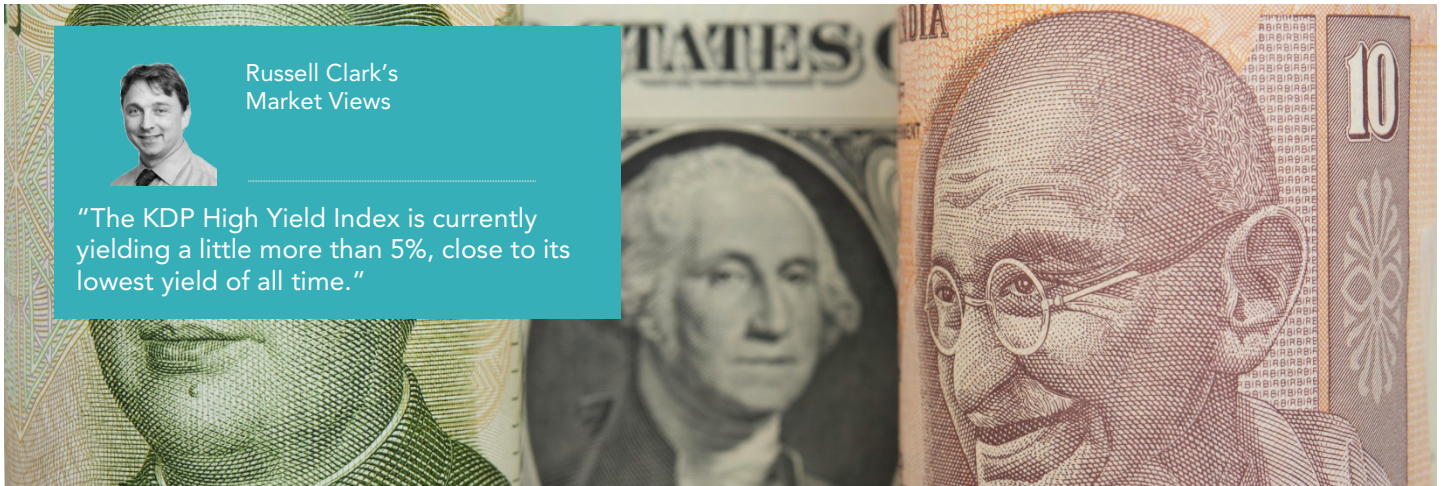
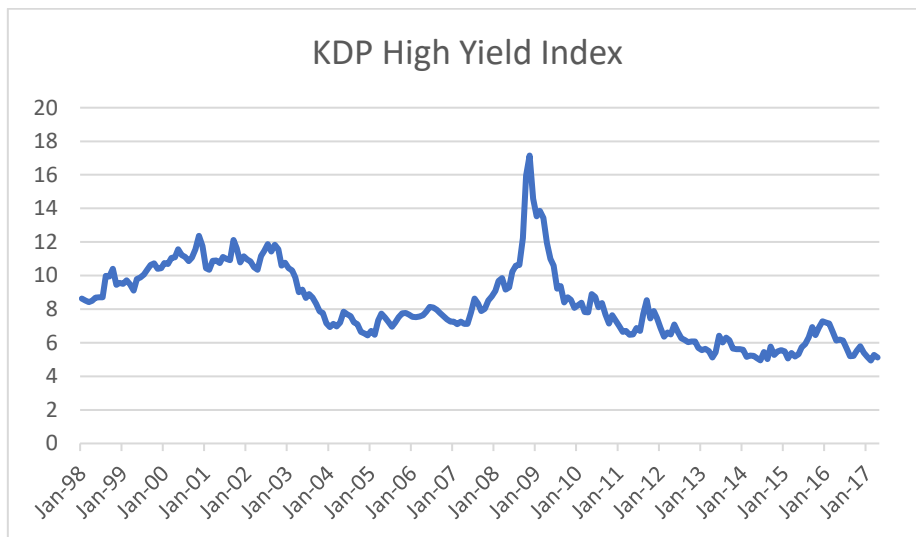


