



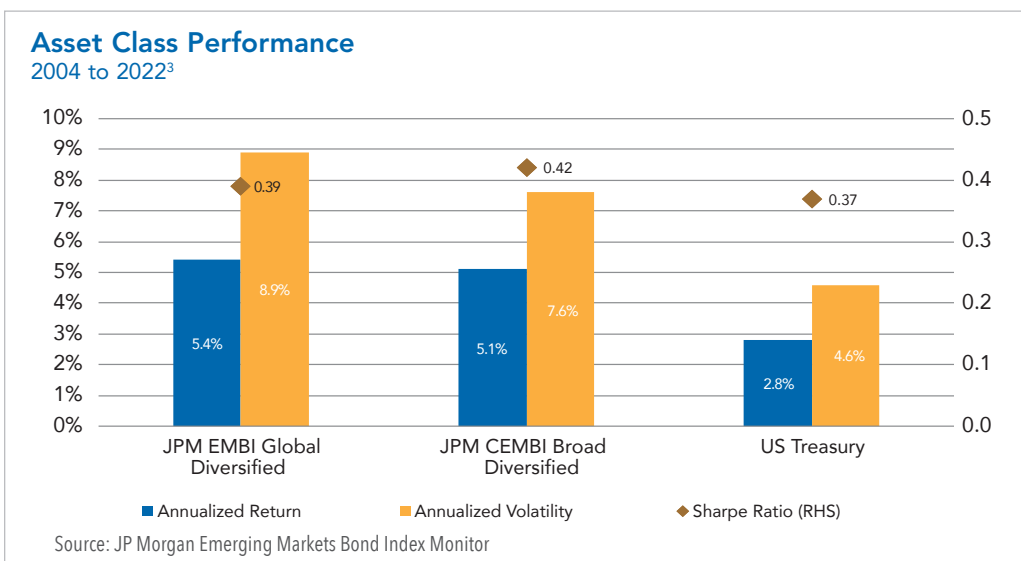
## CASE STUDY: WESTERN & SOUTHERN FINANCIAL GROUP'S COMMITMENT TO EMERGING MARKETS DEBT

### BACKGROUND:

- ▶ Western & Southern Financial Group (W&SFG) is a Fortune 500 insurance group and holding company for seven separate insurance companies.
- ▶ Its wholly owned money manager, Fort Washington Investment Advisors, Inc. (FWIA), is constantly surveilling the investment landscape for asset classes that can add value to a product line-up of deferred annuities, payout annuities, and universal life with both shorter and longer duration characteristics and other benefits to the portfolio.
- ▶ Over the years, as the Emerging Markets Debt (EMD) market matured and deepened, it gained FWIA's attention for a number of value-added benefits, as outlined below.
- ▶ EMD was a relatively small asset class prior to the Great Financial Crisis of 2008-2009 (GFC) with less than \$300 billion outstanding. The asset class grew rapidly in the years following the crisis, surpassing \$1 trillion in 2013, and growing to \$2.2 trillion by 2022.<sup>1</sup>
- ▶ Today, independent investment consultants actively allocate portions of their client portfolios to this space, while EMD tops the current expected long-term return forecasts in public and liquid return seeking credit markets.<sup>2</sup>
- ▶ FWIA built in-house capabilities with a dedicated EMD team by 2013, seeing an opportunity to enhance yield and target desirable risk factors (duration, rating, etc.) in a dynamic asset class. EMD assets supporting W&SFG operations grew from approximately \$700 million in 2013 to almost \$2 billion in 2022.

