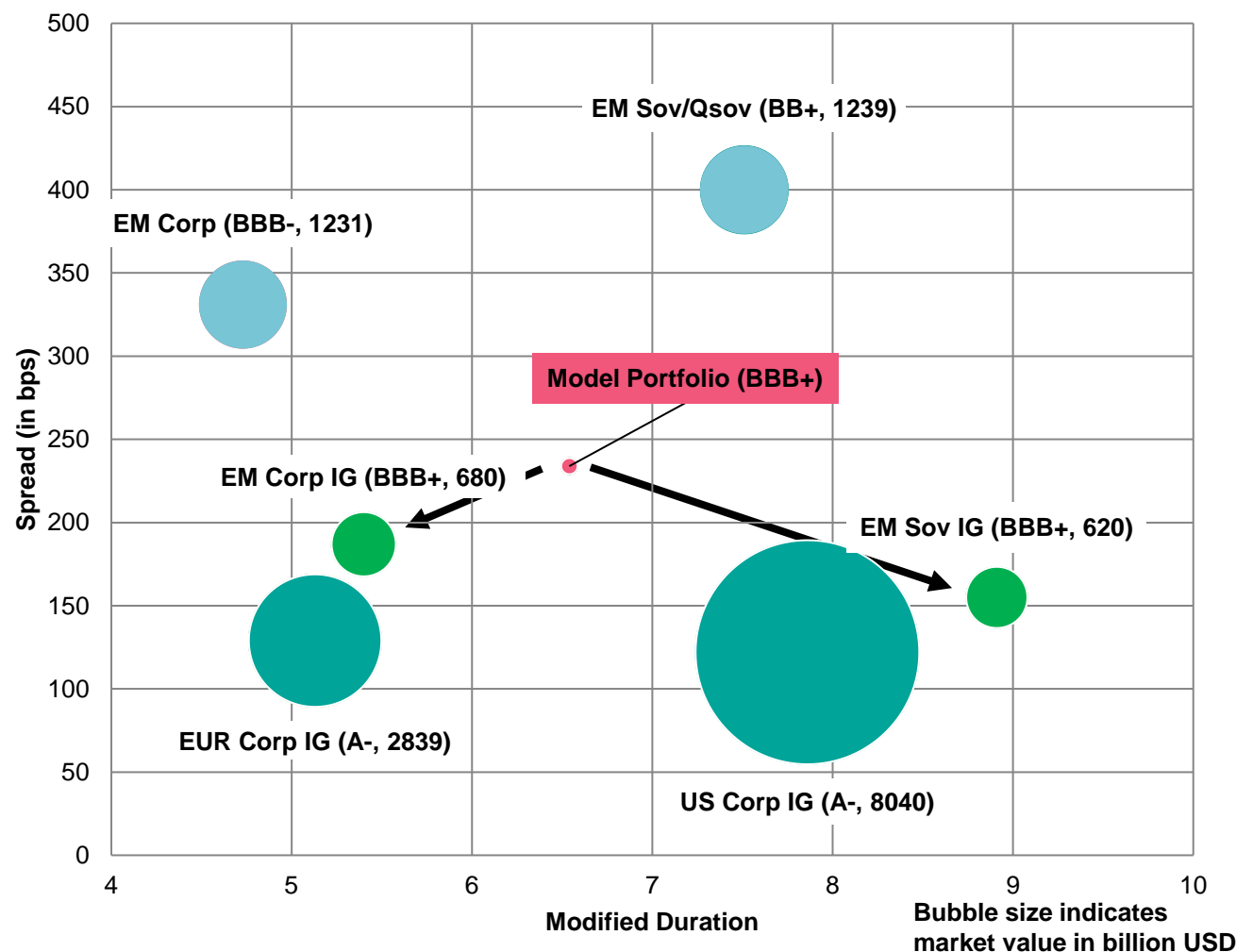
Introduction

**Why EM IG?**

Focus on ESG and Labelled bonds in EM

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## EM Sovereign & Corporate “Beta” delivers more spread than DM

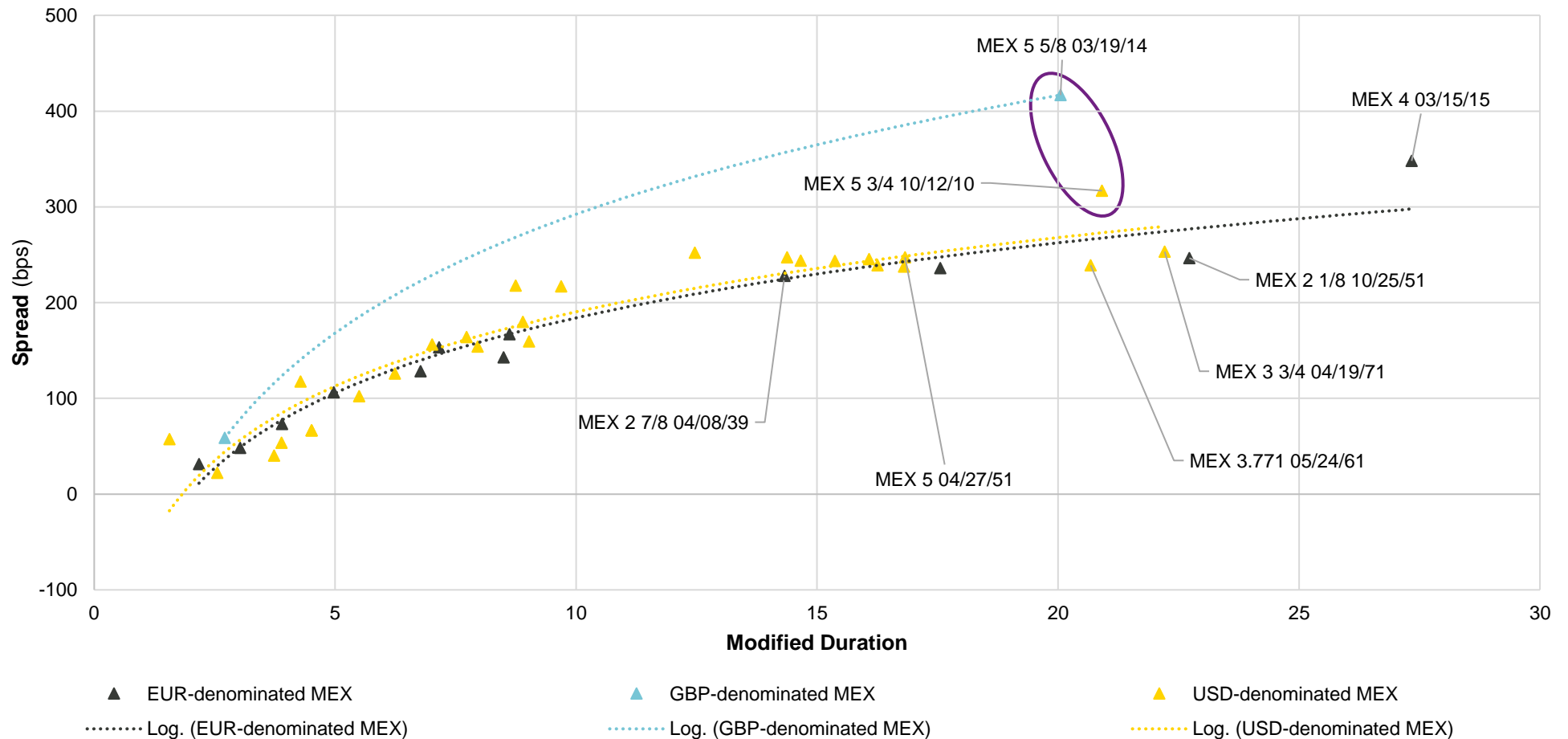


- Given the **low rates environment** globally, we believe that **future returns should come from spreads**.
- EM Corporates shows **similar/lower duration** and **higher spreads** than DM equivalents with a marginally lower average rating.

