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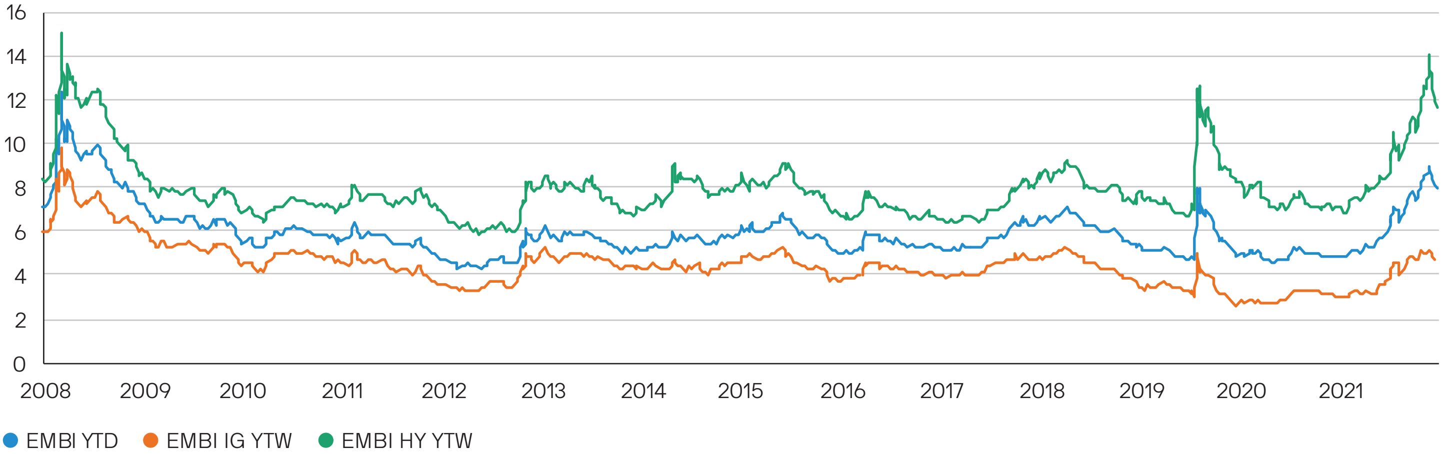
This is a marketing communication. Please refer to the prospectus of the ETF and to the KIID before making any final investment decision.

Emerging markets debt: The new core allocation

JPM USD Emerging Markets Sovereign Bond UCITS ETF

Emerging market debt's role in the portfolio is changing. Previously, emerging markets' small size and relatively high volatility had led many investors to see the space as a tactical asset allocation tool. The segment's higher yields meant that smaller positions could contribute to income while an underweight allocation protected the portfolio's relative performance from potential drawdown risk. China's inclusion in the Bloomberg Global Aggregate Index has increased the space's overall weighting to 15% of the index, and in doing so required investors to look more closely at including emerging market debt in the core of the portfolio. How to best build exposure to the space remains an area of interest. Long-term investors know that emerging markets' performance can be volatile. Since the outbreak of Covid and Russia's invasion of Ukraine, volatility has increased (**Figure 1**). Such moves challenge asset allocators, as investors may not always be compensated for the excess volatility.

Figure 1: Emerging market yield to worst by credit bucket



Source: Bloomberg, 15 August 2022.

What fits best? Comparing emerging market sovereign debt benchmarks

In a rapidly expanding, diverse space, differences in index design can result in meaningful differences in both returns achieved and the character of those returns through the cycle. The most widely followed hard currency sovereign bond index in the emerging markets space is the J.P. Morgan Emerging Market Bond Index ("EMBI") family, of which the EMBI Broad Diversified Index enjoys an elevated profile. This is because the Broad Diversified variant reflects the widest sample across countries and ratings in the range, while others more narrowly define the opportunity.

J.P. Morgan EMBI Global and Global Diversified are sister variations, with each offering exposure to 70 countries and 160 issuers. Where their composition differs is around weight, with Global Diversified offering more exposure to the BB space (21%), a common target for active managers, compared to EMBI Global (19%). As a result, EMBI Global is slightly less volatile than its diversified sister.

Concerns around liquidity are a common criticism of both indexes and the broader space, an effect magnified by increasing levels of country inclusion. As the emerging market universe has grown, so too has the J.P. Morgan EMBI Global. Addressing this criticism, the provider introduced J.P. Morgan EMBI Core, which imposes liquidity filters around issue size and maturities. The resulting index offers exposure to 44 countries, with a concentration in Latin America. J.P. Morgan EMBI Core has proven to be a popular variant, especially in the index replication community where the smaller tail is less costly to replicate.

The three step solution: Introducing EMBI Risk Aware

EMBI Risk Aware is a distinct alternative to EMBI Global, EMBI Diversified and EMBI Core. This is because the index is built around the active filtration of the EMBI universe, to provide a more efficient reflection of the opportunity. Recognising that investors are commonly challenged by liquidity and country risk, the index seeks to reduce these through active filtration of both short dated and smaller issuance, and removing the riskiest countries. From there, the index rebalances into higher yielding credit, effectively elevating the index's return.

The difference in EMBI Risk Aware's performance versus its more traditional peers is striking and shows up clearly in quantitative analysis. Relative to two variants – EMBI Core and EMBI Global – the Risk Aware Index produces stronger returns on lower volatility. More importantly, the Risk Aware Index's tail returns are much smaller versus more traditional peers. Using kurtosis, a measure of the combined weight of the portfolio tails relative to the centre of the distribution, helps to show this quality: selectors often favour lower kurtosis assets for core positions in the portfolio. With a kurtosis of 1.25, Risk Aware's returns are notably less variable than either EMBI Global (1.45) or EMBI Core (1.56).

EMBI Risk Aware also stands out for its relative resilience. We think the Sortino ratio offers an appealing way to assess drawdown resilience, because it differentiates downside volatility from total volatility. For investors looking for core exposure, a higher Sortino ratio may be desirable. Comparing Sortino ratios against EMBI Core and Global Diversified, we find Risk Aware's three-year track record superior for the majority of the sample period. This may be explained by Risk Aware's higher quality and more liquid portfolio: when emerging markets draw down, higher quality, more liquid bonds have a tendency to bounce back more quickly than less liquid, riskier peers.

Simply better beta

Taken together, we think these three measures – returns, kurtosis, and Sortino – contribute to the conclusion that the Risk Aware Index offers a distinctive emerging markets beta relative to better known peers EMBI Global, Global Diversified and Core. For selectors seeking exposure to the diverse, broad, and deep universe of EMD, we see an argument for a more focused engagement with risk, which focuses on the benefits of a more liquid exposure.

In our view, it is fair to call an asset exhibiting a lower kurtosis, higher average return and superior Sortino measure a higher quality play versus peers. While index inclusion typically broadens sponsorship, the benefits do not always accrue equally to issuers. Issuers showing a track record of quality public policy and credible central banking will always attract interest versus less reliable alternatives. By increasing exposure to the former, while reducing the latter, Risk Aware's more active approach to the opportunity should deliver a more compelling beta.

The **JPMorgan USD Emerging Markets Sovereign Bond UCITS ETF** is the only ETF within J.P. Morgan Asset Management tracking the J.P. Morgan Emerging Markets Risk-Aware Bond Index. The ETF offers core exposure to emerging market debt with the potential for improved risk-adjusted returns. The ETF is a Smart Beta ETF which was launched in February 2018 and has $373m in assets under management (as of 28 August 2022). There are two share classes available, JPMB (USD, distributing) and JMBE* (EUR hedged, accumulating).

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