GMO

VALUATION METRICS IN EMERGING DEBT

EMD Quarterly Valuation Update | 2Q24

A NOTE ABOUT OUR METRICS

QVU metrics are designed to give asset allocators a time series of risk premia associated with the two sovereign emerging debt benchmarks for hard and local currency. The purpose is to help allocators time investment decisions. Our team uses them to create blended currency benchmark portfolios. We cover the pricing of credit in EMBIG-D, and currencies and rates in GBI-EMGD by comparing prices to relevant fundamentals.

Technical appendices covering methodology are available from your GMO representative.

This quarter we make the following enhancements to our hard currency spread metric:

1. In light of Venezuela's re-inclusion in EMBIG-D during the quarter and the uncertain length of time until its future restructuring, we are introducing spread-duration-weighted EMBIG-D spreads alongside J.P. Morgan's published EMBIG-D spread on page 4. Related to this change, on page 5, where we have shown our "credit multiple" (the quotient of the market spread/expected credit losses) from page 4, we have:
   - Used our duration-adjusted spread (rather than the J.P. Morgan published spread) to compare to the expected loss; and
   - Expressed this as a difference instead of a multiple, and this spread difference was used in the box-and-whisker graphs on the right-hand side. This subtle change was mainly motivated by the anticipated introduction of analogous spread assessments for U.S. investment-grade and U.S. high yield indices by our GMO Fixed Income colleagues for use in multi-asset credit strategies.
   - Used the duration-adjusted yield of EMBIG-D on slide 9.
2. We performed the annual update of the historical credit transition matrix to include 2023 data (i.e., the history now spans 1975-2023 vs. 1975-2022). This adjustment was immaterial to the results.

2Q24 VALUATION ASSESSMENT

Local currency rates and FX screen attractive, while credit is neutral.

HARD CURRENCY DEBT

Credit Spreads: Neutral+

- The current excess spread of 167 bps is in our second quintile of attractiveness, though very close to the third quintile.
- Historically, an excess spread in this quintile has been associated with a subsequent 2-year annualized credit return of 0.6% (above the risk-free rate). As a reference, the third quintile's mean return has been +4.0%.

USD Rates: Neutral

- The forward curve remains inverted, although less than last quarter.
- We find this pricing somewhat ambiguous in generating a clear outlook, so we remain neutral.

LOCAL CURRENCY DEBT

FX: Attractive

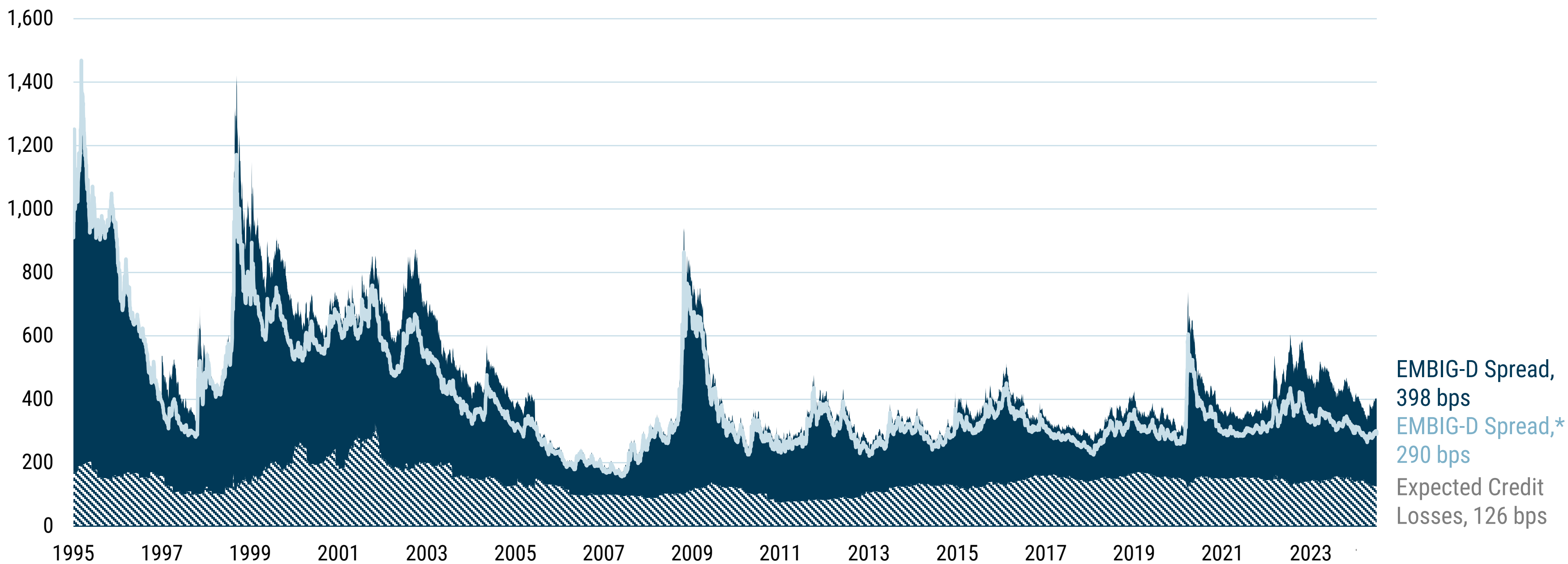
- Our expected spot return indicator lands in the attractive third quartile.
- Mean subsequent GBI-EMGD weighted spot returns have been +5.5% for the third quartile and +1.4% for the second quartile.