**Is there a reason for the excess spread, or is it an anomaly?**

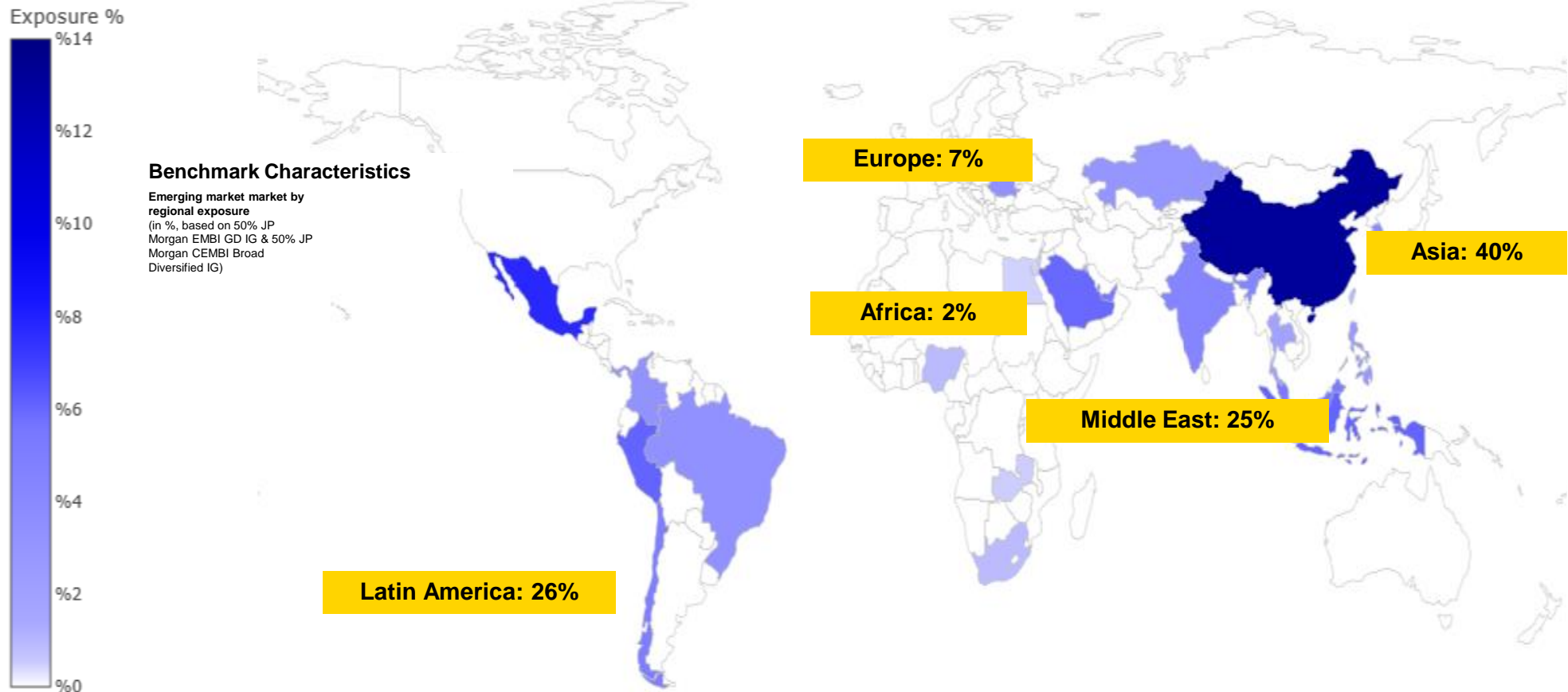
## Example of Spread Optimization

Same issuer, similar duration and maturity, however, different remuneration (value in Mexican GBP century bonds).



**100bp spread pick up for a similar risk (same issuer, coupon, maturity, duration...)**

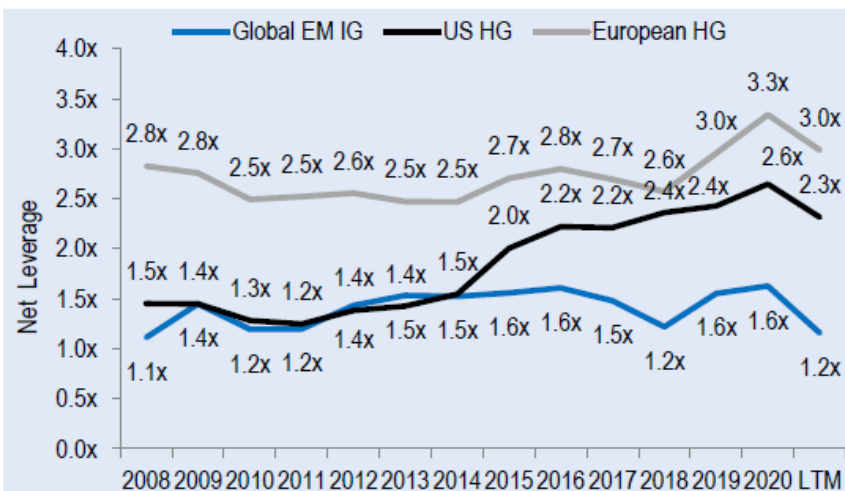
## A diversified investment universe



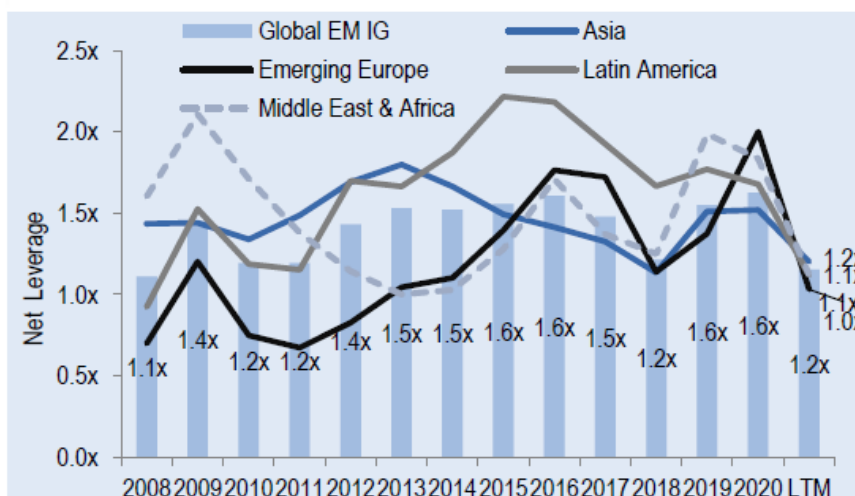
Strong diversification potential across regions, countries, sectors, issuers, capital structures...

# Robust fundamentals

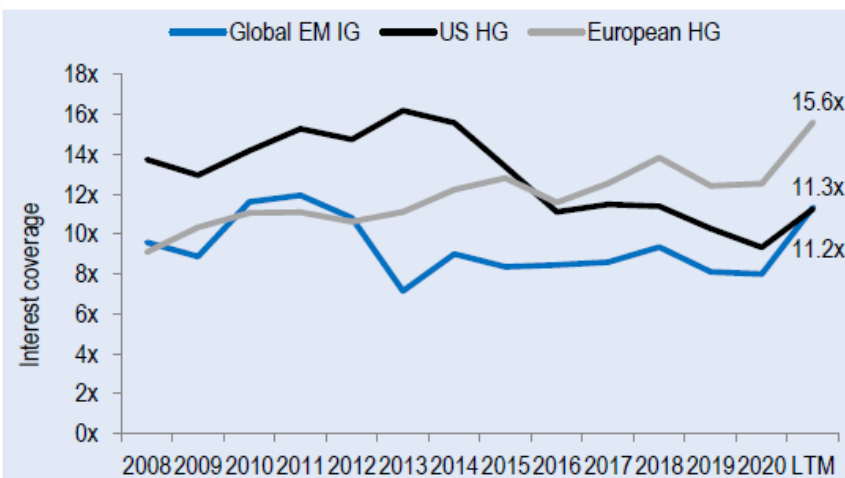
## EM vs DM IG net leverage



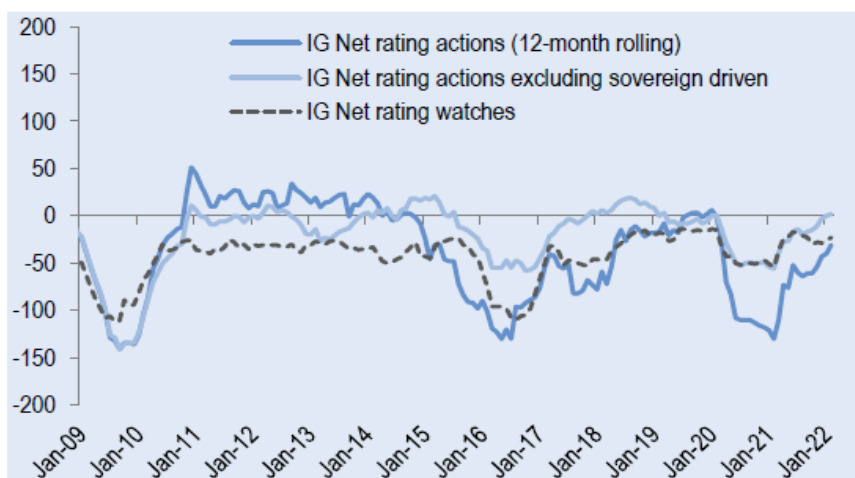
## IG net leverage comparison



## EM vs DM IG interest coverage



## EM corp IG rating trends



Introduction

Why EM IG?

