Wellington Emerging Local Debt Fund

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MARKET REVIEW

Emerging markets external debt returned 1.19 as measured by the JP Morgan Emerging Markets Bond Index Global Diversified (EMBIGD) in US-dollar terms. Spreads narrows 1 basis points to 336 bps, contributing to performance, while a decrease in US treasury rates had a positive impact. Latin America was the best-performing region in the index, while the Middle East lagged. Investment grade issuers underperformed non-investment grade issuers. From a country perspective, Argentina, Lebanon and Ukraine were the best performers in the index during the period, while Venezuela, Bolivia, and Romania lagged.

Emerging local markets debt returned -0.57% in US-dollar terms, as measured by the JP Morgan Government Bond Index - Emerging Markets Global Diversified (GBI-EMGD). Emerging Markets (EM) currencies depreciated, driving negative performance, while EM rates had a positive impact. The Middle East was the best-performing region in the index, while Europe lagged. From a country perspective, Turkey, Peru, and Colombia were the best performers in the index, while Uruguay, Romania, and Brazil lagged. Among the benchmark countries, the Dominican Republic (-25bps to 6.00%), Mexico (-25bps to 10.25%), Peru (-25bps to 5.00%), the Czech Republic (-25bps to 4.00%), and South Africa (-25bps to 7.75%), decreased their benchmark interest rates, while Brazil (50bps to 11.25%), increased their benchmark interest rates.

EM corporate debt, as measured by the JP Morgan CEMBI Broad Diversified Index (CEMBIBD), posted a total return of 0.60% in US-dollar terms. Credit spreads widened by 5 basis points to 250 bps. Investment grade credits performed on par with non-investment grade credits. Metals & mining, and oil & gas were the best performers, while real estate and infrastructure lagged.

In November, the U.S. Federal Reserve, Bank of England, and several EM central banks eased interest rates. In the Middle East, tensions remain elevated amidst continued concerns of a broader regional conflict. Additionally, conflict continued between Ukraine and Russia. In the U.S., Donald Trump won a second presidential term and Republicans swept both houses of Congress, leading to expectations for increased protectionism and tougher immigration policy. Brazil increased its policy rate and presented its fiscal package with lower than expected spending reductions. Meanwhile, China has continued efforts to stimulate improvements in growth and inflation dynamics.

FUND PERFORMANCE AND ATTRIBUTION

- The portfolio modestly underperformed its benchmark during the month.
- Security selection detracted from results. Security selection within Hungary detracted due to an overweight to long-dated local debt. Security selection within Brazil had a negative impact on performance due to our overweight to short-dated local debt. Our overweight to the front-end of the curve and an underweight to mid-dated debt within Poland also detracted from results. Security selection within Turkey contributed due to an overweight to long-dated local debt.
- The portfolio's currency positioning detracted from results. Our overweight to the Turkish lira detracted from performance.
- Duration strategies contributed to performance over the period. Specifically, our overweight positioning in local duration in Hungary, South Africa, and Mexico contributed to results. Conversely, the portfolio's overweight positioning in local duration in Brazil and underweight positioning in local duration in China detracted from results.

FUND POSITIONING AND OUTLOOK

With the Federal Reserve's easing cycle underway, the market has continued to look ahead to the scope of easing that can be expected in the final month of 2024 and into 2025. Hard currency fixed income will directly benefit from developed market interest rate cuts while local yields, even those where central banks have already commenced cutting cycles, should benefit as well. The path forward for easing, as well as for broader macroeconomic conditions and risk appetite, will be largely informed by US policy and a continuation of the cooling inflation trend.

