

# Emerging Market Corporates: Finding Value amid Tight Spreads and Strong Fundamentals

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## Key Takeaways

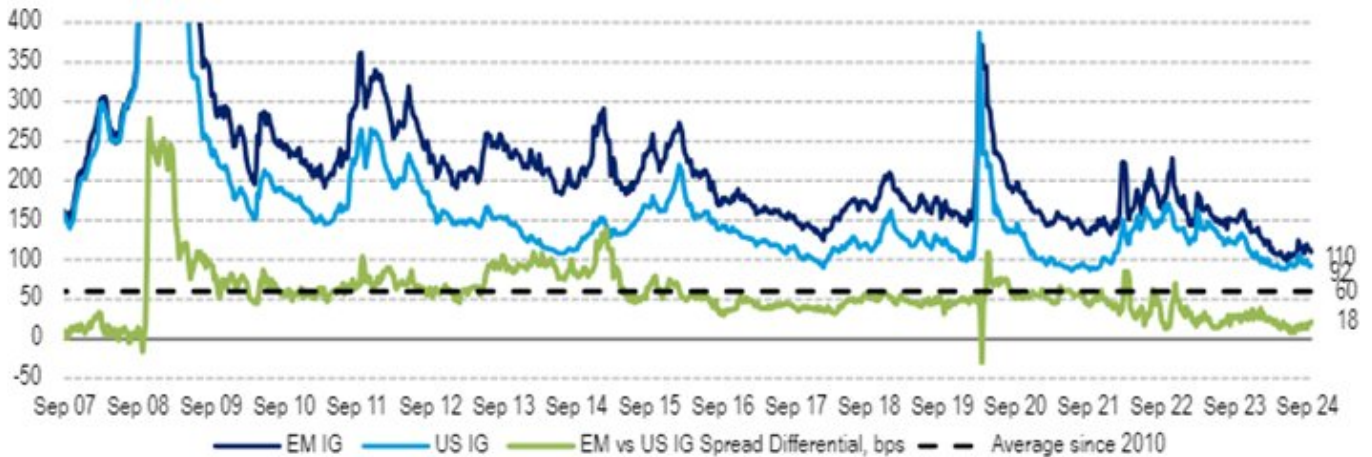
- Emerging market corporate bonds have delivered strong performance in 2024, with spreads tight but attractive relative to U.S. credit, supported by robust corporate fundamentals and declining interest rates.
- Favorable technical conditions, including negative net issuance and low default risks, continue to support the appeal of emerging market corporates, offering geographic diversification and income stability for fixed income investors.
- The [WisdomTree Emerging Market Corporate Bond Fund \(EMCB\)](#) remains cautiously under-weight in Chinese and Southeast Asian high-yield issuers, favoring long-term fundamentals over short-term rallies.

In recent discussions, we have highlighted the growing appeal of (U.S.) dollar-denominated emerging market (EM) corporate bonds in today's financial landscape, particularly for investors aiming to enhance their fixed income portfolios. Since publishing our post, "[Rising Titans: The Allure of Emerging Market Corporates](#)" on March 15, through the end of September, the J.P. Morgan Corporate EMBI Broad Diversified Composite Index has demonstrated a further rally of 6.67%, continuing the strength we have seen throughout 2024.

EM corporates have been delivering solid performance this year, with year-to-date returns notably surpassing those of U.S. credit, accompanied by less volatility. The overall decline in interest rates has certainly played a role in driving these returns, yet the resilience and performance of EM corporates go beyond rate movements—they have excelled in spread terms as well. This year, tight spreads have been driven by historically high yields, drawing in investors seeking higher income. The expectation of a soft economic landing, combined with low default risks and solid corporate fundamentals, has supported this trend.

The spread pickup offered by EM corporates remains attractive in comparison to U.S. credit and some sovereign issuances. Yes, spreads are currently tight, and it's reasonable to wonder if they have room to tighten further. However, considering the fundamentals of EM issuers—often stronger than those of similarly rated developed market (DM) credits—there remain opportunities worth pursuing.

### EM IG vs. U.S. IG OAS Spread Differential



Source: BofA Global Research, ICE Data Indices, as of 9/30/24.

