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Record EM Sustainable Finance Quarterly Commentary

Q3 2024

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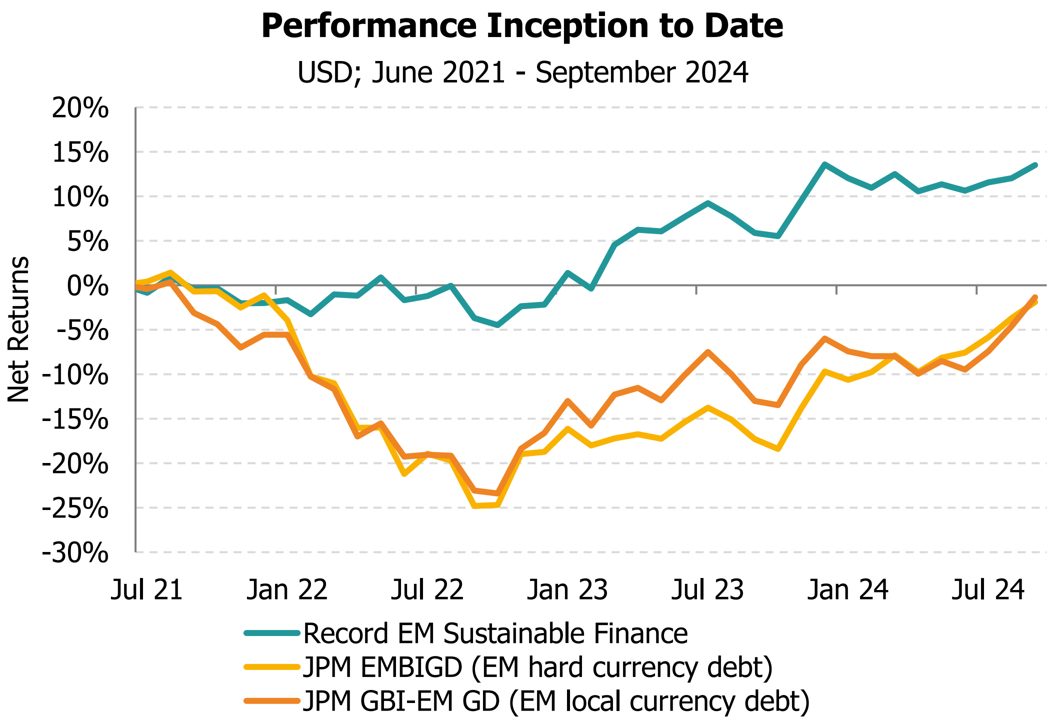
Investment Performance

Market Review

In local currency markets, the JP Morgan GBI-EM index rose by 9% during the third quarter, with approximately 4% coming from local bonds and 5% from emerging market (EM) foreign exchange (FX). On the rates front, bonds across emerging markets saw gains, particularly in Latin America and South Africa. South Africa benefited from declining inflation and a favorable election outcome, while Latin American bonds were buoyed by rate cuts from central banks. In terms of EM FX, the most significant gains occurred in Asia, where currencies were particularly sensitive to the weakening US dollar and the interest rate differentials between domestic yields and US Treasuries. However, currencies in Latin America faced challenges due to the unwinding of the Japanese yen carry trade, prompted by the Bank of Japan's interest rate hikes.

In EM hard currency debt markets, the JP Morgan EMBI GD experienced a 6.2% increase, with both high-yield and investment-grade issuers showing strong performance. This sector benefitted from declining US Treasury yields and a global rally in risk assets. Latin America emerged as a standout region, with Argentina, El Salvador, and Ecuador achieving notable returns. Argentina's fiscal situation continued to improve over the quarter. Additionally, Ukraine saw positive momentum following a debt restructuring agreement that was well received by the market.

Fund/Strategy Performance



EMSF Cumulative Outperformance	
JPM EMBIGD	15.4%
JPM GBI-EM	14.8%
JPM ELMI+	11.6%
70/30 EMBI/ELMI	14.1%

The fund posted a net return of 2.58% (in USD) over the quarter. As a comparison, the fund's reference index (30% JPM ELMI+ & 70% JPM EMBI) posted a 5.88% return.