Local Rates: Very Attractive

- EM local rates maintained an attractive valuation gap versus U.S. interest rates as inflation-related forecasts are falling faster in EM than in the U.S.
- At 0.7%, this is in our most attractive fourth quartile, where the mean subsequent EM/U.S. return differential has been +1.8%.

VALUATION: HARD CURRENCY (SPREADS)

EMBIG-D SPREAD (PUBLISHED AND DURATION-WEIGHTED*) AND EXPECTED CREDIT LOSSES



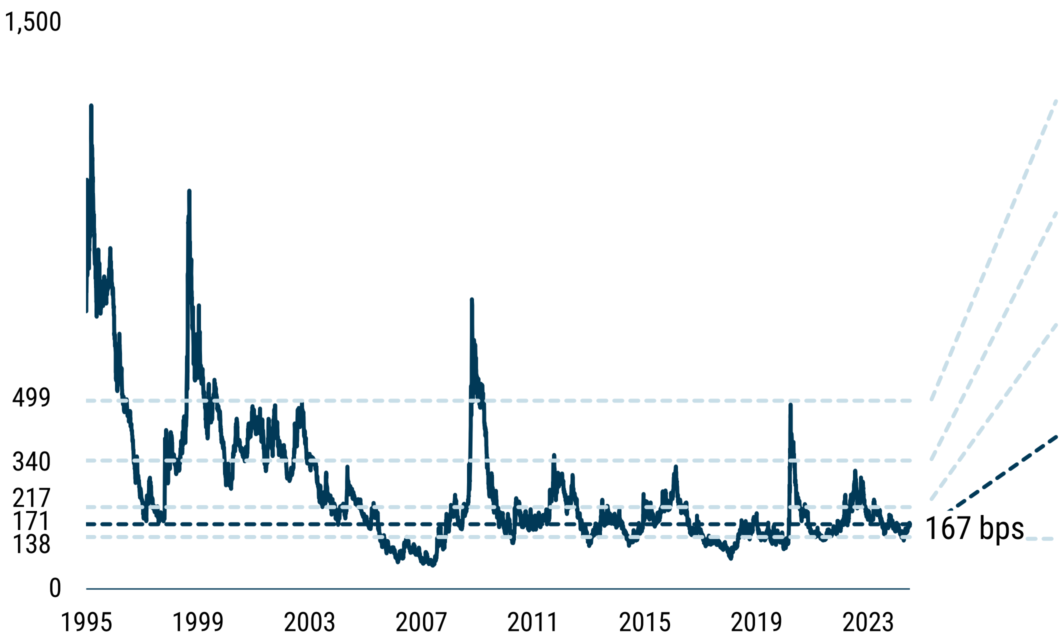
2Q REVIEW

- The EMBIG-D benchmark's published mid-spread over Treasuries widened by 50 bps in Q2, ending the quarter at 398 bps. Our spread-duration-adjusted EMBIG-D spread widened by 11 bps to end at 290 bps this quarter. The gap among the two measures is mainly the result of Venezuela's re-introduction into the index.
- The expected credit loss fell by 11 bps to 126 bps. Rating actions in benchmark countries were mixed, with upward actions in Turkey, Benin, El Salvador, Jordan, and Zambia, while Gabon, Latvia, Lithuania, Estonia, Bolivia, and Peru saw their long-term foreign currency rating downgraded a notch. Venezuela and Latvia entered the benchmark while Vietnam exited.

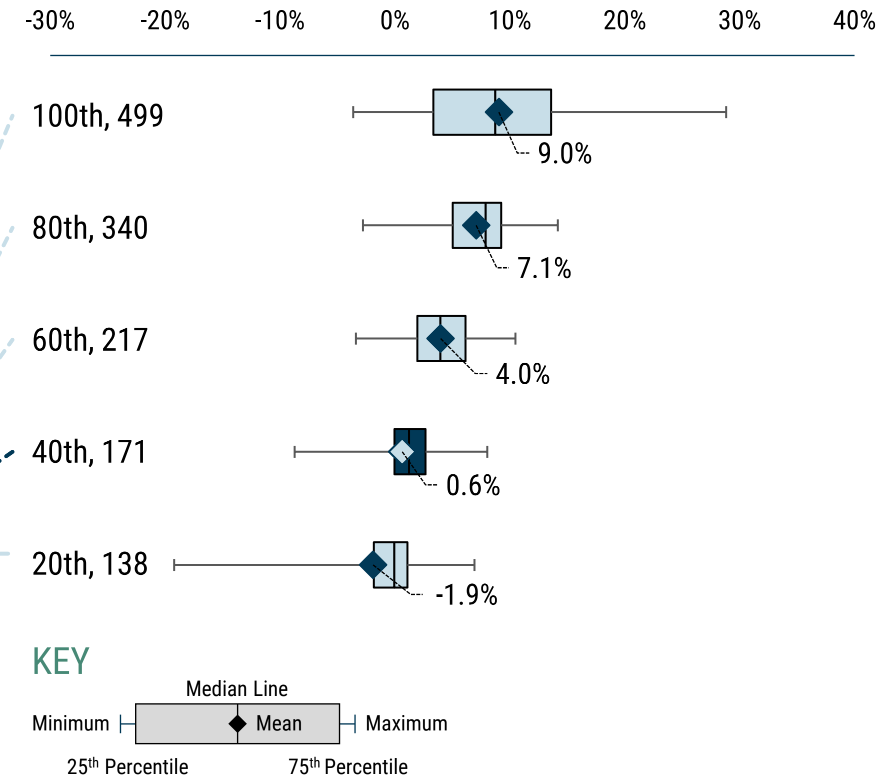
As of 6/30/24 | Source: J.P. Morgan, GMO
*EMBIG-D Spread (Spread Duration Weighted)