EMERGING MARKET DEBT LOOKS MORE ATTRACTIVE THAN US HIGH YIELD



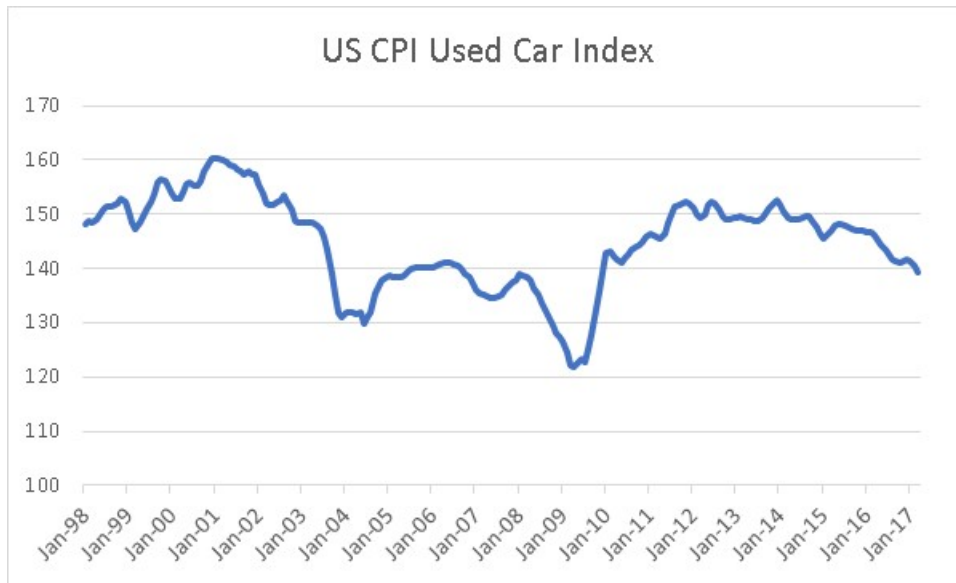
The KDP High Yield Index is currently yielding a little more than 5%, close to its lowest yield of all time.



If we look at the spread between the KDP High Yield and 5 year treasuries, we can see that the spread has only been tighter in 2007.



These spreads look too low when we look at key leading indicators for a number of sectors in high yield market. Auto debt has grown significantly over the years. The lead indicator for auto debt is second hand car prices, which has begun to weaken significantly.



US commercial real estate is also beginning to look as if it is topping out.



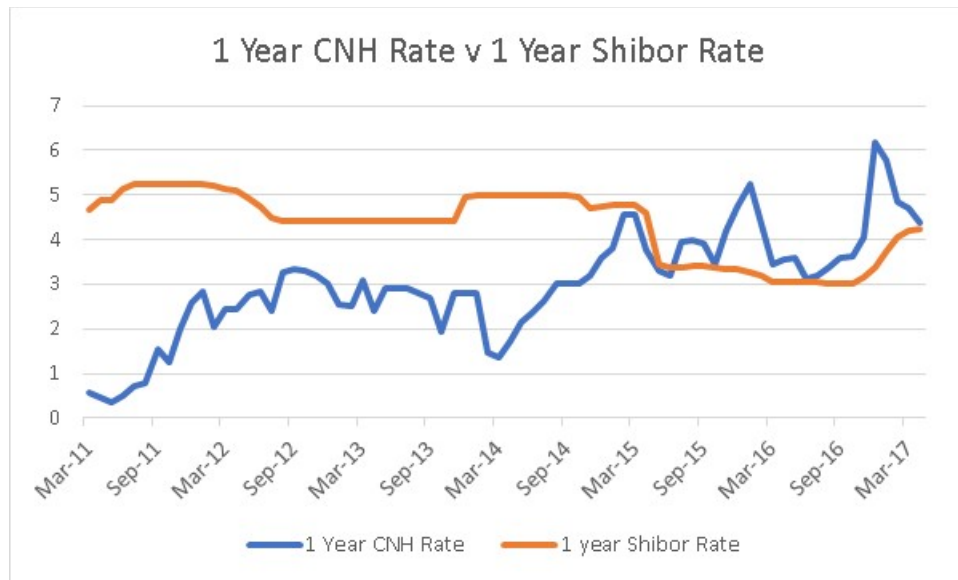
Finally, large US department stores continue to trade poorly and with elevated CDS. To me this suggest that US high yield is not offering enough yield for the risks involved.

