APRIL 2022

EMERGING MARKETS DEBT
THE EVOLUTION OF IMPACT INVESTING

INVESTORS SEEKING A POSITIVE ENVIRONMENTAL OR SOCIAL IMPACT WITH THEIR PORTFOLIOS, ALONGSIDE POTENTIAL FOR ATTRACTIVE RETURNS, MAY FIND COMPELLING OPPORTUNITIES IN EMERGING MARKET DEBT.

- We believe that emerging markets offer clear opportunities for investors to have a meaningful environmental or social impact.
- Recent impact bond issuance in emerging markets reflects growth in investment opportunities with a positive impact.
- The rapid development of impact bond issuance in emerging markets has seen issues from 49 countries overall.

EMERGING MARKETS OFFER A FOCAL POINT FOR MAKING A POSITIVE IMPACT

Investing responsibly in the emerging markets is increasingly seen as a way to support meaningful positive environmental and social outcomes.

This is in part due to three features of emerging markets:

- **People**: 85% of the world's population live in the emerging markets[1].
- **Planet**: Emerging markets represent 77% of the world's land mass, and with 70% of emerging markets' energy supply reliant on fossil fuels[2], there is substantial scope for energy transition initiatives to have a material impact.
- **Prosperity**: With 99% of the world's poorest people living in emerging markets[3], striving to eliminate poverty would clearly represent a significant social benefit.

THE IMPACT BOND MARKET HAS GROWN IN SIZE AND DIVERSITY

In recent years, and particularly in response to the COVID-19 pandemic, there has been an acceleration in issuance of **impact bonds**, also known as 'use of proceeds' bonds, which specify their proceeds will be used to finance activities which have a positive environmental or social impact.

There are three different types of impact bonds. The largest category is **green bonds** where the proceeds are used to pursue specific positive environmental projects.

Another major category is **social bonds** where proceeds are used to finance specific social projects. An example would be social bonds issued by the World Bank, which raised US$8bn in April 2020 to support countries combatting the effects of COVID-19.

The third significant, and rapidly growing, category is **sustainability bonds** where the proceeds are applied to both green and social projects.

Increased demand has led to the evolution of further subsets of impact bonds which seek to finance projects focused on areas such as gender equality, the oceans and wildlife.

Sustainability-linked bonds have also seen an acceleration in issuance over recent years. We do not consider them impact bonds, as their proceeds are not specifically ring-fenced for financing environmental and/or social projects. For these bonds, their terms or structure – such as the coupon they offer – may change, depending on whether pre-defined sustainability targets are achieved, such as a reduction in the issuer's greenhouse gas emissions. They have great potential to support the overall improvement in an issuer's sustainability profile, but to date the vast majority have included both lacklustre sustainability targets and lacklustre financial incentives.

THE GROWTH OF EMERGING MARKET IMPACT BONDS

Impact bond issuance from emerging markets began in earnest in 2017. As Figure 1 illustrates, the growth in impact bond issuance has been so significant, in fact, that it now regularly contributes more than 20% of total emerging market issuance, having been 22% of total issuance in 2021, and 35% of total issuance YTD in 2022.[4]

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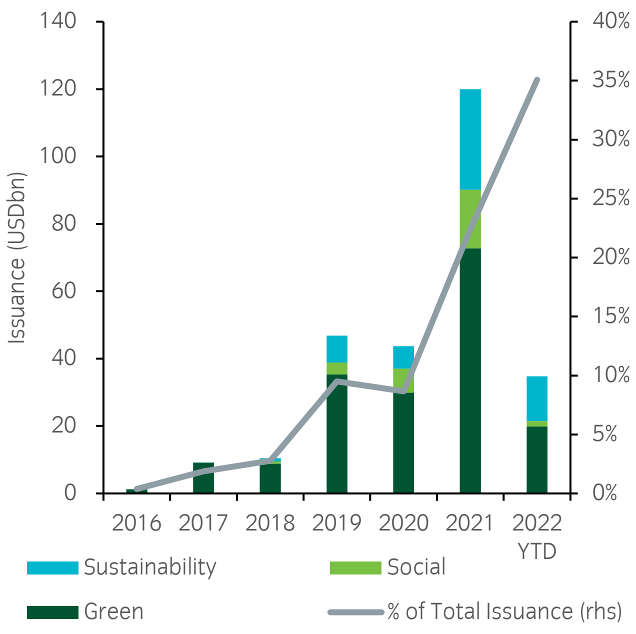
[1] Source: IMF.
[2] Source: BloombergNEF.
[3] World Bank poverty gap at USD5.50 a day (2011 PPP).
[4] Source: Bloomberg

Initially it was dominated by financials and sovereign issuers from China, Korea, and India. Since 2019 however, the asset class has rapidly evolved and grown, with more than USD250bn outstanding as at April 2022, issued by 49 countries overall[5], as Figure 2 shows. The hard currency emerging market impact bond universe now includes over 200 issuers[5], across all major sectors.

Since their emergence as a new asset class, in keeping with their non-impact equivalents, emerging market green bonds have consistently offered a premium versus developed market green bonds, with at present emerging market green bonds offering yields of approximately 4.1%, compared to 2.3% available in developed market green bonds.

