February 2018

The underestimated opportunity set of EM Hard Currency debt

Nordea 1 – Emerging Market Bond Fund

ISIN: LU0772926670 (BP-USD), LU0772925789 (BI-USD)

- In the **search for yield**, do not overlook **EM Hard Currency debt**
- A **compelling risk/return profile:** high returns for an improved quality
- Nordea's solution: **an edge for a comprehensive investment**

For some years now, the low yield environment has been **challenging fixed income investors in their search for yield.** Their attention has been caught by the few pockets still offering returns. Investors traditionally confined to the Developed Markets (DM) have moved towards higher yielding segments like High Yield corporates - often with a sharp compromise on quality. Yet, stepping outside the box, **Emerging Markets (EM) Hard Currency debt has been gathering attention as it is offering a compelling risk/return profile.** The common mind-set discounts EM over DM, just on the back of their shorter track, often linking EM debt to much higher risk than it actually carries. Quite the contrary, **relatively high yields** are not the only advantage of EM Hard Currency debt, as we currently get **much better quality and diversity** than many would think. The progress of EM debt makes a remarkable case: the potential to be one of today's best opportunities for a fixed income investor!

Today, EM Hard Currency debt brings…

… The added return of EM credit risk in hard currency

In general terms, investing in an EM Hard Currency (HC) bond refers to buying the external debt of an EM issuer. For USD-denominated bonds, the investor receives an **extra-yield over the USD term structure.** Besides **market supply/demand effects,** this additional return reflects the premium for the **liquidity risk and credit risk:** it is intrinsically linked to **the ability of the EM issuer** (e.g. sovereign and quasi-sovereign) **to repay its debt in the external currency.** With an average coupon close to 6%[1], the asset class offers investors the additional pick-up of the EM region without the direct volatility stemming from EM currencies.

… An underestimated diversity and quality

The diversity and the quality of the asset class have improved significantly, coming a long way from its early stage. **Past risks perceived by investors are often no longer relevant** – many EM countries have taken measures to address previous crises. In recent years, individual EM countries have shown increased resilience to specific political and credit events. Moreover, **contagion risk has diminished considerably** across the investment universe, stressing a rising diversification benefit. With fairly differing economic features (e.g. oil importers/exporters or various stages of developments), **more than 65 EM countries** are now issuing debt denominated in USD. Finally, the EM HC index has experienced a gradual re-rating over the years. **With close to 50% of the market rated investment grade**, this represents **a BB+ asset class** - which, beating the odds, offers a higher quality than, for example, the US High Yield market (B+)[2].

… The exposure to a solid trend going forward

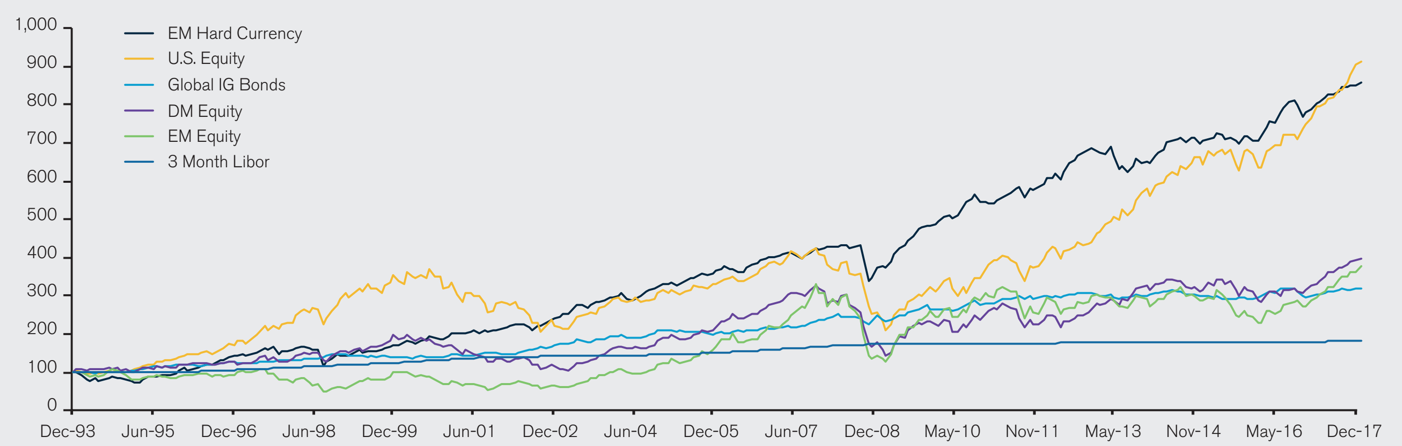
For more than 20 years, EM debt denominated in Hard Currency has been a successful allocation, **granting access to the long term dynamics of EM economies** with a moderate volatility.