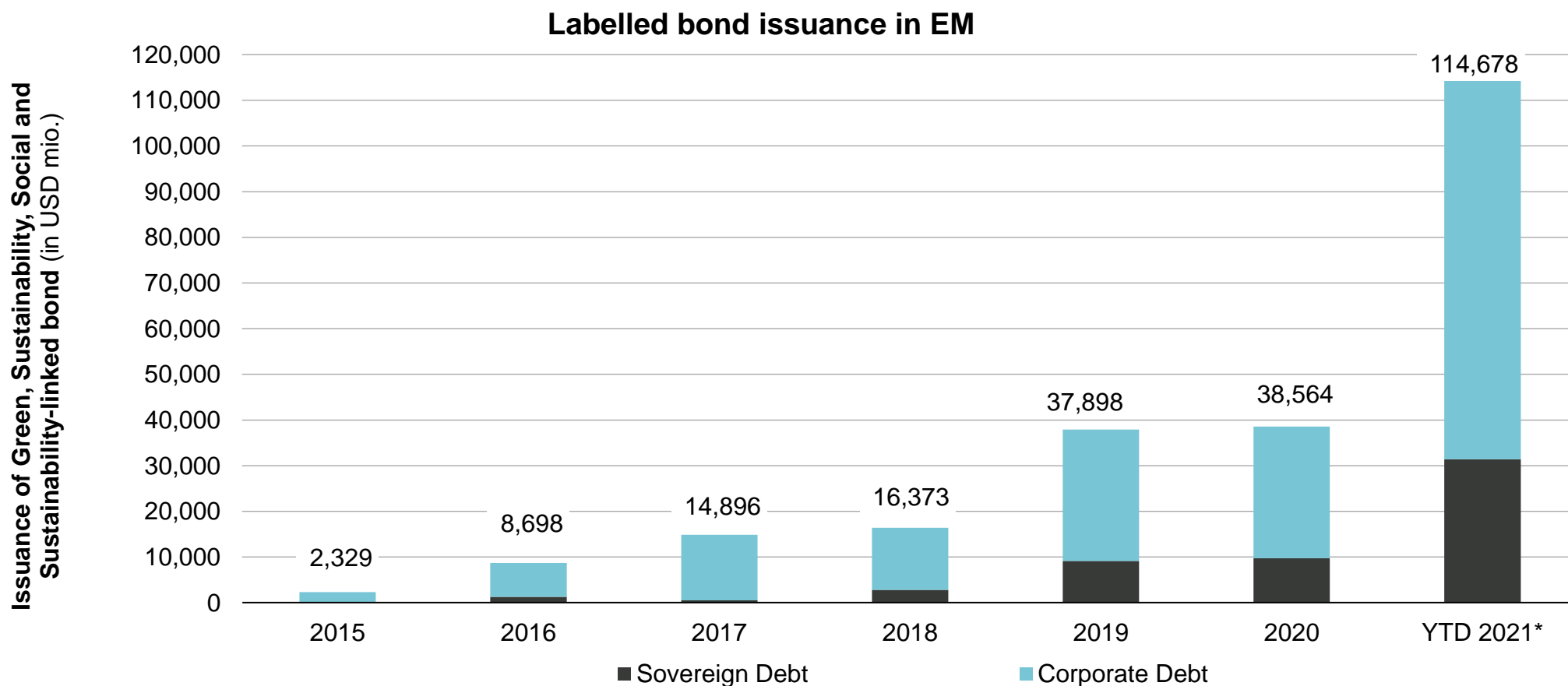
**Focus on ESG and Labelled bonds in EM**

Conclusion



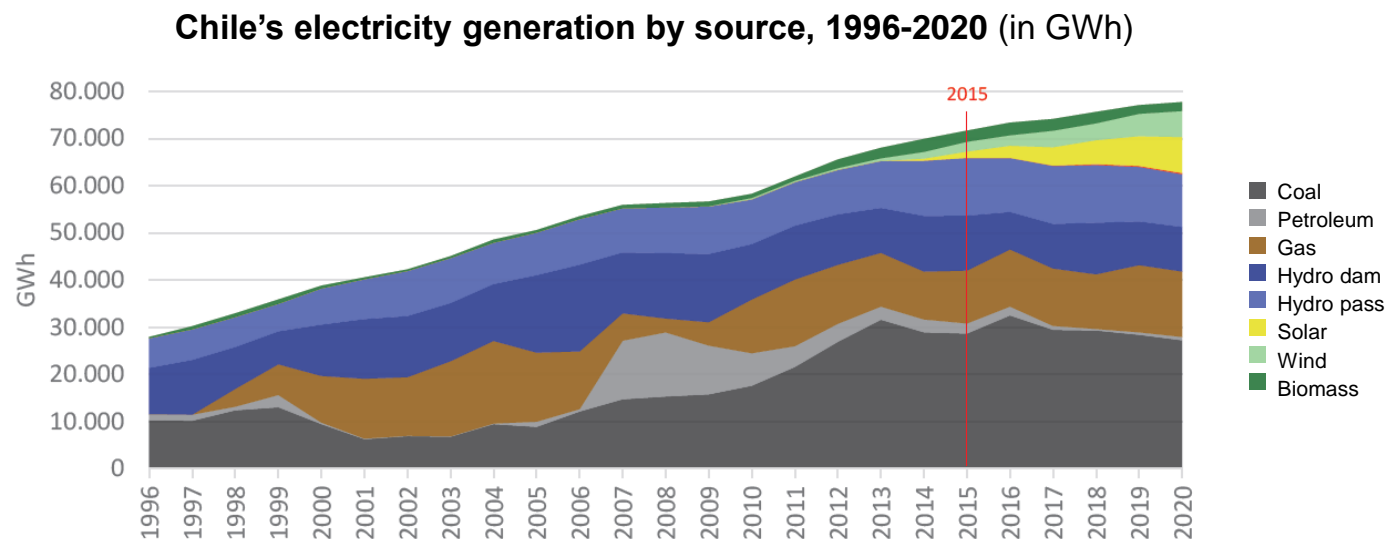
## ESG is growing in Emerging Market fixed income, too!

Bonds issued with labels such as Green, Sustainability, Social and Sustainability-linked have surged massively in issuance volume over the past 6 years with a **CAGR of more than 91%!**



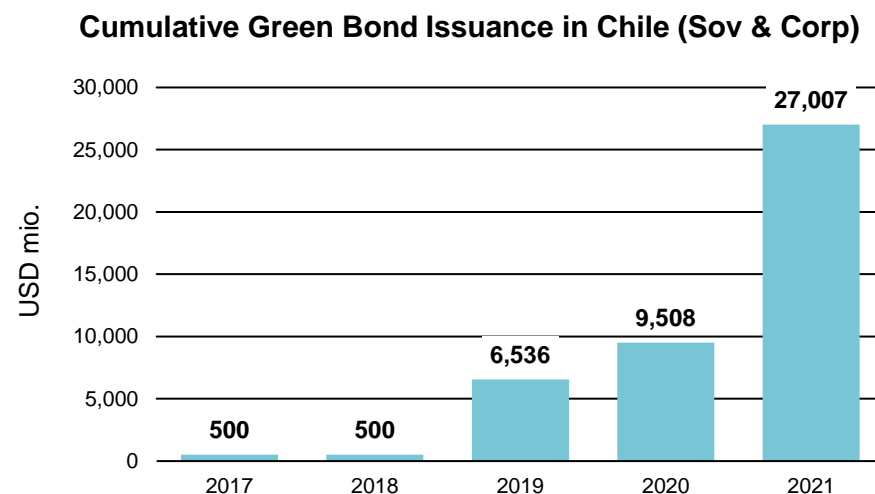
## Case study: Chile's energy transition (1/2)

- Biggest single energy source is still coal
- However, renewable generation offers the most competitive prices, followed by coal, gas- and diesel-powered generation
- In 2019, the Chilean government announced the “[National Decarbonization Plan](#)” to reduce the system's dependence on coal, aiming to terminate 1'047 MW of coal generation capacity by 2024 and 100% of coal generation capacity by 2040

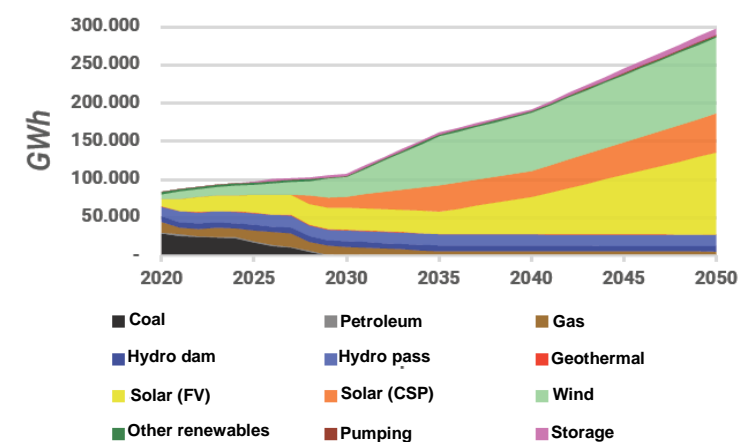


## Case study: Chile's energy transition (2/2)

- Around 380 (private) companies are included in Chile's "[National Decarbonization Plan](#)" and while overall investments into the Energy sector have been fluctuating over the past years, the green bond issuance has increased profoundly especially in the past 3 years (see l.h.s. chart)
- Currently, the Chilean congress passed a bill which would shorten the timeline for no coal-based energy from 2040 to 2025, however, Chilean senate is still pending
- This could further accelerate the green bond issuance and support Chile in their ambitions to become a green energy exporter in the region (see r.h.s. chart)

