Fort Washington Investment Advisors, Inc.

A member of Western & Southern Financial Group

Uncompromised Focus®

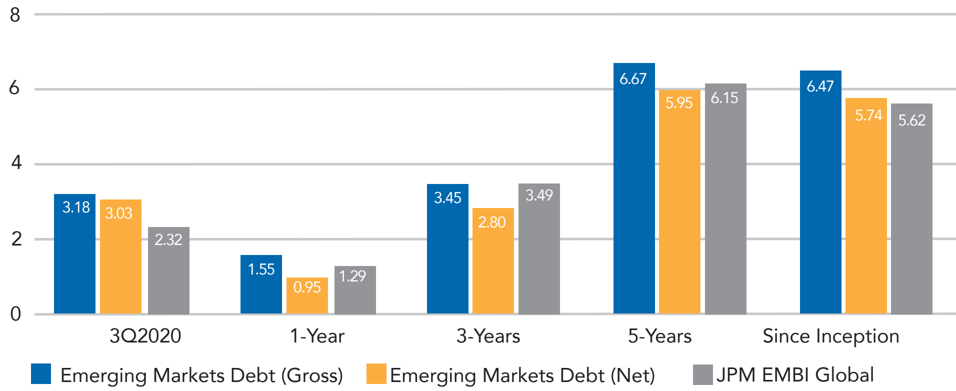
# FORT WASHINGTON EMERGING MARKETS DEBT — 3Q2020

## HIGHLIGHTS

- The JPM EMBI Global Diversified (EMBIG-D) returned 2.3% in the third quarter as spreads continued their compression, finishing the quarter 42bps tighter at 432bps.
- Global markets continued their rebound in the third quarter with the majority of asset classes posting positive quarterly returns. Momentum slowed and the quarter came to a close on a more somber tone, however, with most major asset classes posting negative monthly returns in September for the first time since the start of the recovery in April.
- Solid global economic data pointing towards a stronger than expected recovery underpinned investor sentiment in July and August. Markets turned more volatile in September over near term concerns around uncertainty over US elections and fiscal stimulus, rising COVID cases in Europe, start of the flu season in the northern hemisphere, and moderating economic indicators.
- Our EMD strategy posted a 3.2% gross return in the third quarter, outperforming the EMBIGD by 86bps during the period. Top contributors to performance during the quarter included our corporate sector holdings in Brazil, as well as Argentina and Ecuador which finalized their sovereign restructurings. Top detractors to performance in the third quarter included our overweight to Ukraine which underperformed on negative headlines such as the resignation of the central bank governor, security selection within Oman, and our underweight to Chile.
- Our long term outlook for emerging markets debt is constructive on expectations of a continued global growth recovery, continued policy support, attractive valuations, and sufficient liquidity. Risks to our outlook include a less supportive than expected policy environment, return to more wide-ranging and severe lockdowns, setbacks on vaccine development, and a disputed US election.

### Historical Performance

Annualized Returns as of September 30, 2020




Source: Fort Washington Investment Advisors. Past performance is not indicative of future results. Inception date: 07/01/2013.

## INVESTMENT PROFESSIONALS

**Daniel J. Carter, CFA**
Senior Portfolio Manager
*24 Years Experience*

**Bojan Vidosevic, CFA**
Assistant Portfolio Manager
Credit Analyst
*9 Years Experience*
*Sovereign*

**Brian D. Cloutier, CFA**
Assistant Portfolio Manager
Senior Credit Analyst
*14 Years Experience*
*Sovereign & Corporate*

