Federated Hermes Emerging Markets Debt Regional Assessments

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Why Latin America? – Decades of patience has delivered today's progress *(reasons to maintain a large overweight)*

1 The presence of established checks and balances in respect to sovereign governments in the Latin American region has proven to be an effective buffer against swings in populist sentiments.

2 The region continues to witness an expansion of the middle-class population segment due to up-ward mobility of lower incomes. Such a migration has led to improved standards of living and increased overall consumption.

3 Educational initiatives implemented 15 to 20 years ago throughout the region have translated into higher literacy rates and greater educational access. The advancement in education has been made largely possible by the increased FDI flows in the region's technology sector, thus allowing for greater access to more rural and remote areas.

4 Considerable technology enhancements in industries including mining and agriculture have allowed for increased efficiency, while at the same time mitigating these industries' impacts on both an environmental and societal standpoint.

5 Latin America has experienced greater investments in high value-added sectors. One example is the current growth in e-banking, which is positioned to benefit from the still large un-banked population segment in the region.

6 The strength of the highly developed corporate market in Latin America that is comprised of a diversified array of products and resources that results in it being an anchor to the global supply chain.

7 Furthermore, Latin America provides spread compression opportunities without the dominant geopolitical risks vis-à-vis Eastern Europe. As of December 31, 2021, the Latin America portion of the EMBI Global Index had a spread of 399 bps, compared to 365 bps for the Emerging Europe portion.

Why Africa? – The path to the future is paved in green *(an optimistic view as the trade of the future)*

1 Africa is positioned to experience the same type of economic expansion that Latin America witnessed 20-years ago.

2 The greater global consciousness of ESG will translate into ample funding for the region's much needed infrastructure and educational investments. Government officials across countries have identified the need to address these areas for overall improvement.

3 Africa has been considerably underinvested from an FDI perspective compared to other regions. As a result, there remains ample opportunities for high returns on "low-hanging fruit" greenfield mining projects and easily established infrastructure undertakings. In particular, residential construction is a prime area for infrastructure investments.

4 Africa's population still suffers from low literacy rates. Educational amelioration will be vital for the ability for the region to achieve innovation and productivity gains over the upcoming decades.

5 The region will directly benefit from the strong demand for commodities required in the manufacturing of new technological products including EV's, renewable energy components, and electronics. An example is the large amounts of cobalt that is needed for the production of lithium-ion batteries, of which the vast majority is mined in the Democratic Republic of Congo. Such increased demand will attract global investment from large-scale corporations, which in turn should result in transitioning current mining methods away from controversial artisanal mining to more socially responsible practices.

6 Sovereigns have indicated an openness to suggestions from external investors given their desperate need for funding.

7 Therefore, Africa will stand to benefit from derivatives associated with the technology transfer in areas such as mining and agriculture science.

The Middle East – Lack of democratic institutions vs. considerable fiscal strength *(reasons to maintain a neutral positioning)*

1 The Middle East region has yet to demonstrate a constructive embrace of ESG principles. Particularly, the region continues to fall short in attaining tangible progress in respect to political freedoms (e.g. rights concerning free speech and due process), gender equality, and environmental policy initiatives.

2 Unlike Latin America, the Middle East region has a noticeable absence of checks and balances in government. The predominate driver behind such shortcomings remains the strong presence of autocratic and kleptocratic regimes throughout the area.

3 The region, however, generally benefits from strong fiscal positions given the vast oil production resources available. The current high global oil price environment provides additional immediate accommodations for the region.

4 The fiscal strength of the region is also at times underestimated, as the value of massive sovereign wealth funds is overlooked. Specific examples of such sovereign wealth funds include those of Saudi Arabia, the United Arab Emirates, Qatar, and Kuwait.

Eastern Europe – The return of realpolitik and the reversal of détente *(strategic underweight is warranted)*

1 Eastern Europe is again widely characterized by the risks associated with geopolitics. Such concerns are no more evident than the current Russia-Ukraine Crisis. President Vladimir Putin's ambitions to reestablish a Russian hegemon of the region comes into direct tension with the objectives of NATO and further exacerbates the relations between Russia and the West.

2 The region's largest economies are controlled by autocratic leaders who are immune to any meaningful threat of censure from their respective governments. Both Russia's Putin and Turkey's President Erdogan have largely carte blanche to determine both the domestic and foreign policies of their respective countries. In Turkey, Erdogan's unrivaled position is demonstrated by his erratic and heterodox economic policies that have further led to rampant inflation and recent volatile swings in the lira's exchange rate.

3 Following centuries of ethnic conflicts and tensions, recent fears have once again been heightened in respect to the Balkans. Specifically, Serbian leaders in Bosnia-Herzegovina have threatened secession of the Serbian region of Bosnia (i.e. Republika Srpska), thus breaking the Dayton Accords that ended the Bosnian War. The Serbian separatist movement appears to be further emboldened by the Russia-Ukraine Crisis.

4 The Eastern European region as a whole is also very heavily dependent on fossil fuel production and usage. Such a deep reliance is likely very hard to dislodge despite the global trend towards greater decarbonization and the transition towards cleaner energy sources.

Asia – China remains at the helm, but the voyage will not be as smooth sailing *(underweight given greater concerns on China)*

1 Overall valuations remain an uncompelling story despite the recent weaknesses that have materialized in relation to the troubles surrounding China's real estate sector. Although Chinese policymakers have attempted to stabilize the situation with modest measures, a much broader based and comprehensive set of reforms are in order.

2 Chinese growth expectations remain foggy, as solid resumption in industrial production has been offset to a degree by disappointing retail sales and a notable slowing in the country's real estate investments.

3 Across the region, corporate governance issues are prevalent and outright alarming. Lack of transparency to investors, missing standardized reporting methods, and insufficient accountability are primary areas of concern. The Chinese real estate sector demonstrates the direct effects of such lapses in proper governance, with the segment suffering from considerable use of off-balance sheet debt and abuses related to the employment of keep-well agreement structures.

4 There remain substantial uncertainties in respect to Chinese economic policies. An immediate issue involves Chinese draconian Zero-Covid Policy. At a time that the rest of the world is learning to live with Covid-19, China is still resorting to strict lockdown measures. The anticipated negative impact on economic activity from such a strategy will no doubt become obvious on various high frequency data points over the coming months.

5 As decarbonization and the transition to greener energy is included in global economic blueprints, China's reliance on fossil fuels and resource intensive industrial activities are sure to provide numerous challenges to the country. China has already walked a very fine line in its attempts to address its substantial issues with pollution while attempting to maintain its economic growth projections.

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