Major Indices vs. Universe of All EM Corporate Bonds

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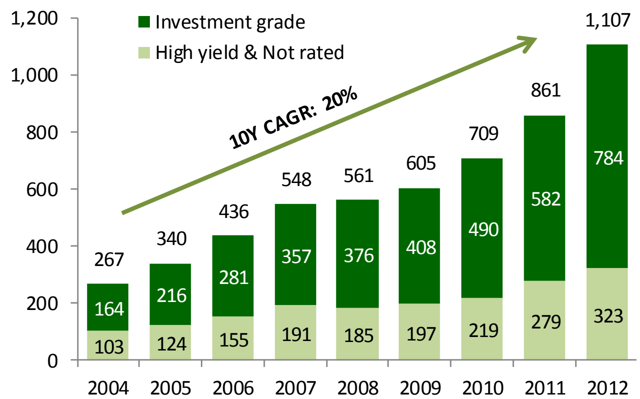
JPMorgan CEMBI Index

USD emerging market corporate bonds have been one of the fastest growing asset classes in global fixed income over the past few years. According to JPMorgan data, there are approximately US$1.1 trillion of hard currency EM bonds outstanding globally.

Exhibit 1: Total EM Corporate Bonds Outstanding According to JPMorgan (US$ in Billions)



Source: JPMorgan, 2012.

Although many Wall Street firms have developed EM corporate bond indices in the last several years, the JPMorgan CEMBI remains the benchmark. The CEMBI offers a robust variety of various emerging market issuers across all major industries and regions. There are four primary versions of the JPMorgan CEMBI index: the CEMBI, the CEMBI Diversified, the CEMBI Broad, and the CEMBI Broad Diversified.

Exhibit 2: Current Characteristics of CEMBI Indices

	YTM %	Mod Duration	Strip Spread (bps)	Current Face Value (US$ in bn)	Index Market Value (US$ in bn)
CEMBI	5.34%	6.22	348.8	337.5	351.9
CEMBI DIVERSIFIED	5.09%	6.18	325.9	191.0	199.4
CEMBI BROAD	5.26%	5.64	344.0	655.5	690.9
CEMBI BROAD DIVERSIFIED	5.02%	5.47	327.0	261.8	274.8

Source: JPMorgan, June 2013.

The CEMBI is a global, liquid corporate emerging markets benchmark. It is a market capitalization-weighted index and includes EM corporate bonds that have an initial minimum of five years maturity and a minimum of $500 million face amount outstanding. Once added, an instrument may remain in the index until 36 months before maturity. Created in 2007, data is backdated to 2001.

The CEMBI Broad was launched as a more comprehensive index, including smaller issues to cover a wider array of corporate bonds and those with something besides a fixed coupon and bullet maturity. The minimum amount outstanding required is $300 million for the CEMBI Broad. Once added, an instrument may remain in the index until 12 months before maturity. Created in 2008, it includes data backdated to 2001.

Additionally, the CEMBI Diversified and the CEMBI Broad Diversified were introduced as uniquely-weighted versions of the CEMBI and CEMBI Broad indices. They limit weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

From each country's total CEMBI/CEMBI Broad eligible debt stock, the Diversified indices pro-rate corporate issues within a certain country as follows:

- 100% of the first US$5 billion of the eligible debt stock;
- 75% of the eligible debt stock that exceeds US$5 billion but does not exceed US$10 billion;
- 50% of the eligible debt stock that exceeds US$10 billion but does not exceed US$15 billion;
- 25% of the eligible debt stock that exceeds US$15 billion but does not exceed US$25 billion;
- 10% of the eligible debt stock that exceeds US$25 billion but does not exceed US$35 billion; and
- 0% of the eligible debt stock that exceeds US$35 billion.

As indicated above, at approximately $691 billion, the CEMBI Broad represents only 62.4% of JPMorgan's estimated $1.1 trillion in EM corporate bonds. What accounts for the exclusion of approximately $400 billion in bonds?

Size and duration are a primary factor in index criteria. The CEMBI Broad only includes issues with a current face amount outstanding of $300 million or more. According to data from JPMorgan, approximately 11.3% of the corporate bonds included in the total corporate bond stock but excluded from the CEMBI Broad failed to meet the minimum size criteria. If the issue is $300 million or larger, it is only included in the index if the instrument has at least 5 years until maturity. Of the corporate bonds included in the total corporate bond stock but excluded from the CEMBI Broad, 45.1% matured within 5 years. Once added, the issue remains in the index until 12 months before maturity.

