Vanguard

Q3 2021

EMERGING MARKETS BOND FUND

Quarterly update

LOW-COST ACTIVE FIXED INCOME

The Vanguard Emerging Markets Bond Fund is an actively managed fixed income solution investing primarily in emerging market sovereigns. The fund is managed by Vanguard's Fixed Income Group and aims to generate a diversified, consistent level of return over the long term.

Highlights

- Emerging market bonds delivered a negative return over the quarter.
- Further hawkish rhetoric from the US Federal Reserve was again a headwind.
- The Vanguard Emerging Markets Bond Fund performed better than its benchmark.
- Country selection, specifically positions in Chile and Hungary, added value.
- Despite a challenging backdrop, emerging market bonds offer pockets of value.

Market overview

Emerging market (EM) bonds experienced one of their roughest periods for some time in the third quarter, with September the most volatile month. EM high-yield bonds in particular sold off as fresh concerns around persistent inflation across developed and emerging markets and more hawkish signals from the Federal Reserve (Fed) combined to cool risk sentiment. This was compounded by signs that economic expansion is slowing, particularly in China. Over the quarter as a whole, EM bonds, as measured by the JPM EMBI Global Diversified Index, returned -0.77%.

As the market reacted to the prospect of tighter Fed policy and US Treasury yields rose, EMs came under strain across the board, particularly the EM high-yield market, while EM currencies also struggled.

There were headwinds for EMs in the technical backdrop, too, as September in particular was marked by a rebound in EM sovereign and corporate issuance. With the market already wary of a number of macroeconomic risk factors, some large, surprise new issues (such as Egypt's US $3 billion new issue) weighed on new-issue performance[1].

However, the performance of the primary issuance market had stabilised somewhat by the end of the period, with well signalled and lighter new issues (such as Nigeria) performing more favourably.

EM debt markets were also rocked in September as Chinese real estate developer Evergrande—China's largest corporate issuer—neared default on its bond payments. While Evergrande's debt was high yield, the default triggered concerns in the market around possible contagion to other areas of credit, although this did not ultimately transpire.

Turkey was again in the news late in the quarter as the country's central bank unexpectedly cut interest rates in spite of rising inflation. Elsewhere, yields on Chilean government bonds rose sharply amid political concerns.

1 Source: J.P. Morgan as at 30 September 2021.

Strategy, performance and positioning

The Vanguard Emerging Markets Bond Fund recorded a negative absolute return but outperformed its benchmark over the quarter, returning -0.71% compared with a return of -0.77% for its benchmark, the JPM EMBI Global Diversified Index[2].

Factors contributing to performance this quarter included country selection. Specifically, the fund benefitted from positions in Chile and Hungary as well as in Egypt and Brazil. The largest contributor to performance was Chile, where our relative-value positioning profited as Chilean government bonds sold off amid investor concerns around the political situation and high inflation.

The largest detractor from relative performance was the allocation to El Salvador. The fund's overweight in El Salvador was impacted as the country's government bonds sold off on concerns around political developments and the country's adoption of cryptocurrency bitcoin as legal tender. Our positions in Colombia, Zambia and Lebanon also detracted from performance.

In terms of the portfolio's positioning, in some respects, we are more constructive on the EM asset class than we have been for some time as segments of the market have repriced to much better valuations.

For example, we see select areas of value in parts of EM high yield. Looking ahead, however, market conditions warrant a cautious approach overall in the sector.

There are also risks from China, where a slower growth trajectory and the risks there of an energy crisis are key risk factors that we'll be watching given their close linkage to developing countries.

In terms of fundamentals, the quality of EM investment-grade debt has weakened in recent months (such as Chile, Peru and Colombia), although this is now largely priced in, while some other investment-grade names remain solid, notably some issuers in the Gulf.

Over the coming months, many of the upcoming EM distressed-debt events, including those in Zambia and El Salvador, have already been baked into prices, although further ahead, parts of frontier markets are still vulnerable.

Outlook

The outlook for EM remains more uncertain than for developed markets, with further market weakness likely at least until there is a stabilisation in China's macroeconomic environment and an end to the broader global slowdown and inflation mix. Developed market central bank tapering is likely to cause disruption in EM bond markets, and we also expect the US dollar to remain strong, which is another headwind.