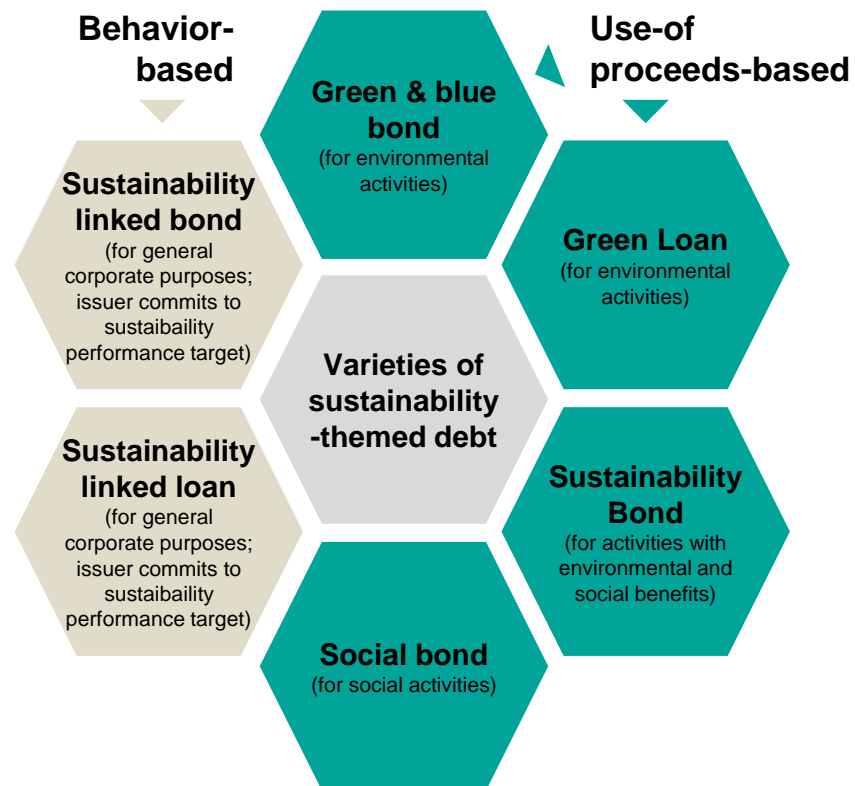


**Projection of Chile's Electricity Generation by Source**

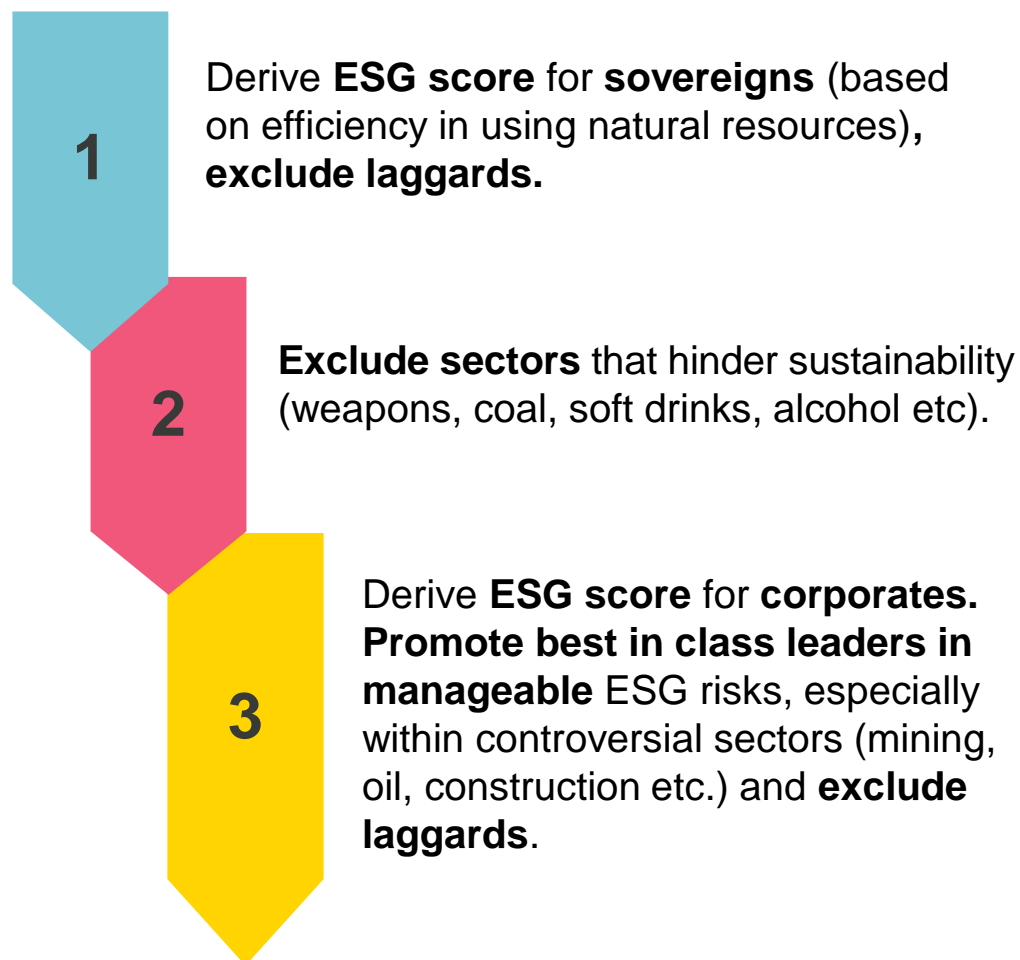


# Labelled bonds are a market based solution to the ESG problem...

We aim to be systematically overweight labelled bonds in the EM IG portfolio



## ...But we will use ESG models while the labelled bond market matures: illustration of the “sustainable waterfall” approach



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## **Round up**

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**EM Fixed Income is a deep,  
diversified but  
underinvested asset class**

**Vontobel AM has a unique,  
tried and tested financial  
and ESG approach to  
deliver competitive risk  
adjusted returns**

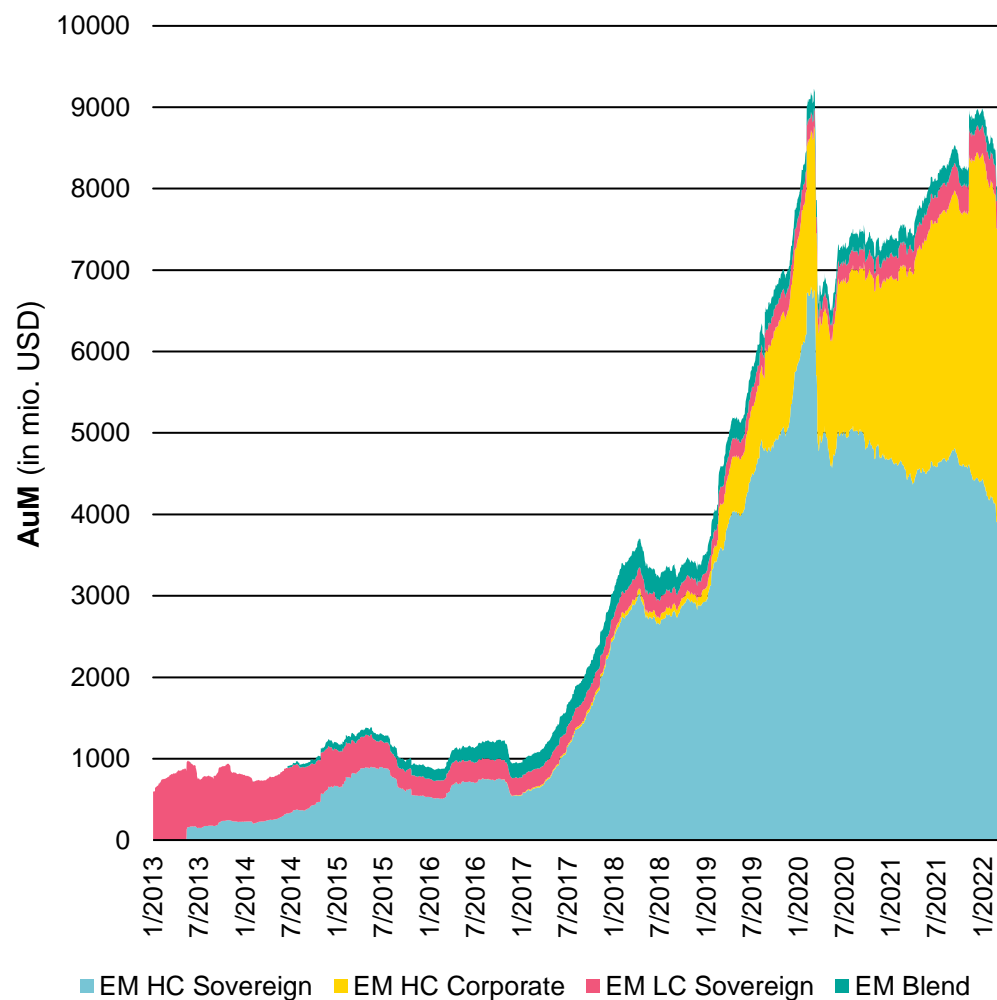
**To help investors achieve  
their sustainability, risk,  
performance and income  
objectives**