VALUATION: HARD CURRENCY (SPREADS)

EMBIG-D EXCESS SPREAD* (BPS) AND PERCENTILE CUT-OFFS



EMBIG-D EXCESS SPREAD* PERCENTILES AND TWO-YEAR ANNUALIZED SPREAD RETURNS



2Q ASSESSMENT

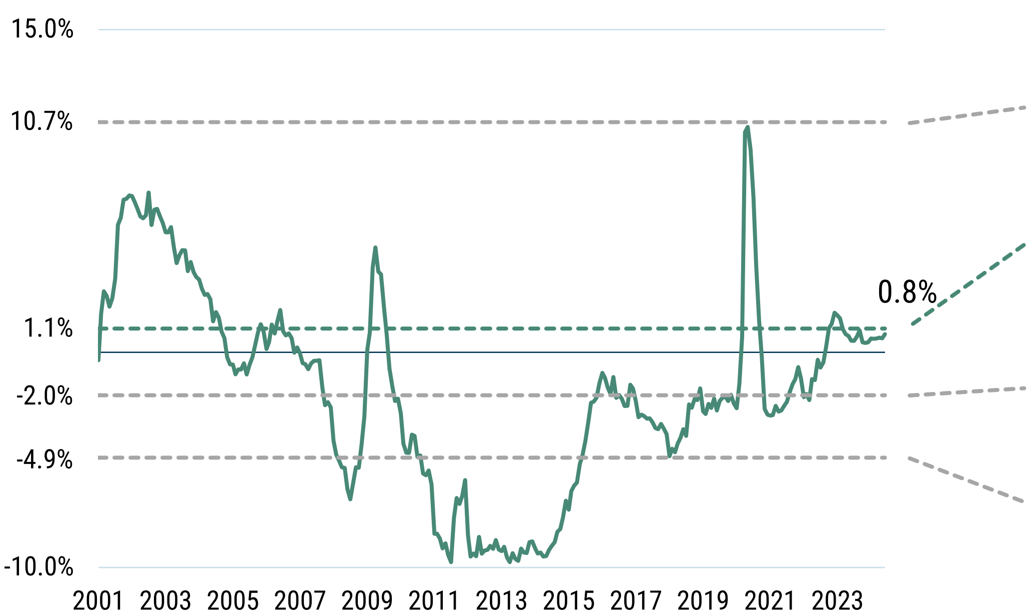
- The current excess spread landed in the second quintile though very close to the third quintile. This second quintile has had a 0.6% mean 2-year subsequent annualized credit return, ranging from 0.0% (25th percentile) to 2.7% (75th percentile). For reference, the figures for the third quintile are 4.0% (mean) and in the 1.9% to +6.1% range. We consider the current level to be neutral to slightly positive.

As of 6/30/24 | Source: J.P. Morgan, GMO

* EMBIG-D Excess Spread is the difference between the EMBIG-D Spread (spread duration weighted) and the expected credit losses.