1) As measured by the JP Morgan Emerging Markets Bond Index Global Diversified. 2) As measured respectively by the JP Morgan Emerging Markets Bond Index Global Diversified and the BofA Merrill Lynch US High Yield Index.

* investing for their own account – according to MiFID definition

Asset Class Returns

Growth of $100 from December 31, 1993 to December 31, 2017



	Annualized Returns (%)	Standard Deviation (%)	Sharpe Ratio
JPM EMBI Global Diversified (EM Hard Currency)	9.4	11.7	0.58
S&P 500 (U.S. Equity)	9.7	14.4	0.5
Bloomberg Barclays U.S. Aggregate (Global IG Bonds)	5	5.4	0.45
MSCI EAFE Equity (DM Equity)	5.9	16	0.21
MSCI EM (EM Equity)	5.7	22.6	0.14
3 Month Libor (Money Market)	2.5	0.7	--

Source of chart: PGIM Fixed Income. Source of indexes: JP Morgan EMBI Global Diversified, JPMorgan; S&P 500 and 3M T-Bills, Bloomberg; Bloomberg Barclays U.S. Aggregate and Bloomberg Barclays U.S. High Yield, Bloomberg Barclays; MSCI EAFE Equity and MSCI EM Equity, Morgan Stanley. Information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan's prior written approval. **Past performance is not a guarantee or a reliable indicator of future results.** An investment can not be made directly in an index.

EM economic growth continues to outpace developed markets, on the back of narrower current account deficits, falling inflation, and growing central bank reserves for many EM economies.

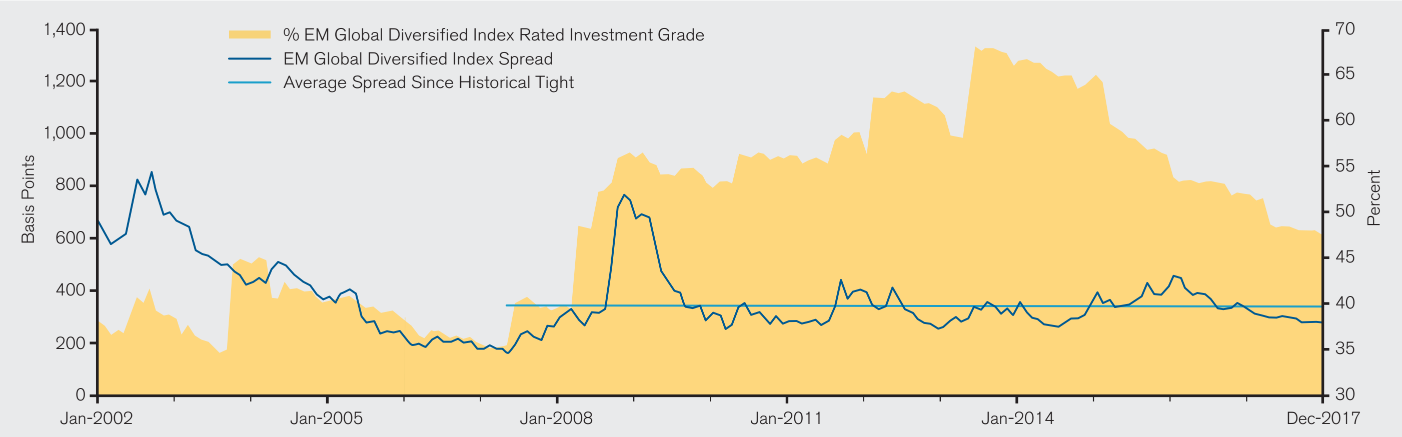
Even though macroeconomic factors remain in play, with DM central banks slowing step by step on monetary easing, **EM countries are now in a much better shape**, alleviating concerns about a repeat of 2013's "taper tantrum" effect – the last EM sell-off experienced, related to Fed tapering. In fact, during the last sustained Fed hiking cycle (between 2004 and 2006), EM HC debt returned roughly +25% - **the asset class is not necessarily bound to suffer in a rising US rate environment[3].**

