

Emerging Debt Hard Currency Strategy

Quarterly Newsletter (EUR)

Market review

The asset class returned 1.5% (in USD terms) over the quarter as it saw stabilisation in the lead up to the start of Fed tapering in December, but it should be noted that almost half of the return was from Argentina and Ukraine. Investment-grade countries returned less than half a percent over the quarter. Ukraine returned close to 11% given Russia's purchase of \$15 billion in Ukrainian bonds, but the long-term fundamentals remain weak as evidenced by the recent downgrades to credit ratings not much above default. Argentina returned 18% given demand by speculative investors. Mexico returned over 1%, outperforming most other investment-grade countries as the government passed its landmark energy reform bill and S&P upgraded its external debt to BBB+. In signs of greater market differentiation, Brazil underperformed returning zero over the quarter as the budget deficit now at 3.2% is unlikely to be addressed as we enter a presidential election year and growth is unlikely to break out of the 2% range in 2014. In the small window of opportunity between the Fed's non-taper decision, the temporary resolution of the US fiscal gridlock and the start of tapering in December, several issuers rushed to market to lock in lower borrowing costs. The Dominican Republic issued a 2024 maturity bond which was several times oversubscribed. Hungary, Croatia and Mexico also issued while Venezuela issued PDVSA bonds.

Performance analysis

Despite the strong outperformance in December, it was not enough to offset the underperformance earlier in the quarter. One of the most significant detractors was from an underweight to Argentina as the bonds were driven 18% higher by speculative investors despite the continued messy legal proceedings with 'hold-out' creditors and President Kirchner being politically weakened. Elsewhere in higher beta countries, an underweight to Serbia, where our recent research trip revealed deteriorating fundamentals, detracted while a marginal overweight to Sri Lanka contributed. In high-grade countries, we underperformed where our bias was to be marginally underweight duration given rising US Treasury yields. Instrument selection in Brazil detracted despite a generally neutral duration to benchmark, while a marginal overweight in Mexican sovereign bonds versus quasi-sovereigns detracted. However, an underweight duration in China and the Philippines contributed. Performance was better in middle-grade countries, where an overweight to Indonesia outperformed for example, however the underweight to Romania, given the country's fragile economy, detracted from performance as the bonds registered a positive return. In off-benchmark exposures, the Chinese renminbi contributed while a defensive position to the Brazilian real also benefited performance.

Performance¹

Annualised %	Q4	YTD	1yr	3yr	5yr	Since inception ²
Pictet Emerging Debt Composite	-0.53	-9.19	-9.19	5.75	11.90	12.18
JP Morgan EMBI Global Diversified (TRI)	-0.26	-9.34	-9.34	5.16	11.91	8.31
Relative performance	-0.27	0.15	0.15	0.59	-0.01	3.87

Calendar years %	2013	2012	2011	2010	2009	2008	2007	2006
Pictet Emerging Debt Composite	-9.19	16.02	12.26	17.40	26.33	0.62	-3.18	0.46
JP Morgan EMBI Global Diversified (TRI)	-9.34	15.63	10.94	20.04	25.76	-7.47	-4.26	-1.72
Relative performance	0.15	0.39	1.32	-2.64	0.57	8.09	1.08	2.18

¹Pictet Emerging Debt Composite for pooled portfolios, gross of fees in EUR, 31.12.2013. ²Inception date 30.11.1998. Benchmark 50% ELM+ & 50% EMBI+ (TR) Index to 31.01.2002.

For professional investors only

Risk statistics 5yr annualised in %

	Pictet Emerging Debt Composite	JP Morgan EMBI Global Diversified (TRI)
Standard deviation	10.26	10.35
Ex-post Tracking Error	1.48	—
Information ratio	-0.01	—
Beta	0.98	—