# Vontobel



## AuM history

### Evolution of the EM franchise's AuM across our 4 major strategies, as of 31.3.2022



#### EM Strategies

#### AuM, in mio USD

EM Hard Currency Sovereign

3'715.1

EM Hard Currency Corporate

3'528.3

EM Local Currency Sovereign

328.9

EM Blend

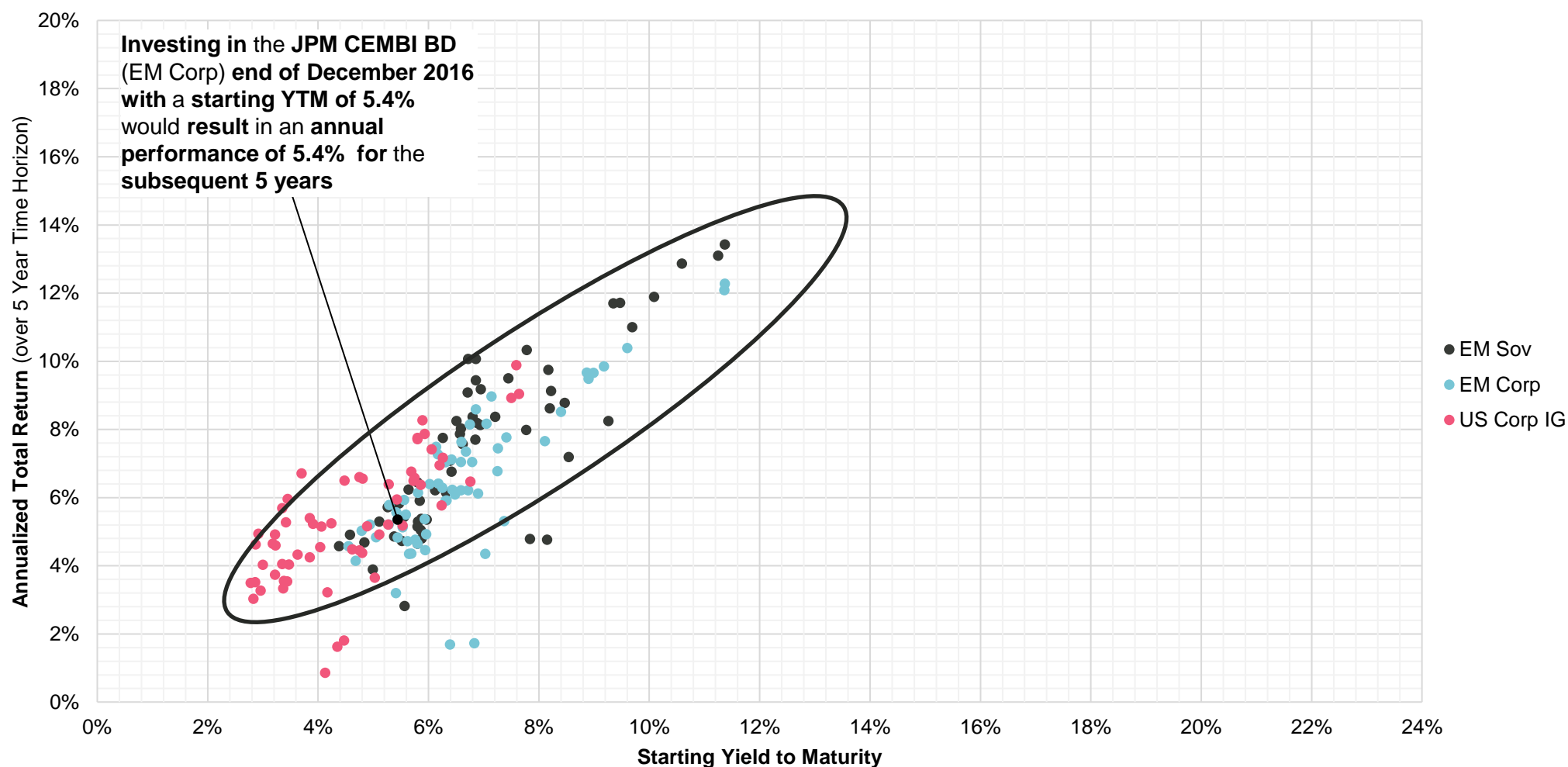
169.9

**Total**

**7'742.2**

## Why is yield important?

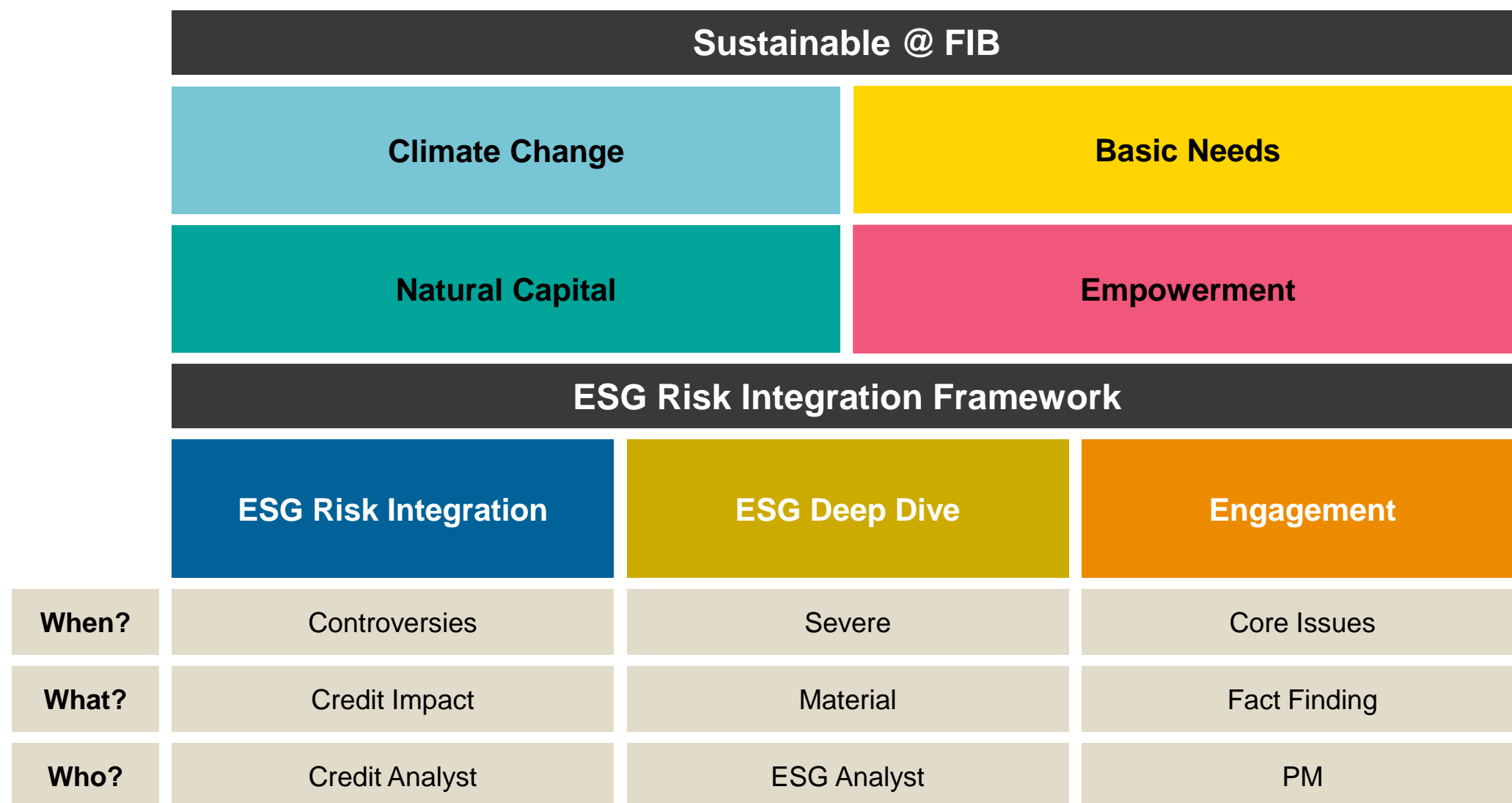
**We observe a link in spread markets between the starting yield and the performance which is effectively achieved over a 5-year rolling holding period**



Note: each dot represents an annual, rolling, 5-year annual return versus the original, starting yield (to maturity) of the index. EM Sov stands for JPM EMBI GD, EM Corp for JPM CEMBI BD, US Corp IG stands for ICE BofA US Corporate Index.

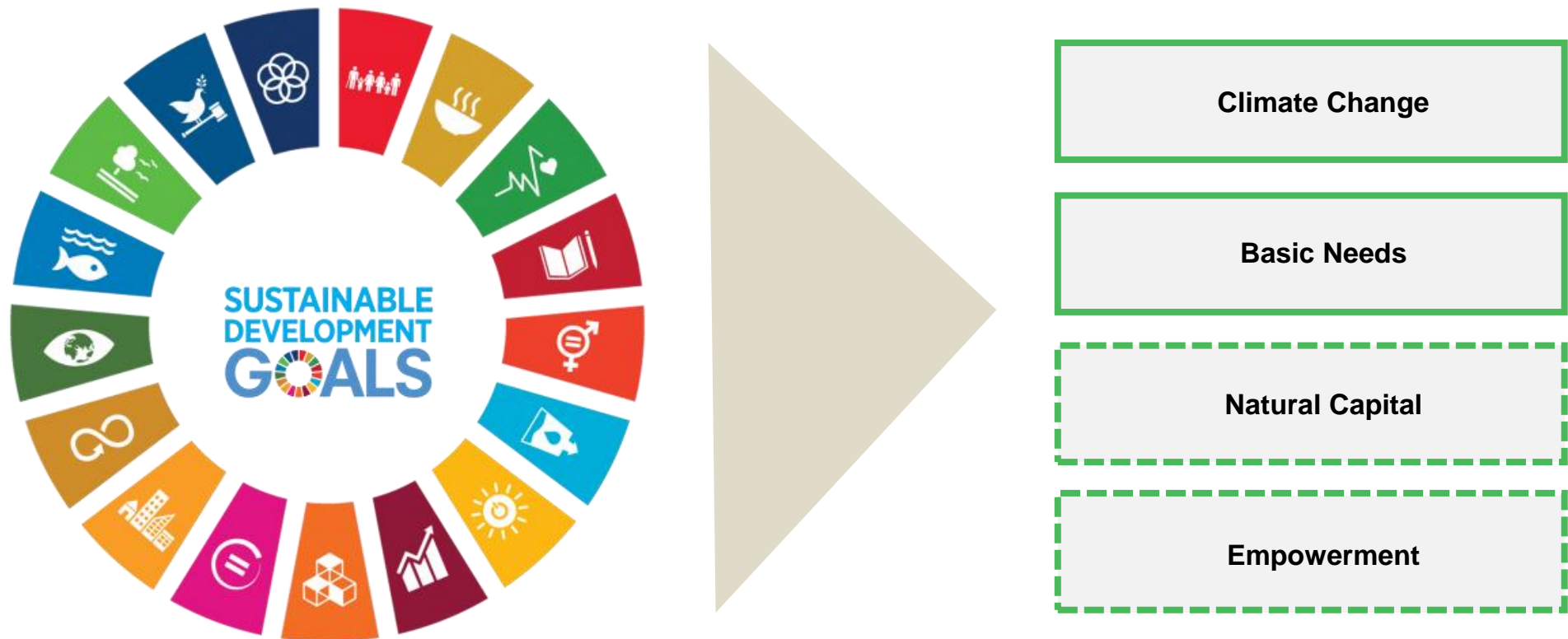
Source: Vontobel Asset Management, Bloomberg, from 31.12.2001 to 31.12.2021.

