Introduction to Emerging Markets Inflation Linked Bonds
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Traditionally, two hallmarks of emerging market economies have been attractive growth opportunities and concerns about inflation. Accessing these growth opportunities has been a well-worn path for most investors, with emerging markets portfolios of varying sizes now commonplace for investors both large and small. Inflation however, has been harder to address directly for many investors within their emerging markets allocations, with many using imperfect proxies, such as basic resources stocks, for inflation protection. Now however, investors concerned about inflation have a new tool at their disposal in the form of emerging markets inflation linked bonds.

The SPDR® Barclays EM Inflation Linked Local Bond UCITS ETF is the first ETF in the world to give investors simple, diversified and transparent access to the global emerging markets inflation linked bond market. In one simple trade, investors are able to diversify their current emerging markets fixed income allocation into inflation linked bonds issued by nine different emerging market governments. The ETF tracks the Barclays Emerging Markets Inflation Linked 20% Capped Index.

INFLATION IN THE EMERGING MARKETS
After the crises that hit various emerging markets in the 1990s (Mexico in 1994, Asia in 1997 and 1998) central banks began to adopt policies that aimed to make inflation targeting part of their standard, ongoing monetary policy. These, combined with increased independence for the major emerging market central banks and broadly lower levels of domestic currency volatility have meant that emerging market inflation has generally trended downwards over the past 10-15 years with fewer spikes of hyper-inflation.

If we compare various emerging markets’ CPI data from between 1971 and 1998 with more recent data since the implementation of these more adequate monetary policies, countries within the index show a clear trend towards more successful management of inflation. This historical improvement is also reflected in future projections, with EM inflation rates expected to be approximately 4.5% for the coming years; this compares with just below 2% for most developed economies.¹

What are Inflation Linked Bonds?
A standard bond has three main elements:

- **Nominal** - the fixed initial investment amount
- **Coupon** - the regular payments of interest which must be made
- **Maturity** - the fixed period of time until the debt must be repaid

Because with a standard bond, both the nominal and the coupon are fixed, the impact of inflation can significantly affect the return realised by the bond holder.

Inflation linked bonds (or ‘linkers’) however, maintain the same three elements (a nominal, a maturity and a coupon) but the nominal is no longer fixed; it is linked to an indicator of inflation (e.g. the Consumer Prices Index or CPI) so that the coupon is applied to a proportionately larger or smaller nominal, thereby adjusting the bond holder’s return and offering some protection from the impact of inflation.

Inflation linked bond issuance has grown dramatically over the past 30 years, with much of the initial issuance being driven by the UK; and later, by the US. UK-issued linkers (‘index linked gilts’) and US-issued linkers (Treasury Inflation Protected Securities, or TIPS) still make up a significant proportion of the market, but government issuers have diversified over time and in the past 10 years, emerging market governments have also begun to participate. Emerging market inflation linked debt now makes up c.20% of the investable inflation linked universe.

FIGURE 1: ESTIMATED SIZE OF GLOBAL INFLATION LINKED BOND MARKETS

Source: Barclays as of 28 February 2013. ‘Developed Markets’ indicates the Barclays Global Inflation Linked Index and ‘Emerging Markets’ indicates the Barclays Emerging Markets Global Inflation Linked Bond (EMGILB) Index.
When one considers the full range of emerging market debt that exists today, a picture emerges of a fairly broad spectrum of issuance by both governments and companies. Issuance patterns have tended to move in line with both market confidence, and the nature of the issuer; government issues precede companies, and in general, hard currency precedes local. When market confidence remains low, typically governments are only just beginning to issue debt and the bonds issued tend to be in hard currency. As market confidence grows over time, a subset of these countries mature and develop sufficiently to build a local currency bond market, represented by either nominal bonds, or for some, inflation linked debt. The growing market confidence in the sovereign can also unlock the capital markets for its domestic companies who, following the path of their government, issue initially in hard currencies.

The development within emerging market inflation linked bonds has also been significant. As we saw earlier, in the past, investors may have used investments in equities, commodities or property to try and offset inflationary factors within their emerging markets allocations. Direct access via the more traditional route of inflation-linked bonds was impossible due to limited issuance, prohibitive capital controls and liquidity concerns. However, the market for emerging market linkers has grown strongly over the past 10 years, with the number of issuers doubling and the number of issues increasing three-fold. The total market now stands at almost $600bn, approximately the same size as the hard currency emerging markets government universe, making it sufficiently diversified and liquid for an indexed investment approach.

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ABOUT THE INDEX

The Barclays Emerging Markets Inflation-Linked 20% Capped Index measures the performance of inflation linked bonds from nine emerging market countries in Latin America, EMEA and Asia. The index includes only government debt i.e. direct obligations of the state issuer. Quasi-government and corporate debt are excluded. The index limits country exposure to a maximum of 20% and redistributes the excess market value index-wide on a pro-rata basis.