Top 10 country exposures for USD Bonds in %

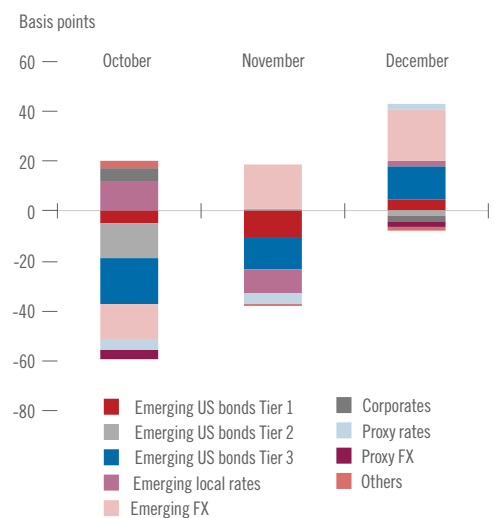
	Rep A/C	JP Morgan EMBI Global Diversified (TRI)
Philippines	5.8	4.9
Indonesia	5.2	4.5
Russia	4.6	5.1
Brazil	4.6	5.0
Turkey	3.9	4.8
Venezuela	3.7	3.5
Colombia	3.5	3.8
South Africa	3.4	3.4
Lebanon	3.3	3.5
Mexico	3.3	4.8

Off benchmark

currency exposure 14.5

Country positions are taken from the Pictet-Global Emerging Debt fund, which is included in the composite.

Attribution in USD



Attribution is taken from the Pictet-Global Emerging Debt fund, which is included in the composite.

All data presented as at 31.12.2013 in EUR, (apart from attribution data which is in USD)

Source: Pictet Asset Management

Portfolio activity

In October, duration was marginally increased to a more neutral position from the middle of the month as the market continued to see some recovery, particularly as US Treasury yields moved lower. However, November saw yields creep higher as the market re-focused on the headwinds of tapering. We moved the strategy's duration to a small underweight which continued for the rest of the quarter, particularly in the highest rated countries that trade at tight spread levels. These include countries such as Chile and China. No meaningful changes were made to the exposure to middle-grade countries, where we maintained a small underweight to countries with weaker fundamentals such as Romania and Azerbaijan. In higher-beta countries, we maintained a neutral position, but with highly selective overweights in Rwanda, where growth was forecast to be over 7% this year, and Sri Lanka, where manageable inflation has allowed the central bank to cut rates to stimulate the already robust growth and improving credit picture. We remained underweight and defensively positioned in Argentina, which we believe will pay off despite some recent positive performance driven by speculators. In off-benchmark positions, we significantly reduced local rates exposure namely in Brazil and Mexico while we became more defensive in emerging currencies such as the Turkish lira.

Market outlook

Tapering has started and global data is improving, but we believe caution should be maintained for now. The primary reasons for weakness in the asset class are the upward trajectory in US Treasury yields as well as the trend lower in exports since 2010. Now with expected stronger US and developed-market growth, emerging-market data could become stronger as well. However, weakness has also been driven by a focus on idiosyncratic factors such as political risks in Turkey and poor investment as a share of GDP in Brazil and lack of structural reforms. The Fed pointed out that "asset purchases are not on a pre-set course", giving leeway to adjust the pace of tapering

to counteract any disorderly rise in treasury yields which would lead to further outflows and weakness while each Fed decision will result in potentially different market reactions. At the same time, US interest rates are expected to remain low and some believe that emerging-market dollar debt has oversold relative to other high-grade spread asset classes, but we expect continued dispersion. Tapering has occurred against a back-drop of continued outflows since May even though we still believe there is a long-term push factor from underweight institutional investors. When those inflows will return remains a big question.

Portfolio strategy

Despite some recent stabilisation in the asset class, we still see each Fed meeting as having the potential to exert further downward pressure on the asset class while we continue to see investor outflows. As a result, we are likely remain neutral to underweight duration and we are prepared to react quickly and reduce duration further if we start seeing a meaningful rise in yields, which is likely to be driven by macro events such as key US data that give some clarity on the pace of tapering. We are looking to take advantage of pockets of value around positive credit rating events. However, in the short term we are more likely to go underweight as the asset class's fundamentals are likely to have peaked for now with Brazil and Turkey potentially facing downgrades this year according to some. Below-investment-grade countries that trade more on underlying fundamentals may provide interesting opportunities which we are looking to take advantage of, such as Vietnam. We will continue to actively use US Treasury futures as a way of managing the strategy's duration given the lower market liquidity, and we will continue to look to be defensive in currencies of more vulnerable markets as an off-benchmark strategy. We continue to remain very cautious on taking corporate bond exposure and expect to have close to no exposure over the coming weeks.