LOCAL CURRENCIES

GBI-EMGD EXPECTED 6-MONTH ANNUALIZED SPOT RETURN



GBI-EMGD EXPECTED SPOT RETURN PERCENTILES AND EX-POST TOTAL FX RETURN

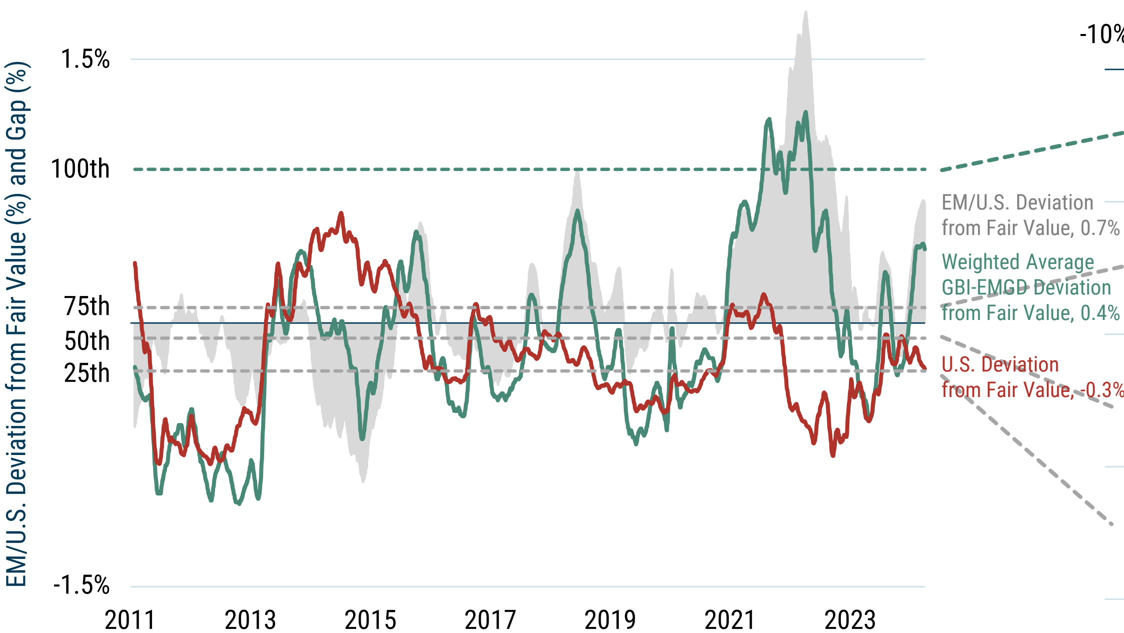
2Q ASSESSMENT

- At 0.8%, the expected spot return remains in the third quartile, where the subsequent GBI-EMGD weighted 6-month spot returns have been 5.5% (mean, with a 25th and 75th percentile range of 1.5% to 9.5%). For reference, the figures for the second quartile are +1.4% mean return and in the -1.6% to +5.1% range. Since 2001 it has been rare for EMFX to be this attractive outside of crises, consistent with our broad view that the U.S. dollar is still rich/EMFX cheap.

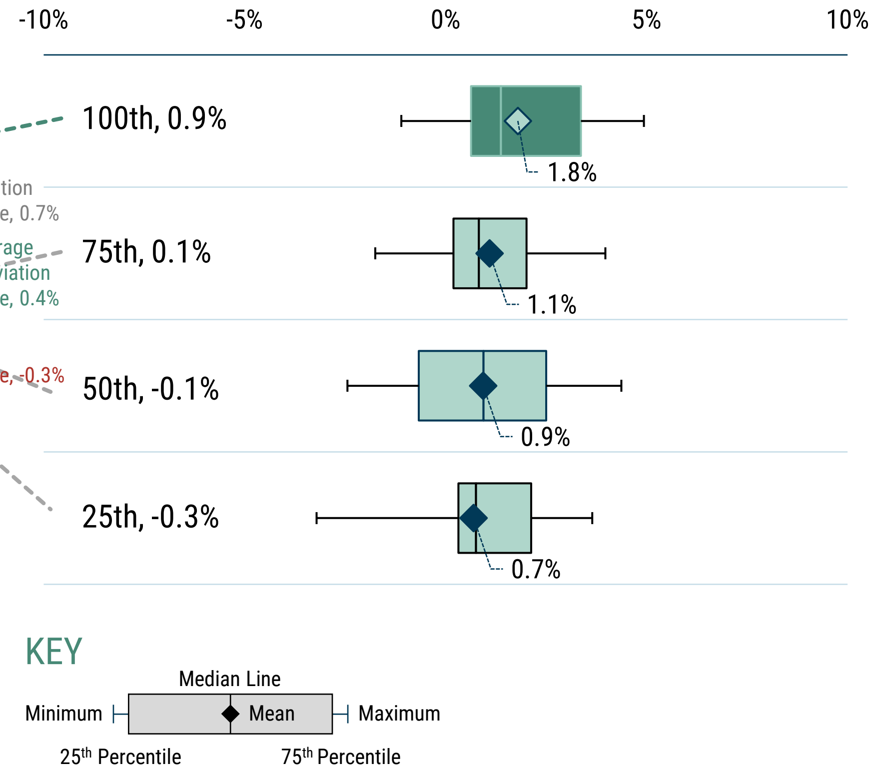
As of 6/30/24 | Source: J.P. Morgan, GMO