Main detractor on relative performance came from our funding basket where our smaller dollar short relative to peers weighed on returns during the period of dollar weakness we witnessed over the quarter. Our GBP short also weighed on relative returns. The GBP rallied on the belief that the Bank of England would struggle to cut interest rates much lower, compared to the US Federal Reserve which was expected to aggressively slash rates.

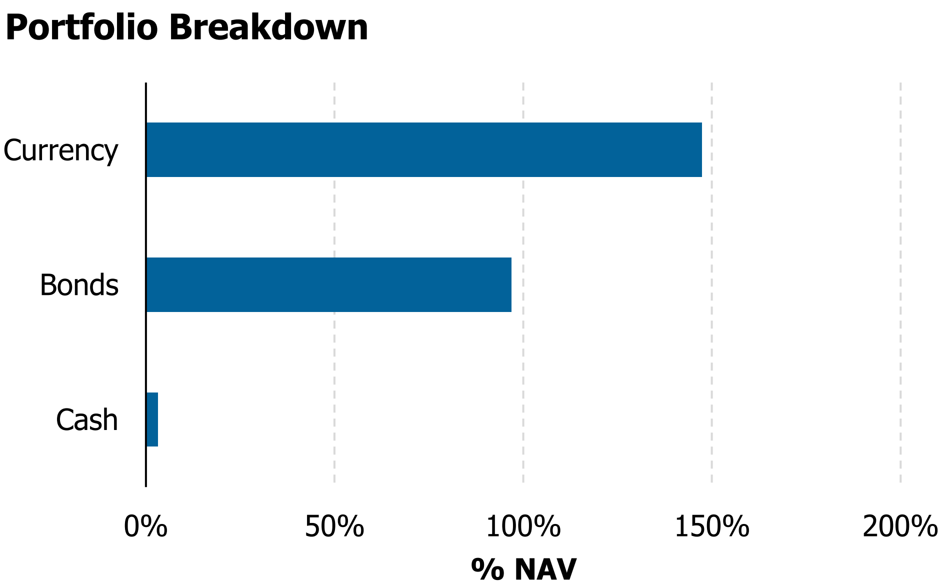
Note: Past performance is not a guide to the future. There is no guarantee that any strategy or technique will lead to superior performance. The use of derivatives means there is credit risk associated. A high level of exposure to a single currency may result in significant losses which may be realised in a short period of time due to sudden changes in relative currency values.
Source: Record. Data as at 30th September 2024.

On the positive side, Asian currency pairs performed notably well over the quarter on the back of dollar weakness (IDR, PHP, THB, KRW, VND). The long IDR position was one of the main outperformers over the quarter as the Bank of Indonesia maintained rates to support the rupiah, allowing the currency to benefit from rising foreign capital inflows. Outside Asia, the ZAR also strengthened from ongoing structural reforms, reducing risk premia tied to the rand. In Latin America, the high-yielding currencies traded weaker due to ongoing carry unwinds, with the Mexican peso under significant pressure given recently planned judicial reforms.

Asset Allocation Moves

Over the last few months, we have been increasing our exposure to frontier currencies. Key reasons for this increase include enhanced impact credentials via peer-to-peer transaction opportunities available in this universe and portfolio-level diversification benefits due to insulation from sentiment-driven flows and higher yield/carry/return opportunities. At the same time, we reduced the gearing of our EM positions to keep fund's total foreign currency exposure relatively unchanged in view of risks of elevated volatility in EM FX asset class in a period of late cycle slowdown, US elections and elevated geopolitical risks.

On the funding side, we increased the size of our US dollar short (as a result decreasing the deviation relative to EMD peers which are exclusively funded in dollars) and reduced the size of our CHF short.



Source: Record. Data as at 30th September 2024.