### EMERGING MARKETS DEBT OVERVIEW:

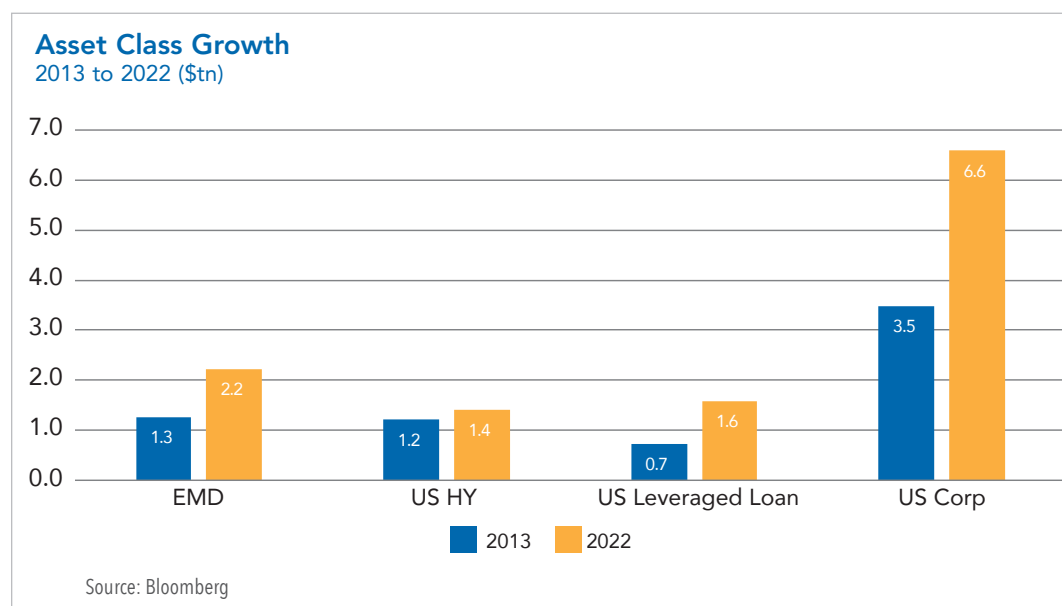
- ▶ EMD refers to publicly traded bonds of borrowers domiciled in emerging economies (EM) such as Brazil, Poland, and Indonesia. FWIA focuses on USD denominated bonds that are governed by U.S. or U.K. law with issuers ranging from sovereign, quasi-sovereign (state owned enterprises), and corporate entities. Common EMD benchmarks include:
  - Bloomberg EM USD Aggregate Total Return Index. This index offers a good representation of the investible USD denominated EMD universe
    - ▶ As of 12/31/2022 this index captured \$2.2 trillion of outstanding debt of which \$1.3 trillion was investment grade rated<sup>1</sup>
  - JP Morgan indices are popular with active managers due to their diversification characteristics
    - ▶ EMBI Global Diversified: EM USD sovereign and quasi-sovereign bonds
    - ▶ CEMBI Broad Diversified: EM USD corporate bonds



## BENEFITS OF EMERGING MARKETS DEBT:

### ► Market depth and acceptance

- After rapid growth following the GFC, the EMD asset class has grown at a similar pace to U.S. investment grade corporate bonds, both almost doubling since 2013 with a roughly 4% compounded growth rate (CAGR), while U.S. high yield has stagnated at the expense of U.S. leveraged loans.<sup>4</sup>
- The average allocation to EMD for large life insurers was 1.75% - 2.0% from 2013 to 2022.<sup>5</sup>



### ► Relative value

- EMD can provide yield enhancement opportunities across:
  - Quality: full ratings spectrum from IG to HY
  - Duration: availability of long duration bonds that are typically not callable
  - Sector: gain exposure to sovereign, quasi-sovereign, and EM corporate sectors
  - Geography: diversify into Latin America, Europe, Middle East, Africa, and Asia
  - Economic structure: varying macroeconomic drivers ranging from commodity exporters to manufacturing-based economies

### ► Favorable historic default experience

- EM historic default rates have trended lower than domestic credit
- Recovery rates vary on a case by case basis, but EMD historic averages are in-line with domestic credit

Moody's 5-Year Cumulative Default Rates (1983 – 2022) <sup>6,7</sup>	Investment Grade	All Rating
EM Sovereign	0.74%	5.52%
EM Corporate	0.88%	7.37%
North America Corporate	0.90%	8.84%

### ► Available liquidity

- EMD bonds are publicly traded with deep and liquid markets for major EMD issuers
- Liquidity in EMD tends to be comparable if not better to domestic bonds with a similar profile based on FWIA's observed experience; Barclays research from September 2021 corroborates this observation — finding EM bonds to be more liquid overall<sup>8</sup>

- ▶ Hard currency
  - EMD bonds are typically denominated in U.S. dollars, meaning U.S.-based investors bear no direct currency risk on interest and principal payments as they would in local currency denominated EM bonds; additionally, EMD bonds are typically governed by U.S. or U.K. law
  - The NAIC capital treatment for EMD USD bonds is based on ratings similar to domestic bonds
- ▶ Structural improvements
  - Large EM economies have reduced their external vulnerabilities compared to periods such as the Asian financial crisis of 1997-1999. Implementation of prudent policy frameworks in the 2000s have increased resiliency:
    - ▶ Inflation targeting has helped anchor prices and stabilize business cycles
    - ▶ Flexible exchange rates have served as a shock absorber and made a balance of payments crisis less likely
  - This has allowed deeper local markets to develop while the growth of external market debt has remained relatively modest relative to GDP
  - The troubled areas of EM today are predominately confined to “frontier” countries with low institutional capacity, or areas with failed policies such as Argentina and Russia