LOCAL INTEREST RATES

DEVIATIONS FROM FAIR VALUE LEVEL/PREDICTED RETURN DIFFERENTIAL



EM/U.S. FAIR VALUE GAP PERCENTILES AND THREE-YEAR ANNUALIZED RETURNS DIFFERENTIAL



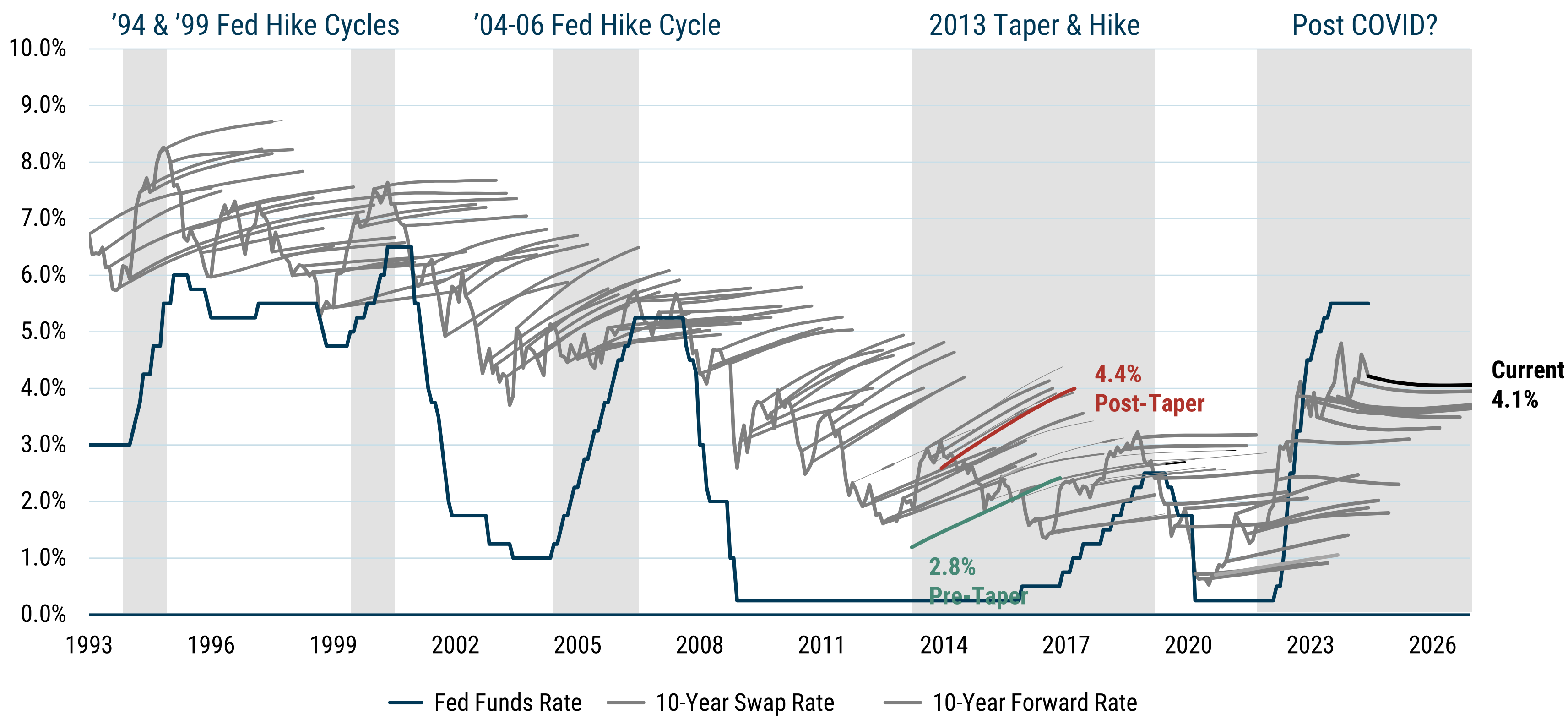
2Q ASSESSMENT

- The gap between the EM local rates and U.S. interest rates remained attractive as inflation-related forecasts fell faster in EM than in the U.S. At 0.7%, this is in our attractive fourth quartile, where mean EM/U.S. return differentials have on average been 1.8% with an inter-quartile range of 0.6% to 3.4%.

As of 6/30/24 | Source: J.P. Morgan, GMO

U.S. DOLLAR INTEREST RATE HISTORY

USD 10-YEAR SWAP RATES AND FORWARDS



2Q REVIEW

- Given the recent Federal Reserve rate hike campaign, Fed funds yield more than 10-year swaps and the forward curve remains inverted. At the end of the second quarter, the 10-year forward pricing was at 4.1%. This level is comfortably above the Fed's 2% inflation target and the latest Core PCE inflation figures. We note that following the 2013 rise in U.S. rates stemming from the anticipated tapering of Fed quantitative easing, this forward pricing topped out at 4.4%.

As of 6/30/24 | Source: Bloomberg, GMO

Projections as of each date, including those that are beyond 2015, are future prices as determined by the market and are not a GMO projection.

OUTLOOK: 1-YEAR TOTAL RETURN SCENARIOS

HARD CURRENCY

EMBIG-D Spread* (12 bp Increments) / USD Yield Associated With EMBIG-D (36 bp Increments)

	3.3%	3.7%	4.0%	4.4%	4.7%	5.1%	5.4%
3.3%	12.0%	9.6%	7.3%	5.0%	2.6%	0.3%	-2.0%
3.1%	12.7%	10.4%	8.1%	5.7%	3.4%	1.1%	-1.2%
3.0%	13.5%	11.2%	8.8%	6.5%	4.2%	1.8%	-0.5%
2.9%	14.3%	11.9%	9.6%	7.3%	4.9%	2.6%	0.3%
2.8%	15.0%	12.7%	10.4%	8.0%	5.7%	3.4%	1.1%
2.7%	15.8%	13.5%	11.1%	8.8%	6.5%	4.2%	1.8%
2.5%	16.6%	14.2%	11.9%	9.6%	7.2%	4.9%	2.6%

LOCAL CURRENCY DEBT

GBI-EMGD FX (1.2%) Higher = Depreciation / GBI-EMGD Yield (20 bp Increments)

	6.0%	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%
1.62	5.9%	4.9%	3.9%	2.9%	1.9%	0.9%	-0.1%
1.60	7.1%	6.1%	5.1%	4.1%	3.2%	2.2%	1.2%
1.58	8.4%	7.4%	6.4%	5.4%	4.4%	3.4%	2.4%
1.56	9.6%	8.6%	7.6%	6.6%	5.6%	4.6%	3.6%
1.54	10.8%	9.8%	8.8%	7.8%	6.8%	5.8%	4.8%
1.52	12.0%	11.0%	10.0%	9.0%	8.0%	7.0%	6.0%
1.50	13.3%	12.3%	11.3%	10.3%	9.3%	8.3%	7.3%

HARD CURRENCY

- Given our neutral+ assessment of the valuation of credit and our ambiguous assessment of USD rates, we believe scenarios associated with the declining spreads are possible (lower half of the table). The U.S. interest rate picture has improved markedly, but we still don't have a very strong view on leftward/rightward moves (those scenarios being associated with changes in USD rates).