Securities must be linked to a reliable measure of local-market inflation that is not unduly revised or inaccurately reported by domestic government agencies. This determination will be made by the Index Sponsor in consultation with Barclays EM Research and economics teams. This rule currently excludes Argentina from the list of eligible countries. Any country where it is restrictively difficult and cost prohibitive for foreign investors to access the local markets will also be excluded from this list. This rule currently excludes Colombia.

FIGURE 6: HISTORICAL MONTHLY TOTAL RETURNS IN UNHEDGED USD, 2005–YTD 2013

Source: Barclays, as at 28 February 2013.

Past performance is no guarantee of future results. It is not possible to invest directly in an index. Index performance does not reflect charges and expenses associated with the fund or brokerage commissions associated with buying and selling a fund. Index performance is not meant to represent that of any particular fund.

FIGURE 7: INDEX COUNTRY BREAKDOWN

Source: Barclays, as at 28 February 2013.

Country, Quality and Maturity Breakdown data is as at the date indicated, is subject to change and should not be relied upon as current thereafter.
WHY INVEST IN EMERGING MARKETS
INFLATION LINKED BONDS?
EXPANDS THE INVESTOR’S OPPORTUNITY SET
The SPDR Barclays EM Inflation Linked Local Bond UCITS ETF opens up a new segment of the emerging markets bond universe for two different groups of investors: those looking to deepen and diversify their emerging market fixed income portfolios into inflation linked bonds, away from pure nominals, and those investors who already have broad inflation-linked bond portfolios who are looking to diversify into EM.

MAY PROVIDE SOME PROTECTION AGAINST INFLATION
Inflation can be partly driven by currency movements, so periods of high inflation are often accompanied by a rapidly depreciating currency. In such a situation, a non-local investor in emerging markets linkers may gain on one hand and lose on the other. Nonetheless, investing in emerging markets inflation linked bonds may offer some protection against modest levels of inflation within emerging markets, and will give better protection than investing purely in nominal emerging market bonds.

ACCESS MORE MATURE EMERGING MARKETS
Those emerging market governments that are able to issue inflation linked bonds in local currency tend to be more mature, having made the transition from hard currency to local and from nominal bonds to linkers. This maturity may suggest a more stable exposure than some of the less-developed emerging markets, whilst the decision of a government to issue linkers may also suggest a commitment to controlling inflation in their home markets.

WHY INVEST IN THE SPDR BARCLAYS EM INFLATION LINKED LOCAL BOND UCITS ETF?
– First ETF in the world to provide exposure to emerging markets inflation linked bonds.
– SPDR ETFs have a proven track record at creating and managing best-in-class emerging market fixed income ETFs:
  • SPDR Barclays Emerging Markets Local Bond UCITS ETF – the first local currency emerging market government bond ETF in Europe. It offers investors diversified access to the onshore local currency government debt of 19 markets.
  • SPDR Citi Asia Local Government Bond UCITS ETF – the first ETF in Europe to offer investors access to 8 Asian local currency government bond markets, including China, through the use of CNH, or Dim Sum bonds.
  • SPDR BofA Merrill Lynch Emerging Markets Corporate Bond UCITS ETF – offers investors access to a broad, diversified index of USD-denominated EM corporate bonds.
– Provides diversified, liquid access to a challenging emerging markets fixed income exposure, in one simple trade.
– Gives investors full transparency of holdings on a daily basis.
– Allows for cost-efficient access to a traditionally expensive area of fixed income, where there are very few other passive alternatives.
ABOUT SPDR ETFs

Offered by State Street Global Advisors (SSgA), SPDR ETFs provide professional investors with the flexibility to select investments that are precisely aligned to their investment strategy. Recognised as an industry pioneer, SSgA created the first ETF in 1993 (SPDR S&P 500® ETF – ticker SPY US). Since then, each new member of the SPDR ETFs family has been built to reflect our intimate knowledge of the ETF market and over 30 years of indexing experience. Today we manage more than $350B in over 180 ETFs worldwide.¹

We believe ETFs are about finding simple solutions to precisely meet investors’ needs. This belief is reflected in every member of the SPDR ETFs family. All of our ETFs are physically backed, providing a simple, transparent way to access each market segment.

SSgA is a global leader in asset management. The firm is relied on by sophisticated investors worldwide for its disciplined investment process, powerful global investment platform and access to every major asset class, capitalisation range and style. SSgA is the asset management business of State Street, one of the world’s leading providers of financial services to institutional investors.

¹ BPIM & 500® ETF (SPY US) is not registered for sale in Europe.²

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2 Barclays as at 28 February 2013.
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