Impact Highlights

Peer-to-Peer Transactions

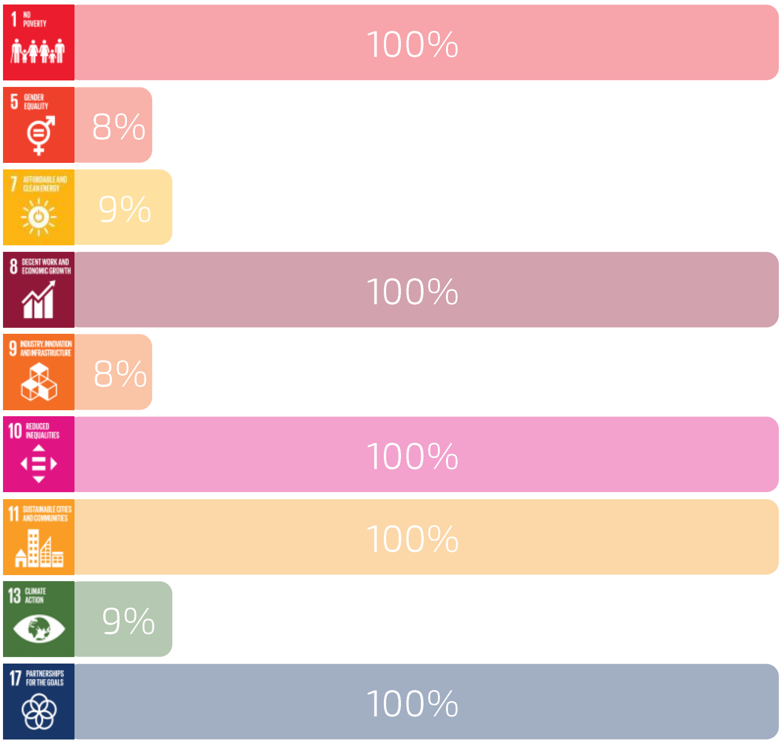
The strategy invests in Peer-to-Peer transactions in partnership with MDBs whereby we onboard FX currency risk, allowing MDBs to finance development projects in local currency. This removes currency risk for end borrowers.

The unique and bespoke structure of Peer-to-Peer trades delivers greater oversight of the use of proceeds alongside transparent and measurable impact. These transactions are aligned with our ambition to design innovative currency solutions that provide long-term, inclusive and affordable funding, protecting vulnerable borrowers from currency risk.

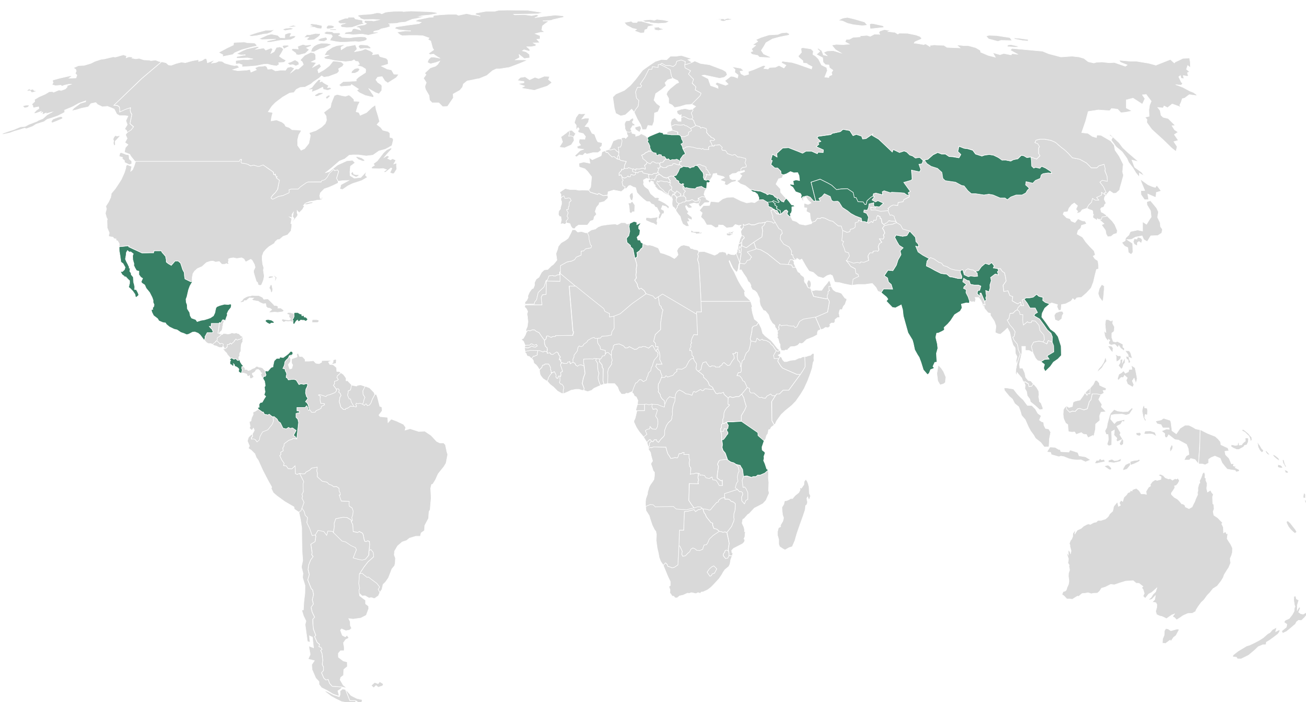
Of the total portfolio $233.4 million is invested in Peer-to-Peer transactions. As part of our impact monitoring we have visibility on the use of proceeds allowing us to map these to the UN SDGs as shown in the chart on the right.