LOCAL CURRENCY

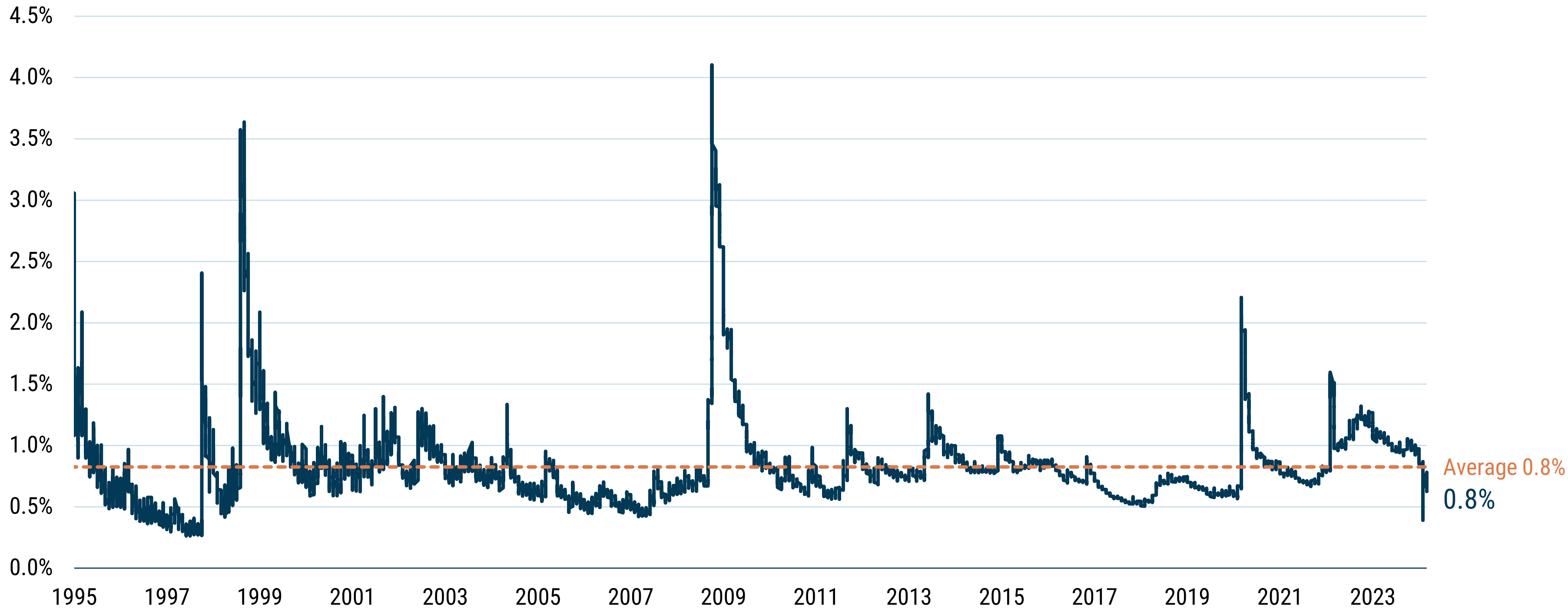
- Given our favorable assessment for both EMFX and EM rates, we believe scenarios associated with the lower left-hand quadrant are possible.

As of 6/30/24 | Source: GMO calculations based on data from J.P. Morgan
* EMBIG-D Spread (Spread Duration Weighted)
We show duration-weighted EMBIG-D yield as outlined on slide 2.

ADDITIONAL INFORMATION

LIQUIDITY

EMBIG-D BID-ASK SPREAD (% OF PRICE)



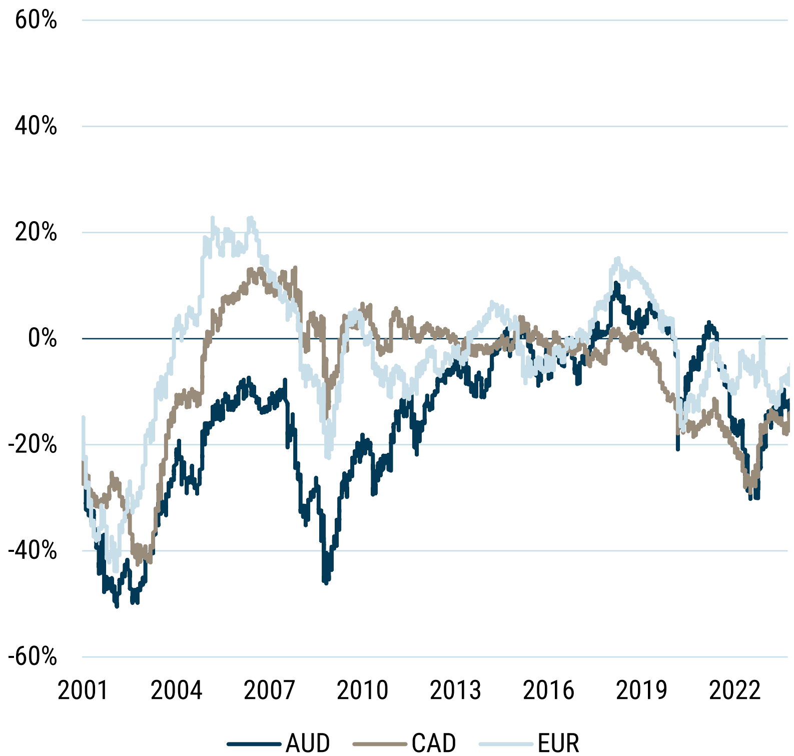
2Q ASSESSEMENT

- Transaction costs measured by the EMBIG-D bid/ask settled close to the long-term historical average.