# Sustainable framework at Vontobel Fixed Income Boutique



## Overview of sustainability

**Sustainable approach for EM Investment Grade: Climate Change & Basic Needs SDGs are the main actionable themes**



## Philosophy: ESG helps avoid blow ups, inefficiencies lead to opportunity

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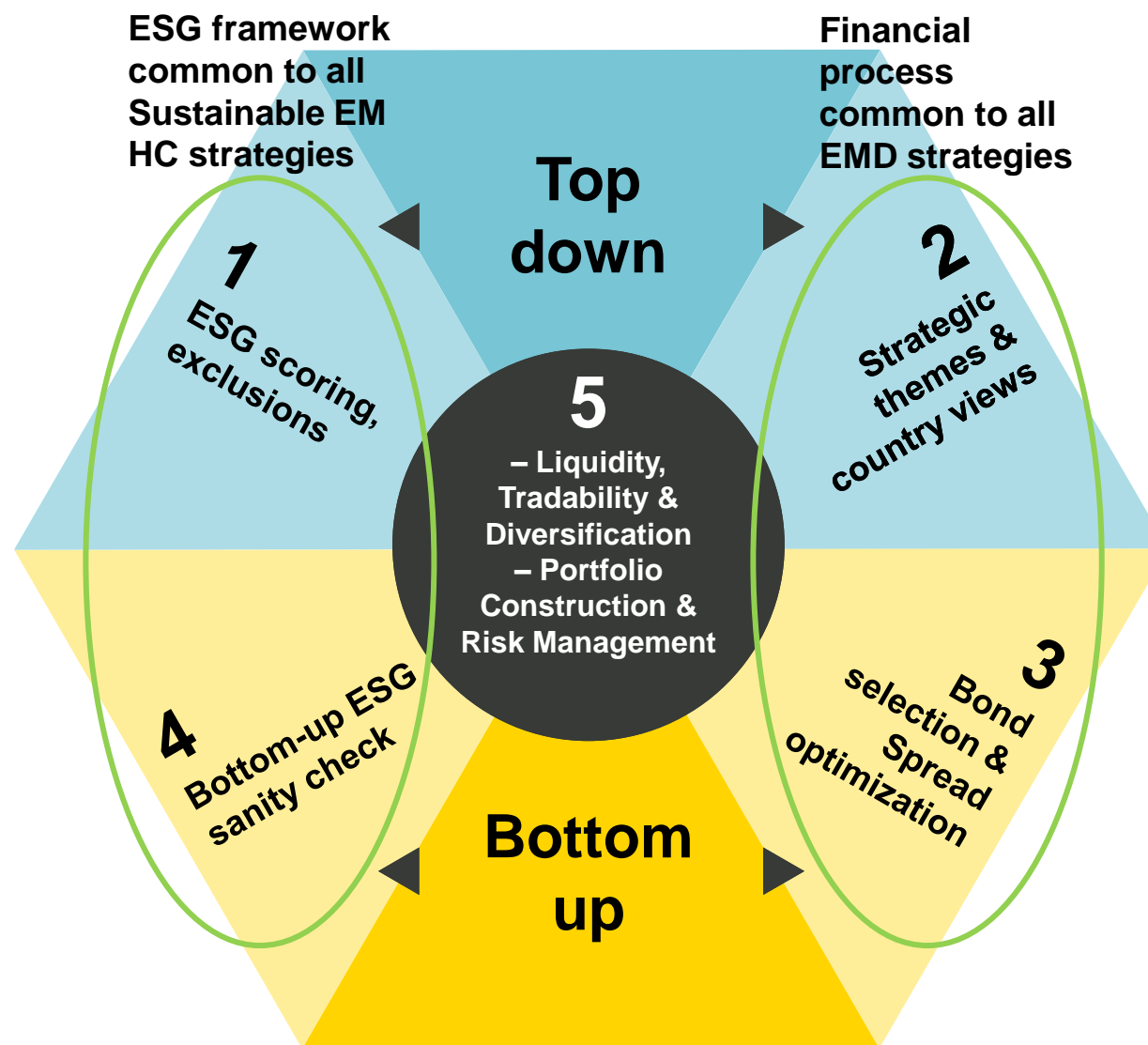
### **Sustainability is a new dimension of investment**

- EM Countries and issuers have the biggest scope for improvement and changing their behaviour will have a bigger impact on the world
- Labelled bonds are a market based solution to the ESG problem
- ESG models are used while the labelled bonds market develops.

### **Output:**

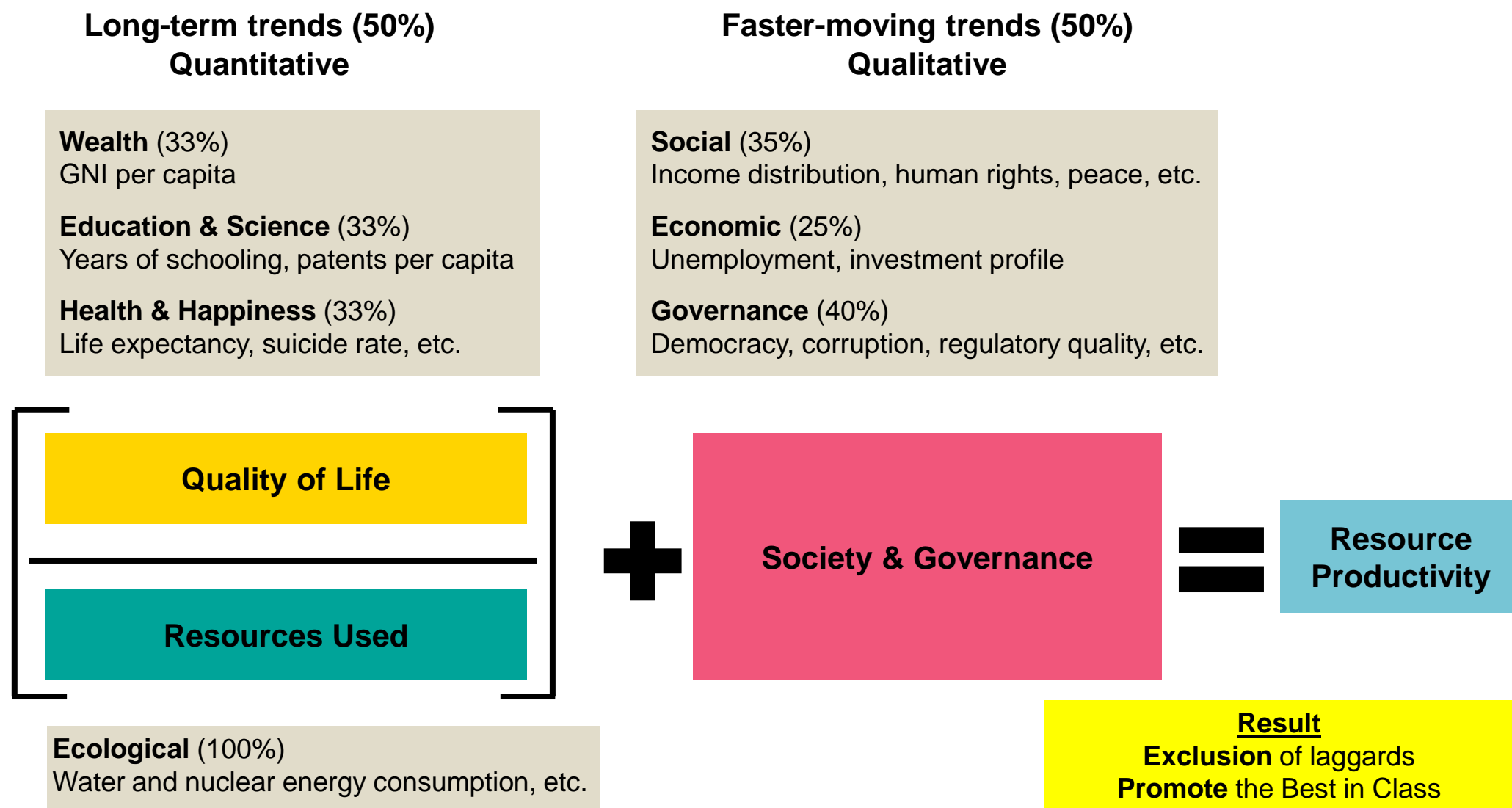
Encourage exposure to labelled bonds and countries - corporates with the most sustainable utilization of limited resources.

