# Private Debt Opportunities in Emerging Markets

## Insights for Building Insurance Portfolios

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### Key Points

- Emerging market debt (EMD) can present distinct advantages but requires significant expertise to help mitigate risk and enhance yield potential.
- Start by defining the role of EMD within the portfolio—diversification, yield enhancement or capital appreciation.
- Balancing quality, duration, diversification and income provides resilience against market volatility while meeting yield and liability objectives.
- Understanding correlation dynamics is key for identifying opportunities and risks during periods of market stress.
- Sovereign debt can be helpful for macroeconomic positioning and accessing broader country exposure, while corporate debt can help target specific demographic trends or government reforms.

MetLife Investment Management

Private debt markets in emerging economies may offer unique opportunities. They can help insurance-industry investors to seek yield enhancement, diversification and less-correlated returns compared to traditional public debt.

**Potential opportunities can include:**

**Higher yields:** Private debt often provides higher returns than public market instruments, reflecting illiquidity and higher perceived risk. Yields can exceed those of comparable public debt by 200–400 basis points, depending on the region and borrower profile.

**Customized structures:** Investors can negotiate bespoke terms—including covenants, collateral and repayment schedules—tailored to specific risk/return profiles. Opportunities exist in mezzanine financing, project finance (infrastructure, renewable energy) and structured credit.

**Underserved borrowers:** Many emerging market (EM) borrowers lack access to public markets but have strong fundamentals, creating opportunities for direct lending. Attractive sectors include those with growth tailwinds, such as renewable energy, technology, healthcare and agribusiness.

**Economic development trends:** Governments in emerging economies often support private debt financing through credit enhancements or guarantees for key industries. Private investors can tap into long-term infrastructure development and public-private partnerships (PPPs). Emerging markets can also be a good source of infrastructure debt projects offering opportunities in the renewables, transportation and transmission spaces. MIM has been investing in these private emerging market assets for over 10 years.

Taking advantage of these opportunities requires careful planning and a solid strategy. The following insights will help insurance companies build emerging market debt (EMD) portfolios that align with their goals.

## Sizing Allocations

First, define the role of EMD within the portfolio. Is it for diversification, yield enhancement or capital appreciation?

**Diversification benefits** can manifest with lower default rates without massive sovereign support. We've seen the importance of investing in countries we believe can withstand the shocks and where valuations look attractive to compensate for the risks. Hence, we look for improving stories, including countries focusing on implementing reforms (e.g., showing commitment to curb fiscal deficits, improving economic growth, etc.) and those with the liquidity reserves and resources to withstand the headwinds.

In terms of **yield enhancement and capital-adjusted yields,** EMD typically offers premiums to public corporates ranging from 75bps to 150bps, where lower-rated issuance has the advantage of higher premiums but still stable capital charges.

Use **tactical asset allocation (TAA)** to increase exposure during periods of dislocated spreads or improving fundamentals in key markets. Employ **strategic asset allocation (SAA)** for long-term alignment with liability profiles.

Understanding **correlation dynamics** helps to identify opportunities for uncorrelated returns while mitigating risks during periods of market stress. **Scenario analysis** can help to model potential impacts of global economic developments (e.g., Fed rate hikes, China slowdown) on EM allocations. Use stress tests to determine the potential capital strain during worst-case market environments.

## Quality, Duration, Diversification and Income

Balancing quality, duration, diversification and income is key for optimizing EMD portfolios. These pillars ensure resilience against volatility while aligning with yield and liability objectives.

### Quality

- **Use credit ratings** as a starting point but conduct independent due diligence focusing on fundamentals, such as fiscal health, political stability and external debt ratios; EM sovereign downgrades can be swift and impactful.
- **Monitor political stability, rule of law and macroeconomic policies** as key indicators of quality.
- **Balance exposure** across sovereigns, quasi-sovereigns and corporates.
- **Consider avoiding concentration in high-yield** (non-investment grade) EMD.

### Duration

- **Short-duration bonds mitigate interest rate risk and liquidity concerns** in rising rate environments.
- **Longer-duration bonds can be attractive** during periods of economic stabilization or declining inflation expectations.
- **Match or mismatch duration relative to liabilities** depending on asset and liability management (ALM) needs.
- **Be cautious of the risk/reward trade-off at the long end of the curve** in volatile EM economies.

### Diversification

- **Geographic diversification reduces reliance on specific regions** prone to systemic shocks.
- **Sector diversification across corporates** (e.g., energy, telecom, consumer goods) lowers idiosyncratic risk.
- **Be wary of over concentration** in commodity-reliant economies.

### Income Generation

- **Leverage coupon payments** to reinvest opportunistically, enhancing total returns.
- **Target high-yield instruments selectively** while balancing risk with sufficient coverage ratios.
- **Assess the spread differential** between EMD and developed market (DM) debt for incremental income while considering the risk of spread compression.

## Sovereign vs. Corporate Exposures

When allocating sovereign or corporate debt, consider the following.

| | Sovereign Debt | Corporate Debt |
|---|---|---|
| **Well-suited for** | Macroeconomic positioning and accessing broader country exposure, as well as liability-matching and regulatory alignment | Sectors benefiting from demographic trends or government reforms (e.g., infrastructure, fintech) |
| **Benefits** | Greater liquidity and transparency | Yield enhancement but with higher credit and liquidity risks |
| **Considerations** | IMF-backed reforms or improved credit ratings can create re-rating opportunities. | Conduct forensic accounting to identify governance risks in less-transparent markets.<br>Monitor cross-default clauses in cases where sovereign distress impacts corporate issuers.<br>Requires detailed due diligence on issuer fundamentals, especially in volatile markets. |

## MIM Can Help

MIM's emerging markets platform is founded on deep expertise and active management to navigate the inherent complexities in the EM space. By blending disciplined risk management with tactical opportunism, MIM has been able to achieve returns while meeting liability-driven objectives. To learn more, visit MetLife Investment Management.

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