

GLOBAL FIXED INCOME: WHAT IS "EMERGING"?

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Following the U.S. election, most of the attention in the fixed income arena seemed to be paid to rate developments here at home, as bond investors found it increasingly difficult not to focus on the twin pillars of domestic policy ([monetary](#) and [fiscal](#)) creating a more challenging domestic fixed income setting in 2017. Obviously, such policy considerations can have global ramifications as well, so we thought it would be useful to provide some updated thoughts on what has been “emerging” thus far.

Emerging market debt (EMD) certainly had moments of volatility in 2016. To be sure, during the “risk-off” period in the first quarter, emerging market (EM) [spreads](#) in local terms (measured as the difference between the [J.P. Morgan EM Global Diversified Composite Yield to Maturity](#) vs. the [U.S. Generic Government 5-Year Yield](#)) reached a high of +575 [basis points \(bps\)](#) before falling to a pre-Brexit vote low of +498 bps in late April. As expected, EMD could not escape post-Brexit anxieties either, as spreads once again widened back out to +545 bps before settling into more of a range-bound pattern leading up to U.S. election. As in most other fixed income arenas, EMD also responded negatively after the U.S. election, once again piercing through the +500 bps threshold. However, this move to wider ground was not long-lived, with EMD finding its footing; in local debt terms, EMD finished 2016 with a total return just under +10% ([J.P. Morgan Government Bond Index-Emerging Markets Global Diversified Index](#)), one of the best performances within all of global fixed income last year.



Source: Bloomberg, as of 2/10/16. Past performance is not indicative of future results. You cannot invest directly in an index.

So, how is 2017 shaping up so far? Six weeks into the new year and EM local debt has thus far produced a positive return of +3.6%, with spreads at +472 bps. As the graph above reveals, from a historical perspective, current spread levels are not too far removed from the 10-year average tally of + 492 bps, as of this writing.

In our 2017 Outlook [On the Markets](#), we stated that many EM central banks face an interesting dilemma in 2017. Economic fundamentals argue that policy can be eased to foster further economic growth in the face of low [inflation](#), but will EM central bankers have confidence in the resilience of their currencies to cut rates as the [Federal Reserve \(Fed\)](#) is hiking them? In our base case scenario, EM currencies could prove very resilient, as higher [carry](#) and strengthening EM growth counter a modest move higher in U.S. [interest rates](#). Differentiation within EM will continue to remain important, especially against the potential uncertain trade backdrop from the Trump administration. We should note that in the more extreme risk-off and rising-rate environments, EM currencies could face much greater challenges.

Conclusion

Investors looking to add EM [local debt](#) exposure to their fixed income portfolios should consider the [WisdomTree Emerging Markets Local Debt Fund \(ELD\)](#), which invests primarily in local currency debt of emerging market issuers. In an effort to boost allocations to issuers pursuing monetary and fiscal discipline and reduce allocations to those who are overextended, countries are ranked into three tiers and then equally weighted. In addition, country exposure to such factors as growth, inflation, debt capacity/debt service and short-term [liquidity](#) are continuously evaluated. Within a fixed income portfolio, ELD can be used to help increase yield as a non-core allocation.

Unless otherwise noted, data source is Bloomberg as of February 10, 2017.

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You cannot invest directly in an index.

DEFINITIONS

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Fiscal Policy : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

Spread : Typically refers to a difference between a measure of yield for one asset class and a measure of yield for either a different subset of that asset class or a different asset class entirely.

JP Morgan EM Global Diversified Composite Yield to Maturity : Represents the yield to maturity of the J.P. Morgan Government Bond Index-Emerging Markets Global Diversified Index.

Basis point : 1/100th of 1 percent.

JP Morgan Government Bond Index – Emerging Markets (GBI-EM) Global Diversified : The JP Morgan GBI EM Global Diversified tracks the performance of local currency debt issued by emerging market governments, whose debt is accessible by most of the international investor base. The index incorporates a constrained market-capitalization methodology in which individual issuer exposures are capped at 10%, (with the excess distributed to smaller issuers) for greater diversification among issuing governments.

Inflation : Characterized by rising price levels.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Carry : The amount of return that accrues from investing in fixed income or currency forward contracts.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Locally denominated debt : Debt denominated in local currencies issued by an emerging market government.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.