## Five-step process: focus on ESG and bottom-up credit opportunities



# Level 1. of the waterfall

## ESG model for SOVEREIGNS – Resource Productivity



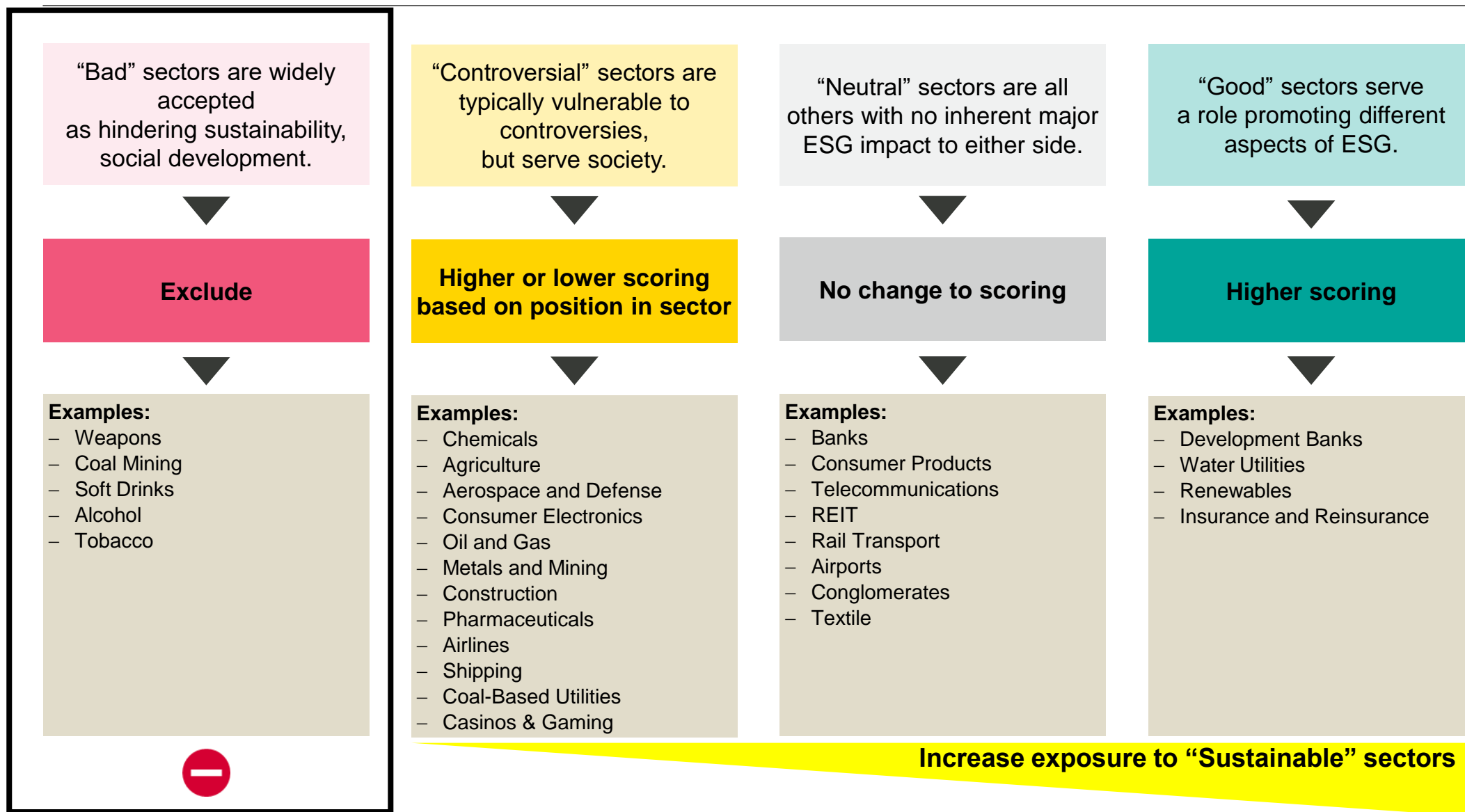
Source: Vontobel Asset Management

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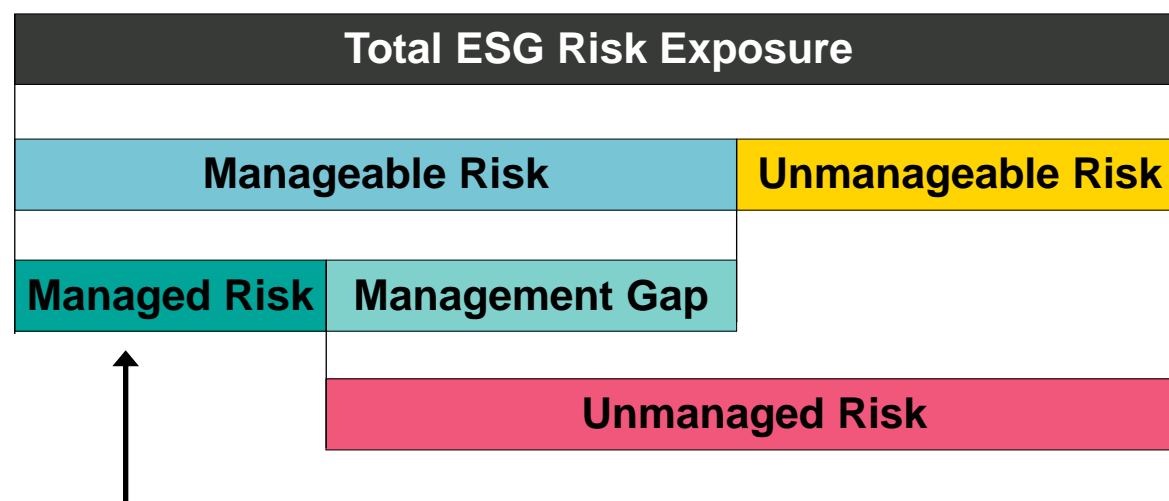
## Level 2. of the waterfall

### ESG model for SECTORS – Values & Norms based exclusions





# Level 3. of the waterfall ESG model for CORPORATES – Management Efficiency

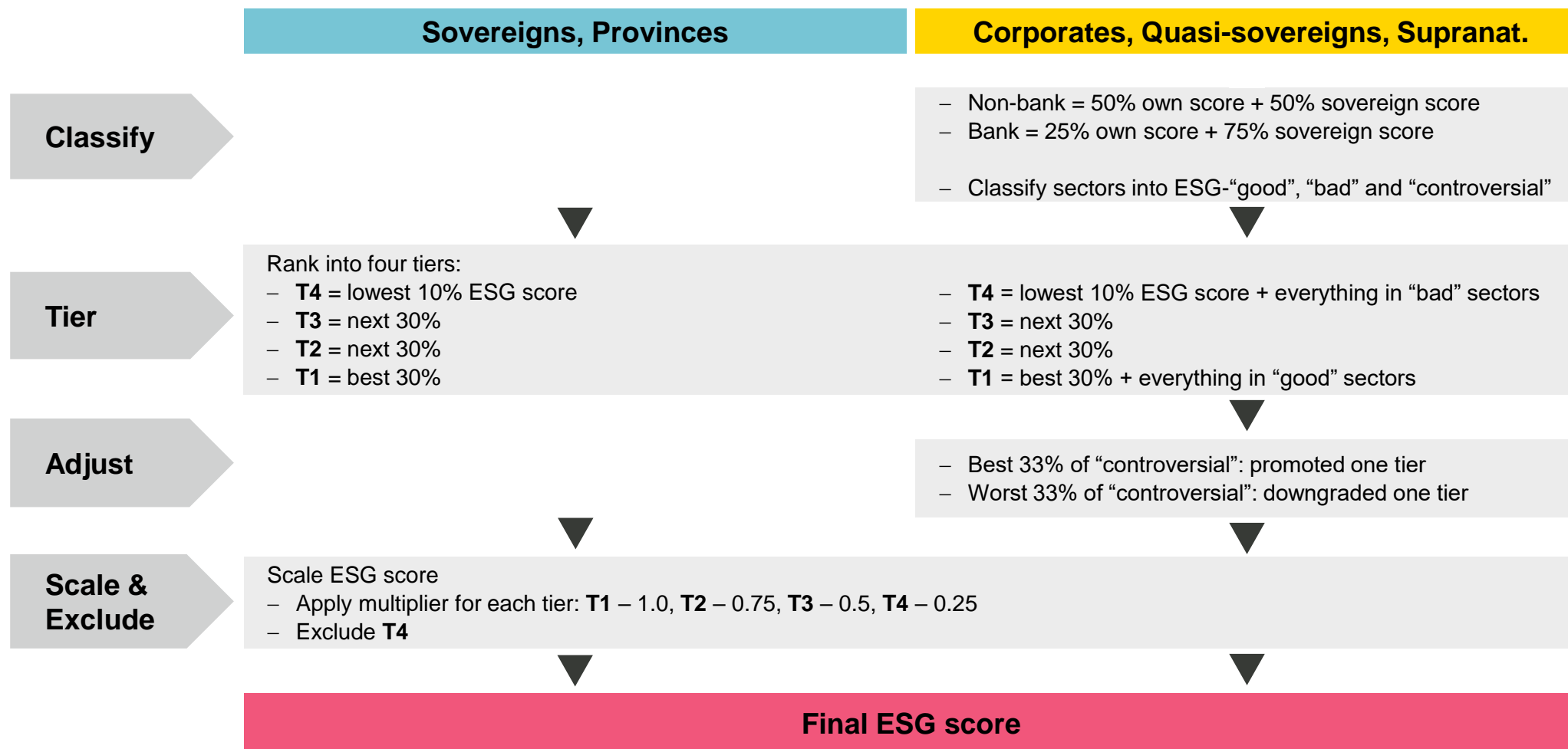


- ← All companies have certain exposure to ESG risks.
- ← Some companies cannot fully hedge such risks, for instance, oil companies.
- ← Management can minimize certain part of the risk via pointed actions.