USD Bond duration in years

	Rep A/C	JP Morgan EMBI Global Diversified (TRI)
Mexico	0.41	0.39
Philippines	0.40	0.40
Indonesia	0.35	0.32
Brazil	0.35	0.35
Turkey	0.32	0.31
Colombia	0.31	0.29
Peru	0.29	0.29
Russia	0.28	0.28
South Africa	0.23	0.21
Kazakhstan	0.22	0.21
Panama	0.22	0.21
Argentina	0.21	0.14
Lebanon	0.20	0.16
Venezuela	0.20	0.17
Uruguay	0.19	0.18
Hungary	0.18	0.20
Chile	0.18	0.25
Poland	0.18	0.17
China	0.17	0.24
El Salvador	0.13	0.11
Croatia	0.12	0.14

Weighted modified duration positions are taken from Pictet-Global Emerging Debt fund, which is included in the composite. Duration breakdown >0.10.

Strategy information

Strategy inception	30.11.1998
Strategy assets	EUR 5.2 bn
Investment objective	To outperform the JP Morgan EMBI Global Diversified index by 1-3% per annum, gross of fees
Investment team	Simon Lue-Fong Orlena Yee Mary-Therese Barton Wee-Ming Ting Philippe Petit Guido Chamorro

All data presented as at 31.12.2013 in EUR, (apart from attribution data which is in USD)

Source: Pictet Asset Management

This material is for distribution to professional investors only. However it is not intended for distribution to any person or entity who is a citizen or resident of any locality, state, country or other jurisdiction where such distribution, publication, or use would be contrary to law or regulation. Information used in the preparation of this document is based upon sources believed to be reliable, but no representation or warranty is given as to the accuracy or completeness of those sources. Any opinion, estimate or forecast may be changed at any time without prior warning. Investors should read the prospectus or offering memorandum before investing in any Pictet managed funds. Tax treatment depends on the individual circumstances of each investor and may be subject to change in the future. Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and is not guaranteed. You may not get back the amount originally invested. This document has been issued in Switzerland by Pictet Asset Management SA and in the rest of the world by Pictet Asset Management Limited, which is authorised and regulated by the Financial Conduct Authority, and may not be reproduced or distributed, either in part or in full, without their prior authorisation. | For UK investors, the Pictet and Pictet Total Return umbrellas are domiciled in Luxembourg and are recognised collective investment schemes under section 264 of the Financial Services and Markets Act 2000. Swiss Pictet funds are only registered for distribution in Switzerland under the Swiss Fund Act, they are categorised in the United Kingdom as unregulated collective investment schemes. The Pictet group manages hedge funds, funds of hedge funds and funds of private equity funds which are not registered for public distribution within the European Union and are categorised in the United Kingdom as unregulated collective investment schemes. | For Australian investors, Pictet Asset Management Limited (ARBN 121 228 957) is exempt from the requirement to hold an Australian financial services license, under the Corporations Act 2001. | For US investors, the Shares of the funds managed by the Pictet Group are being offered to United States tax-exempt investors Shares sold in the United States or to US Persons will only be sold in private placements to accredited investors pursuant to exemptions from SEC registration under the Section 4(2) and Regulation D private placement exemptions under the 1933 Act and qualified clients as defined under the 1940 Act. The Shares of the Pictet funds have not been registered under the 1933 Act and may not, except in transactions which do not violate United States securities laws, be directly or indirectly offered or sold in the United States or to any US Person. The Management Fund Companies of the Pictet Group will not be registered under the 1940 Act. Pictet Asset Management Inc. (Pictet AM Inc) is responsible for effecting solicitation in North America to promote the portfolio management services of Pictet Asset Management Limited (Pictet AM Ltd) and Pictet Asset Management SA (Pictet AM SA). | In Canada Pictet AM Inc is a regulated Investment Adviser authorized to conduct marketing activities on behalf of Pictet AM Ltd and Pictet AM SA. In the USA, Pictet AM Inc's activities are conducted in full compliance with the SEC rules applicable to the marketing of affiliate entities as prescribed in the Adviser Act of 1940 ref. 17CFR275.206(4)-3. | Pictet Asset Management claims compliance with the Global Investment Performance Standards (GIPS).

To receive a full composite list or individual brochures that adhere to GIPS standards, please contact Stephen Gunkel at Pictet Asset Management Limited on +44 (0)207 847 54 06.

© Copyright 2014 Pictet - Issued in January 2014.

Pictet Asset Management

For further information,
please visit our websites
www.pictet.com
www.pictetfunds.com