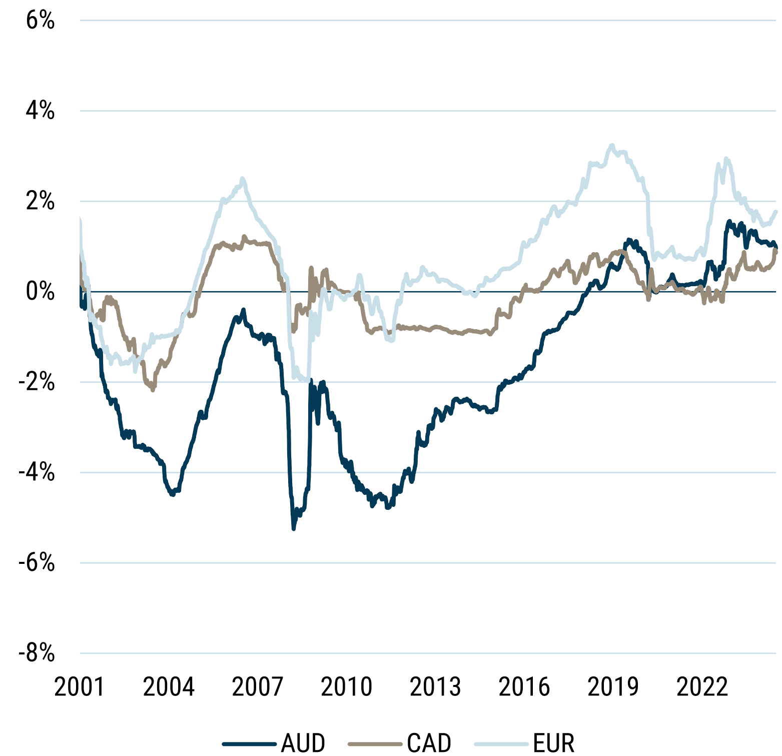
As of 6/30/24 | Source: J.P. Morgan, GMO

INVESTING FROM A NON-USD PERSPECTIVE

USD-RELATIVE CURRENCY VALUATION



HEDGING COSTS

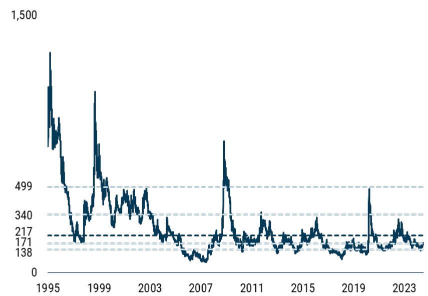


2Q ASSESSEMENT

- EUR, CAD, and AUD remained at the lower end of neutral relative to the U.S. dollar in valuation terms.
- Hedging costs of USD assets remained elevated relative to recent years.

As of 6/30/24 | Source: GMO

OVERVIEW OF METRICS

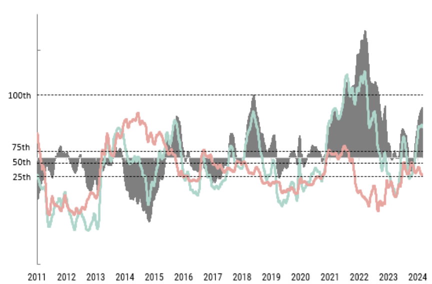


EMBIG-D Excess Spread

The EMBIG-D Excess Spread is the difference between the EMBIG-D Spread (spread duration weighted) and the measure of estimate credit losses that uses the weighted-average credit rating of the benchmark, along with historical sovereign credit transition data, and an assumption about recovery values given default. We estimate the percentile range of the excess spread and consider values in the top three quintiles as “cheap,” values in the first quintile as “rich,” and values in the second quintile as “fair.”

GBI-EMGD Expected Spot Return

The FX valuation model analyzes trends in macroeconomic fundamentals such as balance of payments composition and flows, valuation of the currency, and the economic cycle. It uses regression analysis to produce an estimate of total expected FX returns for each country in the benchmark. These are then combined into a single value of a total expected FX return using a market cap weighted average of currencies in the benchmark. Next, we deduct the weighted carry (interest-rate differential) from the estimated weighted value of total FX expected return to get to an expected EM FX spot return for GBI-EMGD. Finally, we estimate the percentile range based on the back-test of the overall model to assess whether EM currencies are cheap, rich, or fairly valued. A value that falls into the top two quartiles potentially indicates “cheap” currencies, while a value landing in the first quartile potentially indicates “rich” currencies. We consider valuations in the second quartile to be “fairly valued” as levels in that quartile have historically been associated with a more neutral mean ex-post total FX return.



Interest Rate Deviations from Fair Value

We consider the deviations of current 5-year yields from their fair value to gauge the relative attractiveness of EM against the U.S. In this regard, we believe that the best time to buy local debt is when EM deviation from fair value is positive and higher than the U.S. deviation from its fair value. We estimate the percentile range of the fair value gap between EM and U.S. deviation from fair value and consider values in the top two quartiles as “cheap,” values in the first quartile as “rich,” and values in the second quartile as “fair.”