**Donald J. Osborne**
Senior Credit Analyst
*23 Years Experience*
*Investment Grade Quasi Sovereign*

## MARKET OVERVIEW

- Global markets continued their recovery in the third quarter on the back of better than expected economic data. The economic impact of the COVID induced second quarter shutdowns turned out to be somewhat less dire than originally projected, and the third quarter showed signs of a strong recovery. This lead the IMF to upgrade its 2020 global growth projection in October by 0.8% to -4.4%.
- The pandemic has been accompanied by unprecedented fiscal action globally to the tune of $12 trillion. This amount of stimulus has kept people and businesses afloat, but also left a bulging hole in government finances. The IMF projects global fiscal deficits will widen 8.8 percentage points, from 3.9% of GDP in 2019 to 12.7% in 2020. As a result, global government debt is expected to make an unprecedented jump to just shy of 100% of GDP.
- Government finances have undeniably deteriorated in 2020; however, the impact on debt ratios has been considerably more limited in emerging markets (EM) compared to developed markets (DM). According to the IMF, fiscal deficits are expected to reach 10.7% of GDP in EM (5.7 percentage point deterioration from 2019) compared to 14.4% of GDP in DM (11.1 percentage point deterioration). In addition, the favorable growth differential between EM and DM persists, with the IMF projecting EM economies to contract 3.1% in 2020 compared to 6.1% for DM. In 2021 EM is projected to rebound 6.5% compared to 3.9% for DM.
- The combined result of smaller deficits and higher growth is a more modest rise in debt levels for EM. Government debt as a percent of GDP for EM is projected to increase 9.6 percentage points in 2020 to 62% based on the IMF. This is compared to a 20.2 percentage point increase to 126% for DM.
- The fallout from the pandemic has propelled the debt of countries with vulnerable finances and weak policy stances into distress. Per JP Morgan, the default rate on the HY portion of the EMBIG (EMBI Global) reached as high as 15.8%. We believe this represents the peak of the current EM sovereign default cycle as both Argentina and Ecuador have now successfully concluded their sovereign restructurings. Argentina alone represents 12% of the outstanding par value of the EMBIG HY. As Argentine bonds start to perform again, going forward, this means that the default rate is likely to be contained to the single digits given our expectations for future defaults which we believe will be contained to countries with more modest debt stocks.
- Factors supporting the broader emerging markets debt market include accommodative global monetary policy which is keeping interest rates suppressed. This has enabled countries to carry higher debt loads, and as a result, government interest expense as a percent of GDP has only risen modestly for EM as a whole. This coupled with a rebound in growth should result in average debt levels stabilizing in the future. Muted inflation has allowed the more robust EM countries more flexibility in implementing monetary policy to address the impact of the pandemic.
- On the financing side, extraordinary support from international financial institutions to cooperative EM governments should remain intact into 2021 in our view. Market access has remained robust for all but the most vulnerable countries with record YTD gross hard currency sovereign issuance in excess of $180bn. Between official sector support and the availability of market financing, liquidity has been adequate for most countries. Lastly, on the current account front, the drop in consumption has helped moderate the drop in export earnings in a lot of cases and softened stress on the balance of payments.
- Current valuations remain compelling in our view, both on a historical basis, as well as on a relative basis compared to other USD fixed income asset classes. The EMBIG-D is spreading 432bps which places it in the 87th percentile going back to 2007 (meaning spreads traded tighter 87% of the time). The high yield portion of the index screens most attractive, trading in the 92nd percentile. The investment grade portion of the index is more fairly priced at the 44th percentile.
- On a relative basis, EM sovereigns screen attractive compared to US corporate credit. If we look at EM sovereigns (Bloomberg Barclays USD Aggregate) versus US HY (Bloomberg Barclays US HY) in the single-B rated, 10 year part of the curve, we find that EM is outspreading US HY by 282bps. Not only is this a considerable spread pickup, but the relationship is trading near its widest at the 95th percentile over the last 5 years. The relationship for 10 year BBs is a more modest but still attractive at the 66th percentile. On the investment grade side the differential stands at a less compelling 34th percentile for BBBs (Bloomberg Barclays US Credit Corporates).

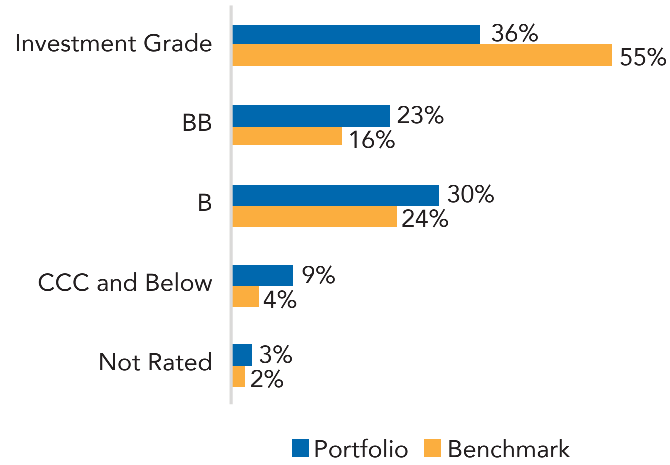
## Top 10 Countries by Market Value

| Country | % of Portfolio |
|---|---|
| Brazil | 7.20% |
| Indonesia | 6.31% |
| Mexico | 5.95% |
| Ukraine | 5.76% |
| Egypt | 4.85% |
| Argentina | 3.98% |
| Dominican Republic | 3.93% |
| South Africa | 3.60% |
| Colombia | 3.40% |
| Kazakhstan | 3.21% |