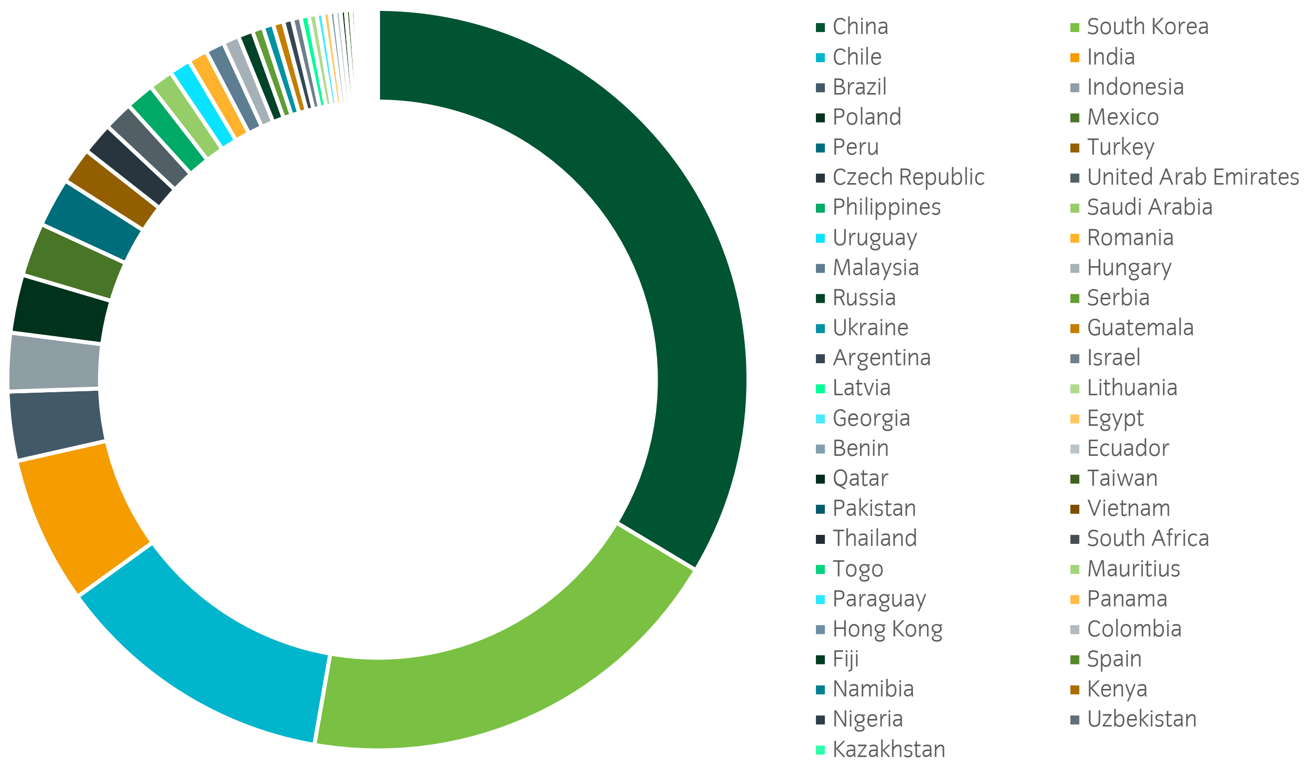
As investors look to identify areas offering attractive total returns and positive impact, emerging market impact bonds are becoming difficult to ignore, as an increasingly diversified, rapidly growing opportunity set, combining the structural yield premium on offer in emerging market debt with the positive impact needed to help support the delivery of the UN Sustainable Development Goals and address key issues facing people, the planet, and prosperity.

Figure 1: Emerging market impact bond issuance has surged



Source: Insight, Bloomberg, as at April 2022. For illustrative purposes only.

Figure 2: China, South Korea, Chile, and India lead 49 emerging markets in issuing impact bonds



Source: Insight, Bloomberg, as at April 2022. For illustrative purposes only.

[5] Source: Bloomberg.

IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

ASSOCIATED INVESTMENT RISKS

ESG

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- **Ratings**: The use and influence of our ESG ratings in specific investment strategies will vary, potentially significantly, depending on a number of factors including the nature of the asset class and the structure of the investment mandate involved. For an investment portfolio with a financial objective, and without specific ESG or sustainability objectives, a high or low ESG rating may not automatically lead to a buy or sell decision: the rating will be one factor among others that may help a portfolio manager in evaluating potential investments consistently.
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Insight applies a wide range of customised ESG criteria to mandates which are tailored to reflect individual client requirements. Individual investor experience will vary depending on the investment strategy, investment objectives and the specific ESG criteria applicable to a Fund or portfolio. Please refer to the investment management agreement or offering documents such as the prospectus, Key Investor Information Document (KIID) or the latest Report and Accounts which can be found at www.insightinvestment.com and where applicable information in the following link for mandates in scope of certain EU sustainability regulations https://www.insightinvestment.com/regulatory-home/sustainability-regulations/; alternatively, speak to your main point of contact in order to obtain details of specific ESG parameters applicable to your investment.

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