

Bond Basics

October 2005

Emerging Markets May Offer Opportunity to Enhance Returns

PIMCO believes emerging markets will continue to evolve and provide opportunities to enhance portfolio returns in coming years. Because investors demand higher interest rates for the money they lend to emerging market borrowers, yields on emerging market bonds may have the potential to be higher than those available on investments like cash or U.S. Treasuries. However, credit differentiation will remain critical to the goal of producing excess returns.

In addition to possibly offering higher yields, this asset class also has the potential to reduce the volatility of a diversified fixed income portfolio, because the returns on emerging market debt are not closely correlated with those of many traditional asset classes. Within the emerging markets, investing in local-currency bonds offers both additional diversification and potential currency appreciation as these economies mature.

Because of their size and rapid growth, emerging markets have become an integral part of the global fixed income investment landscape. Given the ongoing need for substantial amounts of capital in many emerging countries, they are expected to remain major issuers of debt securities, so the marketplace should continue to expand rapidly. Moreover, as the availability of emerging market information has improved, the investor base has broadened.

What Is an Emerging Market?

The emerging markets comprise those nations whose economies are considered to be developing--or emerging from underdevelopment--and usually include most or all of Africa, Eastern Europe, Latin America, Russia, the Middle East and Asia excluding Japan. Some are heavily dependent on commodity exports while others have extensive service and manufacturing sectors. Emerging market debt includes sovereign bonds--issued by governments--as well as fixed income securities issued by public and private companies in emerging market nations.

Companies and governments in emerging market nations can issue two distinct types of debt: external securities denominated in major currencies such as the U.S. dollar and domestic securities denominated in their local currencies. The benchmark JPMorgan Emerging Markets Bond Index Global (EMBI Global) tracks total returns for US dollar-denominated debt issued by 32 nations. (Please see the appendix for a list of these countries.) JPMorgan's Emerging Local Markets Index Plus (ELMI+) tracks local-currency-denominated instruments issued by 22 governments.

Rating agencies publish sovereign ratings that indicate countries' ability to meet their debt obligations. The most creditworthy emerging markets countries will receive investment-grade sovereign ratings, meaning that their debt is rated at least 'BBB-' or 'Baa3' by Standard & Poor's and Moody's, respectively.

Bond Basics

October 2005

Although it may be convenient to lump emerging market debt together into a single broad category, it is far from a homogeneous asset class. Individual markets may have dramatically different growth prospects and risk factors. In the short run, that means one emerging country's or region's bonds may be performing poorly, while another's may be doing relatively well. Therefore, profiting from emerging market investments requires extensive analysis of the risk-versus-return profiles of individual emerging nation markets and issuers.

Conclusion

Emerging market bonds may provide higher yields than Treasuries and due to their low correlation with other asset classes, offer the potential for lower volatility through portfolio diversification. Although credit differentiation is an important factor to consider with regard to particular government or corporate issues, emerging market debt will continue to be an expanding fixed income asset class in the years to come as emerging nations and their investor base continue to grow.

London

PIMCO Europe Ltd
Nations House
103 Wigmore Street
London W1U 1QS
England
44-20-78721300

Munich

PIMCO Europe Ltd Munich Branch
Nymphenburgerstraße 112-116
80636 Munich
Germany
49-89-1220-70

PIMCO Europe Ltd and PIMCO Europe Ltd Munich Branch are authorised and regulated by the Financial Services Authority in the UK and PIMCO Europe Ltd Munich Branch is additionally regulated by the BaFin in Germany in accordance with Section 53b of the German Banking Act. The services and products provided by PIMCO Europe Ltd are available only to investors who come within the category of the market counterparty or intermediate customer as defined in the Financial Services Authority's Handbook. They are not available to individual investors, who should not rely on this communication.

Investing in securities denominated in currencies other than your own may entail risk due to economic and political developments, which may be enhanced when investing in emerging markets. Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. The correlation of various indices or securities against one another or against inflation is based upon data over a long time period. These correlations may vary substantially in the future or over shorter time periods, resulting in greater volatility. The credit quality of a particular security or group of securities does not ensure the stability or safety of the overall portfolio. Diversification does not ensure against loss.

Bond Basics

October 2005

The JPMorgan Emerging Markets Local Markets Index Plus (ELMI+) tracks total returns for Emerging Markets local-currency-denominated money market instruments. The benchmark instrument of the index is FX forward contracts and these are laddered with maturities ranging from one to three months. Country weights are based on a trade-weighted allocation, with maximum weight of 10% for countries with convertible currencies and 2% for countries with non-convertible currencies. The JPMorgan EMBI Global Index is an index that tracks total returns for United States Dollar denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities, Brady Bonds, loans, Eurobonds and local market instruments. This index only tracks the particular region or country.

Past performance is no guarantee of future results. This article contains the current opinions of the author but not necessarily those of the PIMCO Group and does not represent a recommendation of any particular security strategy, or investment product. The author's opinions are subject to change without notice. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. This article is distributed for educational purposes and should not be considered as investment advice or an offer of any security for sale. No part of this publication may be reproduced in any form, or referred to in any other publication, without express written permission.

Copyright 2005, PIMCO

Appendix:

JPMorgan Emerging Markets Bond Index Global (EMBI Global) Market Cap Weights (%) as of August 31, 2005

Country	Weight
Argentina	1.8
Brazil	18.9
Bulgaria	0.6
Chile	1.7
China	2.2
Colombia	3.4
Cote d' Ivoire	0.1
Dominican Republic	0.2
Ecuador	1.2
Egypt	0.4
El Salvador	0.8
Hungary	0.5
Indonesia	0.7
Lebanon	1.6
Malaysia	3.4
Mexico	18.1
Morocco	0.3
Nigeria	1.0
Pakistan	0.2

Bond Basics

October 2005

Panama	2.2
Peru	2.7
Philippines	5.4
Poland	1.2
Russia	13.3
Serbia and Montenegro	0.3
South Africa	1.6
Thailand	0.2
Tunisia	0.3
Turkey	7.4
Ukraine	1.2
Uruguay	1.1
Venezuela	6.1

Source: JPMorgan