Invest in companies which maximize this

Best-in-class positive screening incl score-based exclusions

# ESG scoring, exclusions: Implementation of ESG model into the process



## Summary of exclusions

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### Sovereigns

- UN Sanctioned countries
- Most inefficient countries vis à vis resource productivity

### Sectors

- Weapons
- Coal Mining
- Soft Drinks
- Alcohol
- Tobacco, etc

### Corporates

- UNGC violators
- Most inefficient companies in terms of ESG managed risks (Sustainalytics model)

# EM Corporate Bond selection

## Non-labelled bonds

### Overview of approach

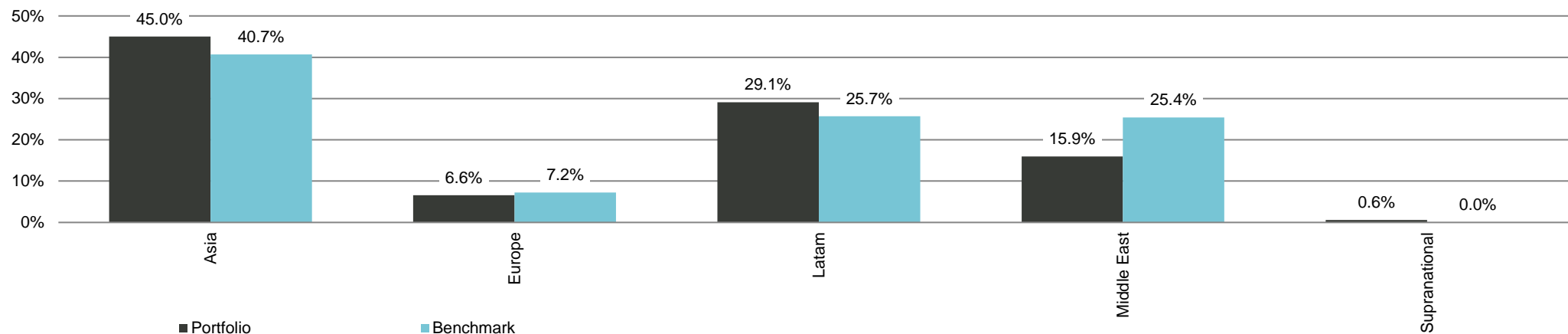
Stakeholder Analysis	Fundamental analysis	ESG Analysis	Attitude to the bond
<ul style="list-style-type: none"><li>- Strategic importance of the company</li><li>- “Soft” power considerations</li></ul>	<ul style="list-style-type: none"><li>- Operating results</li><li>- Cash flow adequacy</li><li>- Credit metrics</li><li>- Liquidity, asset quality</li></ul>	<ul style="list-style-type: none"><li>- ESG impact of the sector</li><li>- Quality of the firm in terms of ESG manageable risks</li></ul>	<ul style="list-style-type: none"><li>- Sovereign rating cap</li><li>- History of default</li><li>- Bond ownership/ typical trading behavior in the name</li></ul>



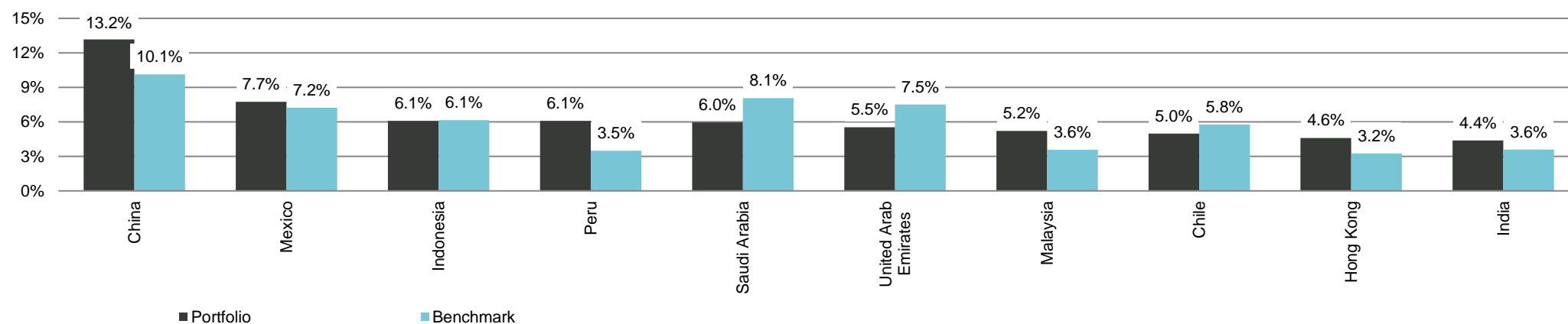
**Is outlier a mispricing or falling knife? Leads to Buy/Hold/Sell**

## Current Positioning of the EM IG model portfolio

### Regional exposure

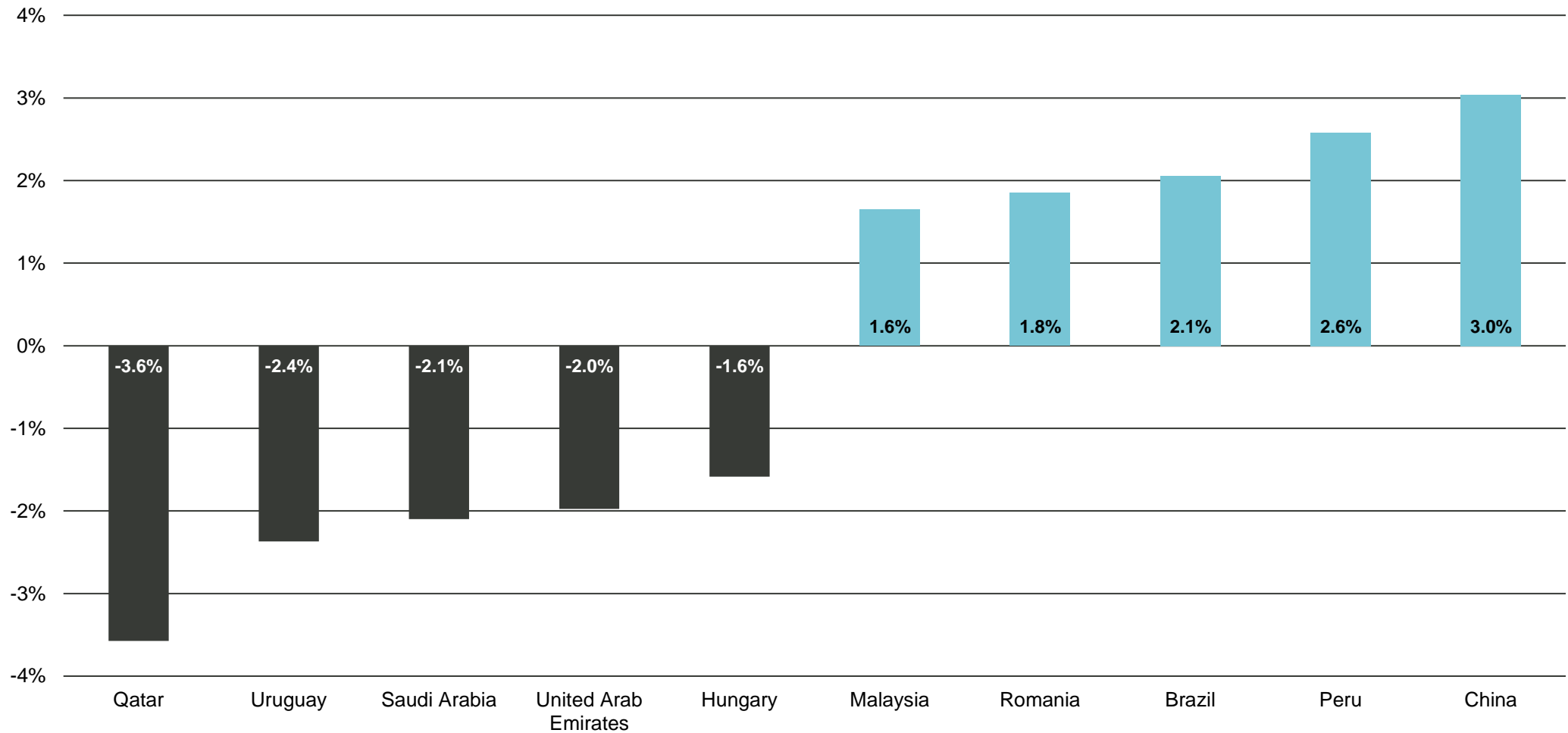


### Top 10 country exposures fund/benchmark (%)



## Current Positioning of the EM IG model portfolio

### Top 5 underweight/overweight (in %)



## Disclaimer (1/2)

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the underlying markets or instruments. They tend to carry higher risks than direct investments. Investments in money market instruments are subject to money market risks such as interest rate risk, risk of inflation and economic instability. Investments in higher yielding and riskier bonds are generally considered to be more speculative in nature. These bonds have a higher credit risk, higher price volatility and a higher risk of loss of principal and current income than bonds with higher credit ratings.

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**Historical performance is not indicative of current or future performance.**

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