Throughout 2024, elections across both emerging and developed markets brought political stability, governance, and policy to the forefront. The second half of the year focused on US elections where Donald Trump and the Republican party swept the executive and legislative branches. Trump's election in the US is likely to have significant impacts to global growth, trade, and inflation. While impacts broadly and for specific countries remain uncertain at this time, US policy will be a key factor in the coming year. Trump's proposed tariff policy could have repercussions across developed and emerging markets for growth, the strength of the dollar, the future path of interest rates and inflation. The degree to which policy moderates, if at all, from its campaign trail form will be key for understanding its impacts. That said, expansionary tariff policy and broad trade restrictions could weaken growth and pressure inflation globally. Importantly though, tariff policy will not have equal impacts across all markets as some could stand to benefit from changing trade patterns and shifts in manufacturing hubs. We expect that there will be relative winners and losers in the new policy landscape, an opportunity to leverage our deep fundamental research. We continue to monitor other key global factors including the conflicts between Israel and Hamas and Russia and Ukraine, oil market supply and demand, and efforts by China to stimulate improvements in growth and inflation dynamics.

In many EM countries fundamentals remain largely constructive, supported by manageable balance of payment positions, improving or steady fiscal deficits, supportive commodity prices, and waning inflation. Within the cohort of distressed and defaulted countries with weaker policies and a lack of access to capital, we continue to find select opportunities. Multiple weaker EMs, having undergone debt restructuring over the past

PAST PERFORMANCE DOES NOT PREDICT FUTURE RETURNS. AN INVESTMENT CAN LOSE VALUE.

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two years, are beginning to reach final resolutions with stakeholders and move towards necessary structural reform. Many EM corporates continue to exhibit considerable financial strength amidst cost pressures and elevated refinancing costs. While improvements to corporate fundamentals may have reached a plateau, attractive opportunities in the sector continue to be met with demand from both dedicated emerging markets investors as well as crossover buyers.

In November, EM sovereign spreads were flat as investment grade widening was offset by high yield tightening. EM corporate spreads widened across both investment grade and high yield cohorts. Dispersion within the opportunity set still provides an opportunity to leverage our deep country and corporate analysis as well as to utilize relative value in security selection.

EM local market yields are still high by historical standards in many countries, and rate cutting cycles are in their early stages. Throughout much of Latin America and in parts of Central and Eastern Europe, EM central banks such as Colombia, Uruguay, Chile, Hungary, and the Czech Republic have initiated rate cutting cycles. Several other EM central banks, having reached pause points as they awaited further clarity on the trajectory of Fed rate cuts, are now able to move more consistently into an easing cycle. Turning to EM currencies, several factors dominate, including USD directionality and rate volatility. In the long term, we anticipate that proactive action by EM central banks and wide US fiscal and external deficits will eventually pose a challenge to USD strength.

In November, hard and local currency funds saw outflows accelerate. Both EM sovereign and corporate new issue supply continued in November but moderated following a busy fall. We anticipate that the new issue calendar will reaccelerate in the early months of 2025.

The strategy has a positive outlook on local bonds and a more conservative lean on currencies, reflecting the view that local rate markets have a favorable tailwind from the economic cycle and still-compelling valuations. We are mindful that changes to US policy could impact the trajectory of global economic financial conditions substantially. As such, while the direction of the strategy has not changed, we have maintained a more moderate level of risk in recognition of that increased uncertainty. Still, EM local rates allocations are focused where central banks preemptively and aggressively raised rates to address inflation. Many are now in a position to ease rates as inflation recedes. In Latin America we see opportunities in Mexico and Colombia while in Europe we favor Hungary and Czech. We are also constructive in South Africa as bond yields remain elevated relative to history and inflation remains under control. In many countries in Asia, however, policy rates remain low and local rate market valuations are less attractive. We remain cautious specifically in China, Thailand, and Malaysia. Over the longer term, proactive efforts by most EM central banks and supportive commodity prices leave us constructive on select EM currencies. Our emphasis remains on exchange rates where fundamental, technical, and valuation factors are consistently supportive. There is meaningful dispersion among currencies which provides opportunities for alpha in proper currency selection without taking undue beta risk. We favor fundamentally attractive, higher yielding currencies in Latin America that have room to appreciate including the Peruvian sol and Uruguayan peso. We also find currency yields in Turkey to be compelling now that the central bank is firmly focused on controlling inflation with orthodox policy. In contrast, we are limiting exposure to the Chilean peso, Colombian peso, and Czech koruna. We maintain exposure to select Asian currencies including the Indian rupee, though we remain less constructive on the Indonesian rupiah.

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