Wellington Emerging Local Debt Fund

WELLINGTON MANAGEMENT®

MARKET REVIEW

Emerging markets external debt returned -1.72 as measured by the JP Morgan Emerging Markets Bond Index Global Diversified (EMBIGD) in US-dollar terms. Spreads narrows 23 basis points to 338 bps, contributing to performance, while a decrease in US treasury rates had a positive impact. Africa was the best-performing region in the index, while the Latin America lagged. Investment grade issuers underperformed non-investment grade issuers. From a country perspective, Argentina, Bolivia and Sri Lanka were the best performers in the index during the period, while Panama, Colombia, and Peru lagged.

Emerging local markets debt returned -4.61% 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, along with EM rates detracting. Asia was the best-performing region in the index, while Latin America lagged. From a country perspective, Uruguay, and the Dominican Republic were the best performers in the index, while Chile, Colombia, and Hungary lagged. Among the benchmark countries, Chile (-25bps to 5.25%), Colombia (-50bps to 9.75%), Dominican Republic (-25bps to 6.25%), China (-25bps to 3.10%), Philippines (-25bps to 6.00%), Thailand (-25bps to 2.25%), decreased their benchmark interest rates.

EM corporate debt, as measured by the JP Morgan CEMBI Broad Diversified Index (CEMBIBD), posted a total return of -0.86% in US-dollar terms. Credit spreads narrowed by 18 basis points to 245 bps. Investment grade credits underperformed non-investment grade credits. Real estate and financials were the best performers, while pulp & paper and industrial lagged.

In October, the European Central Bank, alongside a number of central banks globally, eased interest rates. In the Middle East, the situation escalated following an Iranian attack on Israel, which raised concerns of a broader regional conflict. Additionally, tensions between Armenia and Azerbaijan remained high, with fears of renewed hostilities over disputed territories. Conflict in Ukraine with Russian forces also continued. In the U.S., the presidential race intensified as it entered its final weeks with polling between Donald Trump and Kamala Harris continuing to suggest a tight race. China introduced substantial monetary and fiscal stimulus measures, aiming to bolster its slowing economy.

FUND PERFORMANCE AND ATTRIBUTION

- The portfolio underperformed its benchmark during the month.
- Duration strategies detracted from performance over the period. Specifically, our overweight positioning in local duration in Mexico, Turkey, and Colombia detracted from performance. Conversely, the portfolio's underweight positioning in local duration in Poland contributed positively to performance.
- Security selection contributed positively to results. Security selection within Turkey contributed due to an overweight to long-dated local debt. Positive security selection within Poland came from an overweight to the front-end of the curve and an underweight to mid-dated debt. Our overweight to the front-end of the curve and an underweight to mid-dated debt within Mexico also contributed positively to results. Security selection within Thailand detracted due to an underweight to short-dated local debt. Security selection within Brazil had a negative impact on performance due to our overweight to short- and mid-dated local debt. Our overweight to mid- and long-dated local debt and an allocation to supranational debt within India also detracted from results.
- The portfolio's currency positioning contributed to results. Specifically, our underweight to the Malaysian ringgit and Chilean peso had a positive impact. In contrast, our overweight to the Brazilian real and Polish zloty detracted from results.

FUND POSITIONING AND OUTLOOK

With the Federal Reserve having kicked off their long-anticipated easing cycle in September with a 50 basis point cut, the market has continued to look ahead to the scope of easing that can be expected over the final quarter 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 elections in November, which, as at the time of this writing, are yet to be decided.

Amidst a heavy year of elections across both emerging and developed markets, political stability and governance remain at the forefront. The first half of the year brought the first leadership change in over a decade to Indonesia, better than expected performance from the Regeneration Movement (Morena) in Mexico, and underperformance relative to expectation for the Bharatiya Janata Party (BJP) and African National Congress (ANC) in India and South Africa's elections, respectively. At the time of this writing US elections are still upcoming, likely to demand market focus for the balance of the year as elections are decided and impacts of the eventual outcome come to the forefront. US elections carry important implications for both US domestic and foreign policy and the potential to have acute impacts on emerging markets. We continue to monitor other key global factors including the conflicts between Israel and Hamas and Russia and Ukraine, questions around oil market supply and prices, and ongoing 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 fiscal deficits, supportive commodity prices, and waning inflation. Within the cohort of distressed and defaulted countries with weaker policies and a

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

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lack of access to capital, we continue to find select opportunities. Multiple weaker EMs, having undergone debt restructuring over parts of 2023 and 2024, are beginning to reach final resolutions with stakeholders and move towards necessary structural reform. Many EM corporates continue to exhibit considerable financial strength amidst rising 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 October, spreads tightened across both EM sovereigns and EM corporates, with high yield spreads tightening more relative to investment grade spreads. 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 likely to move more decisively 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 October, hard currency funds saw outflows while local currency funds saw a modest pickup. Both EM sovereign and corporate new issue supply continued in October but moderated following a busy September. We anticipate a slowing to the new issue calendar as US elections take center stage ahead of year end.

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 the upcoming US elections could change the trajectory of global economic financial conditions substantially. As such, while the direction of the strategy has not changed the highly uncertain nature of the outcome has informed the decision to trim risk levels. Still, EM local rates allocations are focused where central banks preemptively and aggressively raised rates to address inflation. They are now in a position to ease significantly as inflation recedes. In Latin America we see opportunities in Mexico and Colombia while in Europe we favor Czech and Hungary. 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 Brazilian real and Peruvian sol. 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 Mexican peso, Chilean peso, and Czech koruna. We maintain exposure to select Asian currencies including the Indian rupee, though we remain less constructive on the Malaysian ringgit.

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