The biggest argument for low interest rates for US high yield is that investors have been starved of high yield in markets such as Japan and Europe due to quantitative easing. This is a hard argument to refute. However, global fixed income investors have recently been able to access the Chinese bond market.

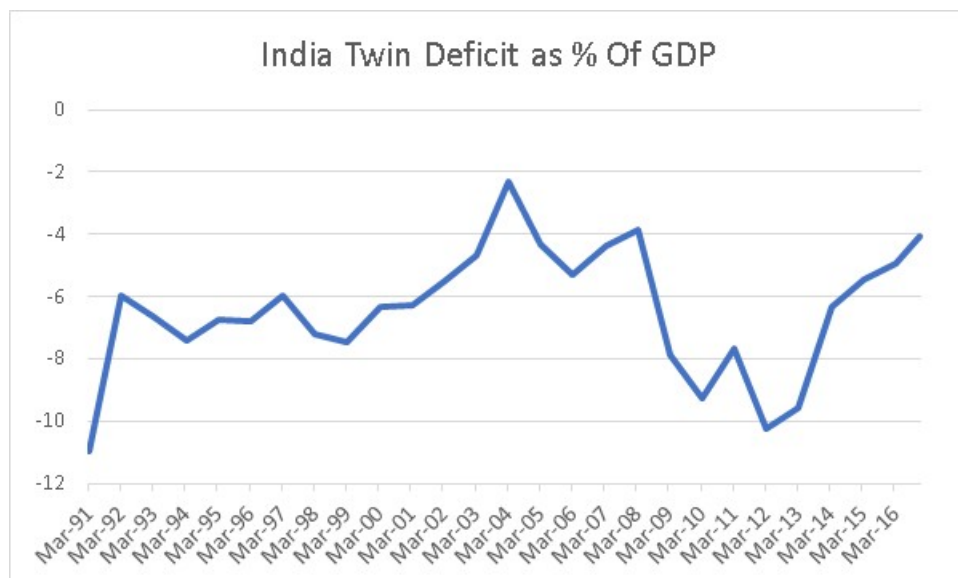
<http://uk.reuters.com/article/us-china-bonds-index-analysis-idUKKBN1860JL>

As the article notes, Chinese bond markets are large, and given the size of the Chinese economy, Chinese bond yields should be more important than German bund yields, or UK gilt yields. Chinese government bonds are issued in Renminbi, so depreciation in the currency is the major risk.

We can assess currency risk by comparing 1 year deposit rates on offshore Renminbi (CNH) in Hong Kong to onshore interest rate markets. Market expectations used to be of an appreciation of the Renminbi, so offshore deposit holders were willing to accept lower rates than available onshore (e.g. 1yr Shibor rate). Over the last few years, expectations of depreciation drove off shore rates higher than onshore rates. Recently, expectations of depreciation have fallen dramatically. This is suggestive that currency risk for the Chinese yuan has diminished significantly, adding to the attraction of Chinese bonds.



India currently offers a 1 year government bond rate of 6.5%. The Indian rupee tends to be an extremely weak currency, and hence the 6.5% yield may seem insufficient to most foreigners. The rupee has tended to be weak due to chronic twin deficits, but recently the combined twin deficit has dropped to very low level, which should support the currency.



The last time the twin deficit of India was so low, in the early 2000's, the Indian rupee was a strong and stable currency.

It seems to me that in the US high yield market yields are too low given the lead indicators for many borrowers in that market. Chinese and Indian sovereign bonds seem to me to offer very attractive rates relative to the currency fundamentals. An unhedged long emerging market bond position looks far more attractive to me than US high yield bonds.

INFORMATION

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Source: Bloomberg, unless otherwise stated
Investor Relations: Alain Zakeossian, Carol Brown
Email: info@russellclarkim.com
Telephone: +44 (0)20 7838 7580
Website: www.russellclarkim.com

Business and registered address: Russell Clark Investment Management Limited, 9 Chester Close, London SW1X 7BE, United Kingdom. Registered in England and Wales - Company number: 04034280

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