## **WORKING WITH FORT WASHINGTON INVESTMENT ADVISORS, INC.**

- ▶ Utilize EMD as a value-enhancing supplement to core ALM allocations, such as U.S. Credit and Structured Products
- ▶ Ideally suited for insurance companies sophisticated enough to benefit from an ALM allocation to \$1.3+ trillion IG rated EM USD market, but without scale to support a dedicated in-house team
- ▶ FWIA can provide a simple, customizable (including by NAIC quality and duration) and low cost solution to access the EM asset class via discretionary and non-discretionary account options
- ▶ Invest alongside W&SFG
  - Aligned interests with W&SFG, fully utilizing EM for ALM purposes
  - Leverage FWIA EMD expertise, market access, and underwriting capabilities with three fully dedicated EMD team members, each with more than 10 years of credit experience
  - Top ranked since inception performance: 1st percentile gross/3rd percentile net in peer universe<sup>9</sup>

## **REFERENCES:**

<sup>1</sup>EMD as measured by Bloomberg EM USD Aggregate Index

<sup>2</sup>NEPC, 10/12/2022, “Asset Allocation and Emerging Markets Review:” <http://ffret.com/wp-content/uploads/2022/08/FRS-Sept-2022-Asset-Allocation.pdf>

<sup>3</sup>JP Morgan, 1/3/2023, “Emerging Markets Bond Index (EMBI) Monitor:” [https://markets.jpmorgan.com/#research.detail\\_search\\_page&referrerPortletId=EMBI\\_accordion&referrerPortletTabNumber=INDEX\\_MONITORS](https://markets.jpmorgan.com/#research.detail_search_page&referrerPortletId=EMBI_accordion&referrerPortletTabNumber=INDEX_MONITORS)

<sup>4</sup>Amount outstanding based on: EMD asset class Bloomberg EM USD Aggregate Index; US Corp asset class Bloomberg US Corporate Bond Index; US HY asset class Bloomberg US Corporate High Yield Bond Index; US leveraged loan asset class JP Morgan, 5/5/2023, “Credit Strategy Weekly Update:” [https://markets.jpmorgan.com/#research.article\\_page&action=open&doc=GPS-4403863-0](https://markets.jpmorgan.com/#research.article_page&action=open&doc=GPS-4403863-0)

<sup>5</sup>Fort Washington Investment Advisors own calculations

<sup>6</sup>Moody’s, 4/13/2023, “Sovereign default and recovery rates, 1983-2022:” [https://www.moody.com/research/Sovereigns-Global-Sovereign-default-and-recovery-rates-1983-2022-Sector-In-Depth--PBC\\_1358913](https://www.moody.com/research/Sovereigns-Global-Sovereign-default-and-recovery-rates-1983-2022-Sector-In-Depth--PBC_1358913)

<sup>7</sup>Moody’s, 2/13/2023, “The performance of Moody’s corporate debt ratings – Q4 2022:” [https://www.moody.com/research/Rating-Transitions-Global-The-performance-of-Moodys-corporate-debt-ratings--PBC\\_1358008](https://www.moody.com/research/Rating-Transitions-Global-The-performance-of-Moodys-corporate-debt-ratings--PBC_1358008)

<sup>8</sup>Barclays, 9/27/2021, “Emerging vs. Developed Markets: Liquidity Comparison:” [https://live.barcap.com/PRC/publication/DR/FC\\_TEJ-bGJfMTU3Mjg3ODA1NTA5Mn4gfIB-IH4g\\_2617279](https://live.barcap.com/PRC/publication/DR/FC_TEJ-bGJfMTU3Mjg3ODA1NTA5Mn4gfIB-IH4g_2617279)

<sup>9</sup>eVestment Alliance, LLC Emerging Markets Fixed Income – Hard Currency Universe. Peer group data as of 3/31/2023 and is subject to change at any time. Strategy inception: 7/1/2013. This supplemental information complements the Emerging Markets Debt GIPS Report.