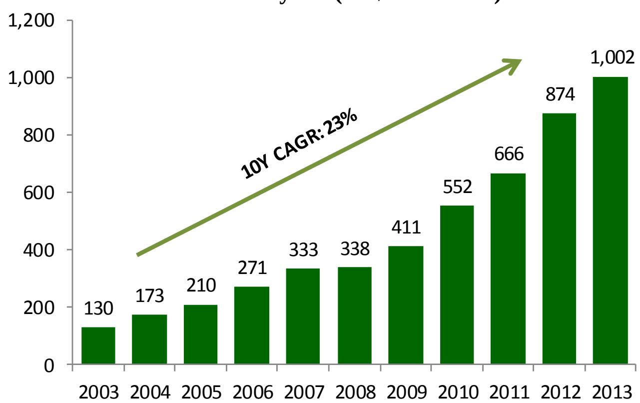
Quasi-sovereign issuers – defined by JPMorgan as issues that are 100% owned or guaranteed by the government – are included in the JPMorgan's estimate for total EM corporate bonds outstanding, but excluded from the CEMBI Broad. Of the bonds counted in the total EM corporate bond stock but excluded from the CEMBI Broad, 24.1% are securities issued by a quasi-sovereign entity. Examples of quasi-sovereign issuers excluded from the CEMBI Broad include $22.6 billion of Pemex bonds, $22 billion of PDVSA bonds, and $8.9 billion of Kazmunaigas bonds. Issues that are given security over commercial receivables or benefit from a guarantee from a guarantor which is not a subsidiary of the eventual obligor are also excluded. Furthermore, only instruments denominated in US dollars are considered for inclusion.

Additional criteria include legal jurisdiction and method of settlement. Availability of pricing is also a consideration. JPMorgan will also exclude instruments with cash flow structures from which verifiable daily returns or other statistics cannot be calculated.

Bank of America-Merrill Lynch EM Corporate Plus Index

Bank of America-Merrill Lynch's Emerging Markets Corporate Plus Index (EMCB) currently has an index market value of $1.0 trillion. Exhibit 3 below shows the growth of the EMCB.

Exhibit 3: EMCB Index Market Value Growth According to Bank of America-Merrill Lynch (US$ in Billions)

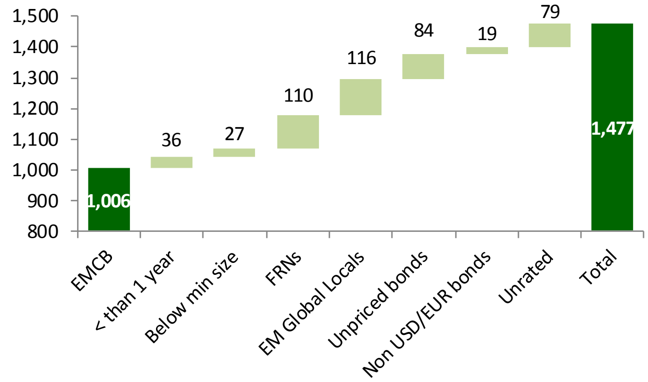


Source: Bank of America-Merrill Lynch, May 2013.

In order to qualify for inclusion in the EMCB index, an issuer must have risk exposure to countries other than members of the FX G10, all Western European countries, and territories of the U.S. and Western European countries. Individual securities of qualifying issuers must be denominated in U.S. dollars or euro, must have at least one year remaining term to final maturity and a fixed coupon.

Similar to the JPMorgan CEMBI index complex, BAML also has a minimum size requirement. Investment grade rated bonds of qualifying issuers must have at least 250 million (EUR/USD) in outstanding face value, while below investment grade rated bonds must have at least 100 million (EUR/USD) in outstanding face value. JPMorgan and BAML differ with respect to issuer type, as the EMCB includes corporate and quasi-government debt of qualifying countries, but excludes sovereign/supranational debt.

Exhibit 4: EM Corporate Bond Universe According to Bank of America-Merrill Lynch (US$ in Billions)



Source: Bank of America-Merrill Lynch, May 2013.

As indicated in Exhibit 4 above, of the estimated $471 billion not included in BAML's EMCB index, nearly half ($226 billion) are excluded because they are either floating-rate instruments or EM global locals, which BAML defines as Euro-clearable local currency bonds registered in the 144A/RegS format that abide by either NY law or English law. The rest of the securities are excluded from the EMCB because they mature in less than one year, fail to meet the minimum size and currency denomination criteria, or are not priced or unrated.

Conclusion

As seen, the EM corporate bond universe is large (and, according to BAML, potentially larger than currently estimated), and the complex of JPMorgan's CEMBI and BAML's EMCB indices only captures a portion of this universe due to the criteria outlined above. In general, the major indices tend to exclude securities below a certain size and instruments that are denominated in local currencies governed under local jurisdictions. Investors need to consider this underlying differential when analyzing the EM corporate bond universe solely based on aggregated index data.

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