… Attractive valuations in light of today's quality and mispriced opportunities

Surprisingly, the **current spread levels of EM HC debt (around 285bps) remain wide of the historical tight** reached in 2007 (166bps) – while the asset class has benefited from a significant quality upgrade since then.

Emerging Markets Hard Currency Spreads

As of December 31, 2017



Source: PGIM Fixed Income, Bloomberg.

3) As measured by the JP Morgan Emerging Markets Bond Index Global Diversified.

EM debt comes with plentiful opportunities as a universe where **active management makes a difference.** The market offers many **mispriced opportunities wide above the average spread levels** for experts able to **differentiate attractive risk-adjusted investments from those that bring sizeable levels of uncompensated risk.** Individual credit stories will continue to make headlines: while sell-offs and idiosyncratic volatility have struck, the asset class has been offering a fertile hunting ground for EM debt experts to build a portfolio **delivering higher returns in a risk controlled manner.**

Nordea's solution: EM Debt with an edge

Risk in EM debt entails both macroeconomic factors and the intrinsic drivers of individual countries. Developing more **comprehensive risk rating frameworks**, which **consider long-term economic fundamentals and near-term institutional and political volatility**, is therefore key to successfully invest in this universe.

Back in May 2012, Nordea appointed PGIM Limited ("PGIM") as the manager of our Nordea 1 – Emerging Market Bond Fund. The fund profits from **the unique set-up of PGIM's EM Debt Team**, which has an extensive experience in investing in the asset class. The team does not rely on rating agencies; **its edge starts in the internal sovereign ratings** produced by its in-house economists. Those out-of-consensus views have proven to be a meaningful driver of alpha generation over the years.

PGIM's framework relies on two major pillars:

- Sovereigns are first ranked based on their **fundamental macroeconomic strengths and vulnerabilities,** with the choice of variables informed by lessons from past crises.
- A **qualitative assessment** comes then with a focus on the **evolving institutional and political setting** that guides policy formulation.

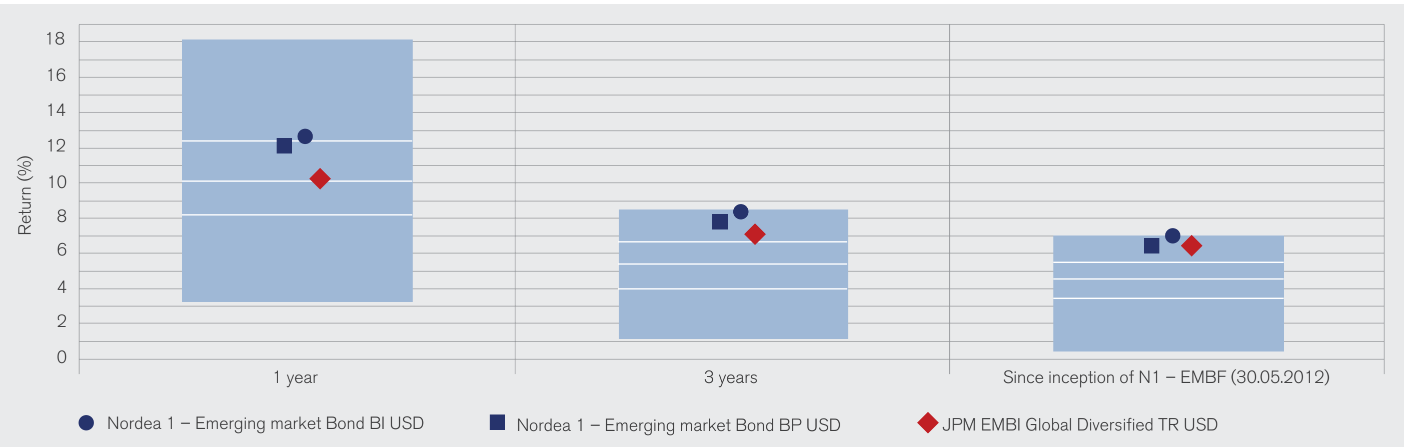
Moreover, the investment process is **anchored in a robust risk framework.** A dynamic systematic risk budget is refined weekly to determine the **most appropriate risk profile of the portfolio, based on PGIM's assessment of market conditions.** Because of the unique set of idiosyncratic risks brought by EM debt, a rigorous process is employed to **tightly monitor risk at all levels.** This includes the use of stress test models that aim to **measure the impact of the "next big EM crisis".** The portfolio can then offer attractive yields while also showing robustness when most needed.

