Danske Invest SICAV
Emerging Market Debt Hard Currency
Class A / Class I / Class I-eur h
SEPTEMBER 2017

Fund focus

Buenos Aires, Argentina

The search for excess yield in the emerging markets

Emerging market bonds issued in hard currency offer investors an excess yield relative to government bonds from the developed markets. Danske Invest's mutual fund Emerging Market Debt Hard Currency provides access to investments in the asset class.

Keywords

- Expected excess return
- Potentially spread portfolio risk
- Currency risk is minimal
- Particular associated risks

Danske Invest

An attractive investment in the emerging markets

Danske Invest Emerging Market Debt Hard Currency invests in bonds from emerging markets in Latin America and Asia, etc. This investment can both increase the risk spread in a portfolio and provide an attractive expected return relative to government bonds from the developed markets. However, there are a number of risks investors should be aware of.

Interest rates in countries such as Germany, Denmark and the US have bumped along at historical lows in recent years, prompting investors to consider other asset classes that can present a more attractive expected return. One such asset class is emerging market bonds, which are now an obligatory element in the portfolios of many professional investors. While the emerging market nations overall have a lower debt-to-GDP ratio and better growth prospects than the OECD countries, emerging market bonds have in recent years typically generated an average excess return of more than 3 percentage points relative to US Treasuries.

Danske Invest's Emerging Market Debt Hard Currency fund invests in emerging market bonds issued in hard currencies like the euro (EUR) and dollar (USD). Essentially, the fund's investment universe comprises bonds from the countries included in the fund's benchmark, which is the J.P. Morgan Emerging Markets Bond Index Global Diversified – an index that tracks bonds from more than 60 different countries. The fund is actively managed: by underweighting or overweighting different countries relative to the fund's benchmark, the portfolio team has an opportunity to create a portfolio that generates a better return than the benchmark – though naturally the team also risks achieving a poorer result. The bulk of the investments are in government bonds from the emerging markets, though the fund also includes corporate bonds. Of these, however, the majority are issued by companies that are ▸▸

TEAM BEHIND THE FUND

Bent Elvin Lystbæk
First Vice President, team leader, co-manager and trader

Jacob Ellinge Nielsen
Senior portfolio advisor, co-manager and trader

Thomas Haugaard
Senior economist, macroeconomic research and country risk models

Sorin Ioan Pirau
Economist, macroeconomic research and quantitative analysis tools

FACTS ABOUT THE FUND

Name: Danske Invest SICAV Emerging Market Debt Hard Currency Class A / Class I / Class I-eur h

Investment focus: Bonds from emerging markets in Latin America and Asia, etc. – mainly government bonds, but also corporate bonds. The bonds are issued in hard currencies like the dollar (USD) and euro (EUR).

Ongoing administration fee: Class A: 1.50%, Class I: 0.76%, Class I-eur h: 0.76%

ISIN: Class A: LU1204910837, Class I: LU1204911488, Class I-eur h: LU1204911561

Risk indicator (1-7): 4

Read more: You will find the Factsheet, Prospectus and Key Investor Information document at danskeinvest.com, where you can also read more about the fund and the risks associated with investing.

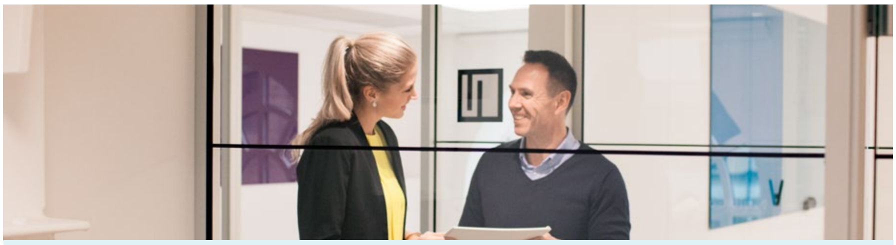
▸▸ either 100% government-owned or where the government is the majority stakeholder.

How bonds are selected
The process by which the portfolio team selects specific investments for the fund and decides what to overweight or underweight relative to the benchmark consists of two steps:

1. ECONOMIC ANALYSIS: To get an overview of the many countries and possible investment opportunities, the team employs advanced mathematical models to calculate potential and risk based on macroeconomic data. As not all factors can be measured and quantified, the team supplements these quantitative models with qualitative assessments of individual countries and companies. Political risks are a major consideration, including willingness to reform, as this can have a positive impact on a country's business climate and in turn on its economy.

2. VALUATION ANALYSIS: Once the portfolio team has completed a detailed risk assessment of each country, the next step is to compare risk and current bond valuations relative to US Treasuries. If a certain emerging market country offers an attractive excess yield relative to the team's risk assessment, they will overweight that particular country in the portfolio, and of course underweight the country if they deem the excess yield to be insufficient to compensate for the risk.

> *Emerging market bonds have in recent years typically generated an average excess return of more than 3 percentage points relative to US Treasuries.*



YIELD SPREAD BETWEEN EMERGING MARKET BONDS AND US TREASURIES

The excess yield from emerging market bonds in hard currency has in recent years hovered around 3-4 percentage points relative to US Treasuries. During the 2008-09 financial crisis this yield spread rapidly more than doubled as jittery investors sold out of emerging market bonds, pressing prices down and therefore yields up. Emerging market bond investors suffered significant capital losses, though prices corrected again in the course of 2009.

Yield spread in per cent

Source: J.P. Morgan EMBI Global Diversified Spread Index. Data for the period 31.12.1997-31.07.2017.

Particular associated risks
The price of the expected excess return from emerging market bonds is greater risk, as these countries are generally less developed financially, politically and economically. Some countries may, for example, be very vulnerable to shifts in commodity prices, while the political situation can be somewhat unpredictable in other countries. That is why the portfolio team has a strict approach to risk management and carefully selects each and every investment in the fund.

Credit risk is generally the most important factor – in other words, the risk that the bond issuer may at some point be unable to make regular interest payments and/or redeem the bonds at maturity. Liquidity risk is another significant factor: the trading volumes of many emerging market bonds are not particularly large, and that lack of liquidity can present a challenge in the event of a major financial crisis, as selling the bonds may prove difficult. Moreover, yield spreads between more secure and less secure bonds tend to widen during periods of financial market crisis. Hence, owners of emerging market bonds, which are generally considered less secure, risk suffering relatively large capital losses over a shorter or longer period compared to government bonds from the developed markets.

As the base currency of the fund is USD, exchange rate fluctuations might also affect return. However, institutional investors can choose a currency-hedged class of the fund, which is hedged to euro.

Disclaimer:

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