## COMPOSITE PERFORMANCE DISCLOSURES

	1Q2023	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013 <sup>1</sup>
Emerging Market Debt (Gross)	2.95%	-17.13%	-0.24%	7.48%	15.33%	-4.18%	11.65%	12.33%	1.55%	8.87%	3.92%
Emerging Market Debt (Net)	2.80%	-17.61%	-0.83%	6.84%	14.65%	-4.82%	10.83%	11.50%	0.80%	8.07%	3.53%
JPM EMBI Global Diversified	1.86%	-17.78%	-1.80%	5.26%	15.04%	-4.26%	10.26%	10.15%	1.18%	7.43%	2.73%
Emerging Market Debt 3-Year Annual Standard Deviation <sup>2</sup>	--	16.55%	13.20%	13.17%	5.05%	5.59%	5.43%	6.32%	--	--	--
JPM EMBI 3-Year Annual Standard Deviation <sup>2</sup>	--	13.36%	10.67%	10.73%	4.85%	5.46%	5.04%	5.78%	--	--	--
Dispersion <sup>3</sup>	--	--	--	--	--	--	--	--	--	--	--
Number of Accounts	≤5	≤5	≤5	≤5	≤5	≤5	≤5	≤5	≤5	≤5	≤5
Composite Assets (\$ Millions)	\$238.3	\$231.8	\$280.2	\$282.0	\$262.8	\$227.9	\$237.8	\$213.0	\$110.2	\$108.4	\$99.6
Total Firm Assets (\$ Millions)	\$68,722	\$66,365	\$73,804	\$65,086	\$59,174	\$49,225	\$52,774	\$45,656	\$42,959	\$45,002	\$43,671

Composite inception and creation date: 07/01/13. <sup>1</sup>2013 returns are partial-year returns, reflecting the composite inception date of 07/01/13. <sup>2</sup>The 3-Year annualized ex-post standard deviation is calculated using monthly gross-of-fee returns to measure the average deviations of returns from its mean. <sup>3</sup>Dispersion is not calculated for years in which the composite contains five portfolios or less. Dispersion is calculated as the equal weighted standard deviation of gross-of-fee returns for those portfolios held in the composite during the entire period. The benchmark for this composite is the JPM EMBI Global Diversified. You cannot invest directly in an index. Past performance is not indicative of future results.

Fort Washington's Emerging Markets Fixed Income strategy seeks to outperform the JP Morgan Emerging Markets Bond Index Global Diversified (JPM EMBI Global Diversified) on a total return basis. The strategy recognizes emerging markets fixed income as a continually evolving asset class as witnessed by the migration and dispersion of credit quality of the benchmark as well as by consistent addition of countries over the years. Therefore, the strategy first employs a forward looking top-down approach drawing on the four analytical pillars of policy, economics, politics, and markets to identify relative value among a truly global opportunity set. Once these opportunities are identified, the fund employs its bottom-up analytical framework to identify the most appropriate securities. All fee-paying, fully discretionary portfolios with at least \$25 million managed in the Emerging Markets style are included in this composite. The fee is 0.55% for the first \$100 million, and 0.50% on additional amounts over \$100 million for separate accounts, and 0.60% for the commingled vehicle. The benchmark for this composite is the JP Morgan Emerging Markets Bond Index Global Diversified. Portfolios in this composite include cash, cash equivalents, investment securities, interests and dividends. Cash is maintained, within each separately managed account segment, in accordance with our asset allocation ratio. The U.S. dollar is the base currency. The specific securities identified and described do not represent all of the securities purchased, sold, or recommended. Returns are presented gross and net of management fees and include the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net of fee performance was calculated using the actual management fees charged. Individual portfolio returns are calculated on a daily valuation basis. Past performance is not indicative of future results. Fort Washington Investment Advisors, Inc. (Fort Washington), a wholly owned subsidiary of The Western and Southern Life Insurance Company, is a registered investment advisor and provides discretionary money management to a broad range of investors, including both institutional and individual investors. Assets under management include all portfolios managed by Fort Washington and exclude assets under management by and marketed as its Private Equity business unit. Fort Washington claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS Standards. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Fort Washington has been independently verified for the periods 7/1/94 - 12/31/21. The verification reports are available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. To receive a complete list and description of composites, contact Fort Washington by phone at 888.244.8167, in writing at 303 Broadway, Suite 1200, Cincinnati, Ohio 45202, or online at fortwashington.com.

## RISK DISCLOSURE

The Fort Washington Emerging Markets Debt strategy invests in fixed-income securities of both domestic and foreign issuers which can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. Investing in the bond market is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk.

## CONTACT US

**Barry D. Pavlo, CFA, CAIA**

Vice President, Business Development

216.543.4528

barry.pavlo@fortwashington.com

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