

Emerging Market Debt: Down but Not Out

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What Took Emerging Market Debt Down in 2015? In a word, currency. If we look at the performance of the J.P. Morgan GBI-EM Global Diversified Index—an important benchmark for emerging market debt in local currency—it was down 14.86% through September 25, 2015. The currency impact was 16.23% over this period, meaning that the return on the locally denominated bonds themselves was actually positive.¹ While there is no question that these currencies can be volatile and difficult to predict, the bonds themselves could have some attractive valuation characteristics. So how do we capitalize on this potential? At WisdomTree, we've been managing a structured active approach for our [Emerging Markets Local Debt Fund \(ELD\)](#) for more than five years, because we think that country fundamentals are better indicators of potential opportunities in these markets. Similar to what we saw in the J.P. Morgan index above, ELD's return at net asset value (NAV) year-to-date through September 25, 2015, was -13.17%, but the impact of currency was -14.82%, meaning that ELD's underlying bond positions—in local currency terms—were also positive. **We Asked Ourselves Two Simple Questions: 1. How far have the emerging market currencies in ELD declined against the U.S. dollar thus far in 2015?** Simply put, greater declines mean these moves may have reflected more risks. **2. What do the country positions in ELD show in terms of potential income generation, with their embedded income yields being one specific measurement?** While by no means the only (or a perfect) measure, this metric does lend itself to thinking about relative valuation potential in these markets. **The Yield Opportunity in Emerging Market Fixed Income**

Fund Name	As of 6/30/2015						Average Annual Returns as of 6/30/2015					
	Fund Information			Fund Yields			Total Return NAV (%)			Market Price (%)		
	Ticker	Expense Ratio	Inception Date	Distribution Yield	Trailing 12-Mo. Dividend Yield	SEC Standardized 30-Day Yield	1-Year	5-Year	Since Inception	1-Year	5-Year	Since Inception
WisdomTree Emerging Markets Local Debt Fund	ELD	0.55%	8/9/2010	4.92%	4.76%	5.44%	-14.02%	N/A	-1.01%	-14.18%	N/A	-1.21%



Sources: WisdomTree, Bloomberg; with data on embedded income yield as of 9/25/2015, and data on currency performance for the period from 12/31/2014 to 9/25/2015.

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available at www.wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

Below, we comment on the performance environment that we've seen from December 31, 2014, to September 25, 2015, nearly three-quarters of the way through the year: • **Brazil Stands Out:** The recent downgrade by Standard & Poor's² that pushed Brazil's sovereign credit rating below investment grade is only a single item on a list of issues plaguing Brazil this year. The currency has lost approximately one-third of its value against the U.S. dollar. However, the positions in ELD show an embedded income yield of more than 15%. It is impossible to say whether the currency will depreciate further, but the fact of the matter is that this potential income is very high—and the reason that it gets this high is to compensate investors for perceived risk. • **ELD at 6.67%:** The embedded income yield of the aggregate ELD portfolio is 6.67%. The journey to this point in 2015 has included a currency depreciation of -14.82%, as stated above, but the truth of the matter is that in the current environment, any measure of potential income above 6.5% is not without significant risk. • **U.S. Federal Reserve Remains "on Hold"** We now know that the Fed did not raise rates at its September policy meeting. Does that mean emerging market currencies remain challenged for the rest of the year? Since the vast majority of emerging market exposure—both within equities and within fixed income—is not currency hedged, this is a major issue that can impact most emerging market investments. Recently we spoke with [Western Asset Management's head of emerging market debt](#), and he thought the most value in various emerging market debt asset classes was in this local currency sovereign market. Fears of the Fed rate hike—whenever it may come—may largely already have been anticipated and accounted for with the sharp falls the currencies have already experienced. For those positioning for a stronger U.S. dollar versus developed market currencies such as the euro and the yen, adding emerging market currency exposure on either the debt or equity side could offer a nice complement and diversifying

element to those stronger-dollar-oriented portfolio allocations. [*Click here to view WisdomTree Emerging Markets Local Debt Fund \(ELD\) prospectus.*](#) 1Sources: Bloomberg, JP Morgan; with data measured from 12/31/14 to 9/25/15. 2Source: Joe Leahy, "S&P Cuts Brazil's Credit Rating to Junk," Financial Times, 9/10/15.

Important Risks Related to this Article

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There are risks associated with investing, including 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. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs.

Diversification does not eliminate the risk of experiencing investment losses. Hedging can help returns when a foreign currency depreciates against the U.S. dollar, but can hurt when the foreign currency appreciates against the U.S. dollar.

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