## Portfolio Statistics

| | Portfolio | Benchmark |
|---|---|---|
| Yield to Maturity | 7.19% | 5.23% |
| Average Coupon | 5.60% | 5.32% |
| Duration | 8.53 years | 7.93 years |
| Average Life | 15.00 | 12.37 |
| Total # of countries | 62 | 75 |
| Number of Issuers | 104 | 198 |
| Number of Issues | 212 | 815 |

## Credit Quality




Source: Fort Washington. This supplemental information complements the Emerging Market Debt Composite Presentation. Quality distribution is subject to change at any time. The above data is rounded for informational purposes. Benchmark: J.P. Morgan Emerging Market Bond Index Global Diversified. Portfolio characteristics are subject to change at any time.

Source: Fort Washington and Bloomberg. This supplemental information complements the Emerging Markets Debt Composite Presentation. Portfolio characteristics are subject to change at any time. You cannot invest directly in an index. Past performance is not indicative of future results.``

## PORTFOLIO ACTIVITY

- Our EMD strategy finished the third quarter positioned at 70% of our maximum spread risk budget, long duration by 0.4 years versus the benchmark and out-yielding it by 2%. Spread risk increased modestly during the quarter. This was primarily driven by the debt exchange in Ecuador given the new bonds have a longer duration which had the effect of increasing our contribution to spread risk. Other trade activity throughout the quarter only marginally increased spread risk as trades were primarily focused on relative value opportunities between countries.
- Notable trades during the third quarter include reducing exposure in Russia and adding Sharjah on an attractively priced new issue, swapping Qatar into a state owned Chinese electric utility, and reducing Oman and swapping into an Argentine energy company. In Latin America, we swapped sovereign exposure in Panama into a state owned Panamanian bank, reduced Mexico and added an attractively priced Brazilian pulp producer, added Dominican Republic in the primary market and reduced exposure in Guatemala, and swapped long end El Salvador into Costa Rica.

## COMPOSITE PERFORMANCE DISCLOSURES

| | 3Q2020 | YTD | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013[1] |
|---|---|---|---|---|---|---|---|---|---|
| Emerging Market Debt (Gross) | 3.18% | -1.05% | 15.33% | -4.18% | 11.65% | 12.33% | 1.55% | 8.87% | 3.92% |
| Emerging Market Debt (Net) | 3.03% | -1.49% | 14.65% | -4.82% | 10.83% | 11.50% | 0.80% | 8.07% | 3.53% |
| JPM EMBI Global Diversified | 2.32% | -0.51% | 15.04% | -4.26% | 10.26% | 10.15% | 1.18% | 7.43% | 2.73% |
| Emerging Market Debt 3-Year Annual Standard Deviation[2] | -- | -- | 5.05% | 5.59% | 5.43% | 6.32% | – | – | – |
| JPM EMBI 3-Year Annual Standard Deviation[2] | -- | -- | 4.85% | 5.46% | 5.04% | 5.78% | – | – | – |
| Dispersion[3] | -- | -- | -- | – | – | – | – | – | – |
| Number of Accounts | ≤5 | ≤5 | ≤5 | ≤5 | ≤5 | ≤5 | ≤5 | ≤5 | ≤5 |
| Composite Assets ($ Millions) | $260.0 | $260.0 | $262.8 | $227.9 | $237.8 | $213.0 | $110.2 | $108.4 | $99.6 |
| % of Firm Assets | 0.42% | 0.42% | 0.44% | 0.46% | 0.45% | 0.47% | 0.26% | 0.24% | 0.23% |

Composite inception and creation date: 07/01/13. [1]2013 returns are partial-year returns, reflecting the composite inception date of 07/01/13. [2]The 3-Year annualized ex-post standard deviation is calculated using monthly returns to measure the average deviations of returns from its mean. [3]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 the returns for those portfolios held in the composite during the entire period. The benchmark for this composite is the JP Morgan Emerging Market Bond Index Global Diversified. Past performance is not indicative of future results. The Fort Washington Emerging market Fixed Income strategy seeks to outperform the JP Morgan Emerging Market Bond Index Global Diversified on a total return basis. The strategy recognizes emerging market 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 the next $100 million and over for separate accounts, and 0.60% for the commingled vehicle. 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. Fort Washington has been independently verified for the periods 7/1/94–12/31/18. A copy of the verification reports are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. Policies for valuing portfolios, calculating performance, and preparing compliant presentations 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.



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