On page 5 we provide a case study of a recent Peer-to-Peer transactions in Uzbekistan.

Alignment of Peer-to-Peer trades with UN SDGs:



Distribution of MDB loan disbursements via peer-to-peer transactions



Source: Record. Data as at 30th September 2024.

Case Study: Private Sector Development in Uzbekistan

On 30 July 2024, the Record Emerging Market Sustainable Finance (EMSF) strategy was the sole investor in an Uzbek Soum-denominated bond issued by the International Finance Corporation (IFC). The bond's size was UZS 250 billion, equivalent to USD 20 million, with a tenor of 6 years and an amortizing structure.

Background

Uzbekistan is a landlocked country in Central Asia with a population of 36.4 million. Following the country's independence from the Soviet Union in 1991, the country remained insular and repressive. Its economy was characterised by state dominance, minimal foreign investment, and endemic corruption.

However, beginning in 2017 under President Shavkat Mirziyoyev, the country has embarked on an ambitious path of economic modernisation and liberalisation. It aims to halve the poverty rate by 2026 and reach upper-middle-income status by 2030. Recent developments include the privatisation of numerous state-owned enterprises, establishment of an independent energy regulator, and removal of various price controls. Significant progress has also been made on issues such as child labour, educational enrolment, and access to clean drinking water. However, private sector participation remains highly limited in Uzbekistan. Empowering the private sector is a top development priority for both the government and multilateral development institutions, who remain committed to working with local authorities and supporting the country's agenda for economic, social and regulatory reform.

Within Record EMSF strategy's portfolio of bond issuers, the largest lenders to Uzbekistan are the Asian Development Bank, the European Bank for Reconstruction and Development, and the World Bank Group (which includes IFC). Together, our issuers have over USD 13.2 billion in outstanding loans to Uzbekistan. Technical and financial engagement has markedly increased since 2017, and IFC's portfolio of investment commitments in Uzbekistan is approx. USD 500 million.

Our Investment

The investment in an Uzbek Soum-denominated bond enables IFC to lend to Uzbek borrowers in their local currency, removing their currency risk. In the absence of local currency lending, Uzbek borrowers would be exposed to potential devaluation shocks that could make debt more risky, more costly, and unsustainable. This issuance also marks IFC's longest-dated UZS-denominated bond to date, and it contributes to funding a senior A loan valued at up to USD 100 million to the end borrower.

The bond proceeds will finance a leading domestic beverage company's development of a greenfield bottling plant, renewable energy installations, and green buildings. Anticipated results include reduced water and energy usage as well as meaningful job creation throughout the supply chain. IFC will also support the company in raising female representation among new hires and management. Moreover, to encourage the company to achieve its sustainability targets, the IFC loan is specially structured as a sustainability-linked loan.

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