### EM HY vs. U.S. HY OAS Spread Differential

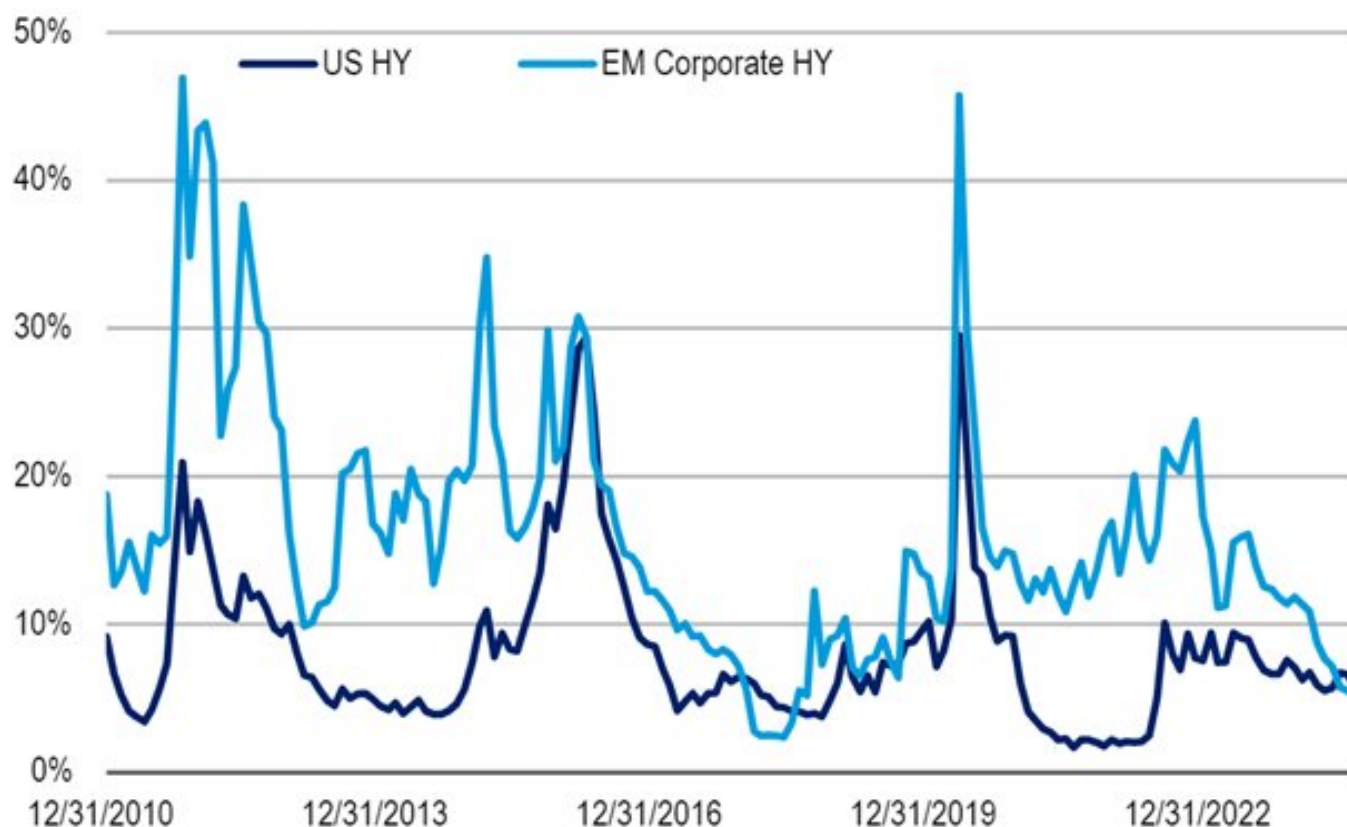


Source: BofA Global Research, ICE Data Indices, as of 9/30/24.

Our optimism toward EM corporates rests on a few key pillars. First, this asset class is predominantly composed of investment-grade (IG) issuers, with about 71% of the total outstanding volume carrying an IG rating. This makes EM corporates a reliable choice for investors seeking high quality within their fixed

income allocations. Second, the geographic diversification offered by EM corporates is another strength. Additionally, the share of distressed debt within EM high yield (HY) is historically low and has fallen below that of U.S. HY. This illustrates how EM corporates, particularly those with higher risk profiles, have largely maintained their stability, outperforming their U.S. counterparts in relative terms.

## Share of Distressed EM HY vs. U.S. HY



Source: BofA Global Research, ICE Data Indices, as of 8/30/24.

Another positive factor for EM corporates is the technical environment, which is likely to remain supportive. With negative net issuance expected through the end of 2024, the supply-demand dynamics for this asset class should lean in favor of continued investor support. A lack of substantial new issuance will help maintain spread tightness while adding a cushion of stability as demand for high-yielding, geographically diversified credit instruments continues.

## China, and EMCB's positioning

In our previous post, we highlighted the [WisdomTree Emerging Market Corporate Bond Fund \(EMCB\)](#) and discussed the importance of security selection when investing in this asset class. One of the Fund's notable under-weights is in China and some Southeast Asian countries, a decision that we have deliberated on extensively. Chinese markets have seen gains in recent months, fueled by hopes of government stimulus, and this positioning has indeed been a drag on the Fund's performance versus the Index year-to-date.

However, it is important to understand the rationale behind this under-weight and why we continue to think it is a prudent decision for the long term.

The majority of our under-weight exposure to China and Asia is within Asian high-yield issuers. Many of these companies do not offer enough income or present sufficiently attractive fundamentals to compensate investors for the risks inherent in their business models and economic environment. While these bonds did rally earlier in the year, supported by domestic growth exceeding expectations and increased government policy support, we have remained cautious about overcommitting to this segment. Long-term risk-reward considerations remain critical. We've resisted getting caught up in short-term movements because we believe a level-headed assessment of long-term fundamentals should guide our positioning decisions.

Recent developments support this perspective. On the day of writing this post (October 8), the Chinese markets took a considerable downturn, with the Hang Seng China Enterprises Index down by 10% following an underwhelming stimulus announcement from the National Development and Reform Commission, China's economic planning body. The expectations for more robust measures from the Chinese government have led to market volatility, illustrating why our conservative stance has been justified.

## Conclusion

In conclusion, emerging market corporates have continued to offer an attractive proposition in 2024. Solid returns, less volatility compared to U.S. credit and supportive market technicals provide a compelling case for investors to consider this asset class as part of their fixed income portfolios. While spreads may be tight, we believe the relative value remains appealing, particularly given the strong fundamentals of many EM issuers. Our cautious positioning toward China and Southeast Asia reflects our focus on balancing risk and return, avoiding unnecessary exposure to unpredictable markets or issuers lacking attractive long-term prospects.

## Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Derivative investments can be volatile, and these investments may be less liquid than other securities and more sensitive to the effects of varied economic conditions.

Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. In addition, when interest rates fall, income may decline. Fixed income investments are also subject to credit risk, the risk that the issuer of a bond will fail to pay interest and principal in a timely manner or that negative perceptions of the issuer's ability to make such payments will cause the price of that bond to decline. Unlike typical exchange-traded funds, there is no index that the Fund attempts to track or replicate. Thus, the ability of the Fund to achieve its objective will depend on the effectiveness of the portfolio manager. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.