As of 6/30/24 | Source: Bloomberg, J.P. Morgan, GMO
A full technical appendix is available from your GMO representative.

OVERVIEW OF METRICS

EMBIG-D Spread* (12 bp Increments)

3.3%	12.0%	9.6%	7.3%	5.0%	2.6%	0.3%	-2.0%
3.1%	12.7%	10.4%	8.1%	5.7%	3.4%	1.1%	-1.2%
3.0%	13.5%	11.2%	8.8%	6.5%	4.2%	1.8%	-0.5%
2.9%	14.3%	11.9%	9.6%	7.3%	4.9%	2.6%	0.3%
2.8%	15.0%	12.7%	10.4%	8.0%	5.7%	3.4%	1.1%
2.7%	15.8%	13.5%	11.1%	8.8%	6.5%	4.2%	1.8%
2.5%	16.6%	14.2%	11.9%	9.6%	7.2%	4.9%	2.6%
	3.3%	**3.7%**	**4.0%**	**4.4%**	**4.7%**	**5.1%**	**5.4%**

USD Yield Associated With EMBIG-D (36 bp Increments)

1-Year Total Return Scenarios: Hard Currency Debt

For hard currency debt, we vary the level of the EMBIG-D spread (spread-duration weighted) in the north/south dimension, and we vary the level of the USD 10-year rate in the left/right dimension. The amount by which these levels vary is calibrated to include +/-1 standard deviation around the quarter-end level (based on trailing three years of data). The expected return in the center of the table is the EMBIG-D duration-adjusted starting yield.

GBI-EMGD FX (1.2%) Higher = Depreciation

1.62	5.9%	4.9%	3.9%	2.9%	1.9%	0.9%	-0.1%
1.60	7.1%	6.1%	5.1%	4.1%	3.2%	2.2%	1.2%
1.58	8.4%	7.4%	6.4%	5.4%	4.4%	3.4%	2.4%
1.56	9.6%	8.6%	7.6%	6.6%	5.6%	4.6%	3.6%
1.54	10.8%	9.8%	8.8%	7.8%	6.8%	5.8%	4.8%
1.52	12.0%	11.0%	10.0%	9.0%	8.0%	7.0%	6.0%
1.50	13.3%	12.3%	11.3%	10.3%	9.3%	8.3%	7.3%
	6.0%	**6.2%**	**6.4%**	**6.6%**	**6.8%**	**7.0%**	**7.2%**

GBI-EMGD Yield (20 bp Increments)

1-Year Total Return Scenarios: Local Currency Debt

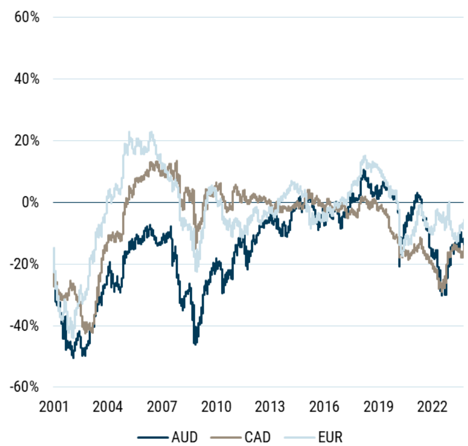
For local currency debt, we compute a currency spot index for GBI-EMGD and then vary it in the north/south dimension and we vary the level of the GBI-EMGD yield in the left/right dimension. The amount by which these levels vary is calibrated to include +/-1 standard deviation around the quarter-end level (based on trailing three years of data). The expected return in the center of the table is the GBI-EMGD starting yield.

As of 6/30/24 | Source: Bloomberg, J.P. Morgan, GMO

* EMBIG-D Spread (Spread Duration Weighted)

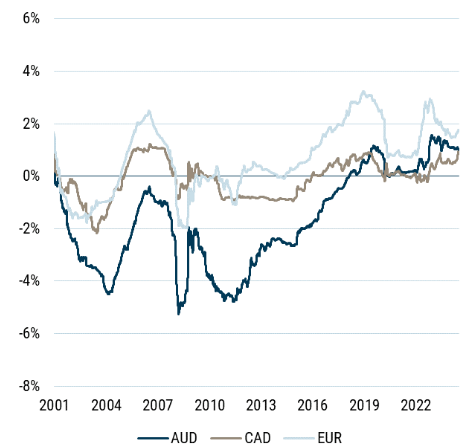
The total return scenarios are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. The total returns scenarios do not represent the past or future performance of any GMO fund or strategy. They are subject to change at any time based on market and other conditions. Actual results may differ materially from these scenarios. A full technical appendix is available from your GMO representative.

OVERVIEW OF METRICS



USD-Relative Currency Valuation

This chart shows the historical currency valuation of the USD relative to the EUR, CAD, and AUD since 2001. The value above the +/- 20% neutral range could indicate overvalued currencies, while the value below the neutral range could indicate undervalued currencies.



Hedging Costs

In this chart, we show the annual roll yield difference when hedging USD to AUD, CAD, and EUR base currencies since 2001.

As of 6/30/24 | Source: Bloomberg, J.P. Morgan, GMO
A full technical appendix is available from your GMO representative.

DISCLAIMER

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