With a track record of **more than 5 years** and a **pure historical allocation to the hard currency segment** (mainly sovereign and quasi-sovereign bonds), the Nordea 1 – Emerging Market Bond Fund:

- **is rated 5 star Morningstar**[4]
- **has reached now more than USD 2.2bn in AuM**
- **offers compelling characteristics in the current Fixed Income environment**
- **has outperformed its benchmark since inception, with a highly competitive track record in light of its Morningstar peer group**

Portfolio Characteristics[5]	N1-EMBF
Effective Duration (yrs)	7.35
Effective Yield (%)	5.53
Option Adjusted Spread (bps)	312
Average Rating (S&P)	BB–

Annualized Performance vs Index & Peers



Data Source – © 2017 Morningstar, Inc. All Rights Reserved as of 31.12.2017. European Open End Funds database, Morningstar EAA OE Global Emerging Market Bond category. Period under consideration: 30.05.2012 – 31.12.2017. Performance in USD, based on monthly returns.

4) Data Source – © 2018 Morningstar, Inc. All Rights Reserved as of 31.01.2018, EAA OE Global Emerging Markets Bond. The Morningstar Rating is an assessment of a fund's past performance – based on both return and risk – which shows how similar investments compare with their competitors. A high rating alone is insufficient basis for an investment decision. 5) Source of portfolio data: PGIM Fixed Income. Date: 31.12.2017. Please note the positioning is on the model portfolios' level and might therefore deviate from the funds' figures.

The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of shares can greatly fluctuate as a result of the sub-fund's investment policy and cannot be ensured.

Seize the opportunity of EM Local Currency Debt

Nordea 1 – Emerging Market Bond Opportunities Fund
ISIN: LU0772920129 (BP-USD), LU0772919204 (BI-USD)

Willing to take a step further in the **broader EM Debt universe** and benefit from the **additional sources of return of local bond markets?**

Nordea offers a second solution managed by PGIM's EMD specialists. The **Nordea 1 – Emerging Market Bond Opportunities Fund invests in EM hard and local currencies bonds**, by carefully analysing HC bonds, EM local rates and currencies. The team seeks to select the best ideas and achieve the **right mix of bonds and currencies reflecting its convictions** and comprehensive assessment of EM countries.

Portfolio Characteristics[6]	N1-EMBOF
Effective Duration (yrs)	6.55
Effective Yield (%)	6.04
Average Rating (S&P)	BB+

N1 – EMBOF	BP-USD	BI-USD	Benchmark[7]
1 year	13.84 %	14.43 %	12.76 %
3 years	15.72 %	17.60 %	15.34 %
Since launch (03.09.2012)	11.89 %	14.99 %	13.88 %

Source (unless otherwise stated): Nordea Investment Funds S.A. Period under consideration: 30.09.2012 – 31.12.2017. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of shares can greatly fluctuate as a result of the sub-fund's investment policy and cannot be ensured.**

6) Source of portfolio data: PGIM Fixed Income. Date: 31.12.2017. Please note the positioning is on the model portfolios' level and might therefore deviate from the funds' figures. 7) 50% JP EMBI GD and 50% JP GBI-EM GD.