EMs are more vulnerable than most sectors to a tail risk of persistent and high US inflation and a subsequent Fed tightening that is earlier or larger than expected.

A key trend in EM in recent years has been of economic rebound on the heels of developed markets; given the ongoing issues around China, this looks set to be delayed.

That said, there are pockets of value in parts of high-yield EM credit, especially in longer-dated bonds where steep yield curves offer attractive active opportunities. We also see value in certain EM credits in the energy sector.

We are closely monitoring EM fiscal funding needs, as we believe that countries that overshoot on this front could be unduly punished by the market. Once EM central banks have implemented more monetary tightening, this will likely create greater value in EM bonds; however, for the moment, the opportunities are rather idiosyncratic.

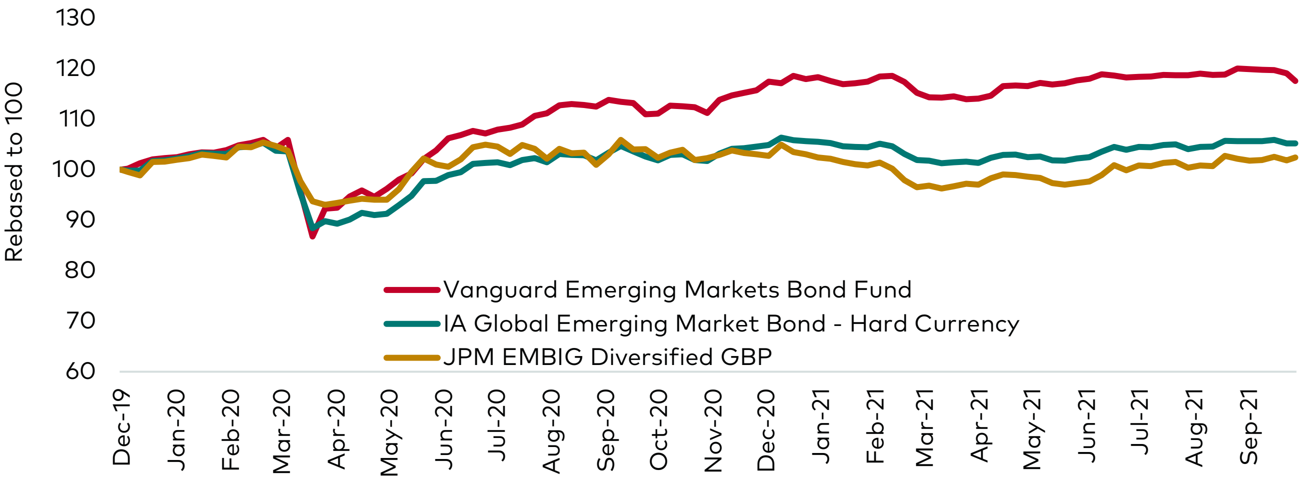
2 Source: Vanguard and J.P. Morgan as at 30 September 2021.

Key fund facts (as at 30 September 2021)

Investment manager: Vanguard Fixed Income Group
Inception date: 03 December 2019
Domicile: Ireland
Benchmark: JPM EMBI Global Diversified Index
Ongoing charges figure[1]: 0.60%
Fund AUM: GBP 336m
Number of holdings: 202

Average coupon: 4.9%
Average maturity: 11.7 years
Average quality: BB+
Average duration: 7.1 years
Turnover rate: 387.7%
ISIN: IE00BKLWXP06

Fund performance since inception (as at 30 September 2021)



Cumulative (%)	YTD	3m	1 year	3 yr (ann.)	5 yr (ann.)	Since inception
Fund	-0.64	-0.71	5.92	--	--	9.28
Peer group	-1.80	0.59	1.36	3.33	1.96	4.48
Benchmark	-1.48	-0.77	3.99	4.31	2.56	2.45

Year on year (%)	1 Oct 2016 - 30 Sep 2017	1 Oct 2017 - 30 Sep 2018	1 Oct 2018 - 30 Sep 2019	1 Oct 2019 - 30 Sep 2020	1 Oct 2020 - 30 Sep 2021
Fund	--	--	--	--	5.92
Peer group	2.95	-2.41	10.64	-1.14	1.36
Benchmark	3.61	-3.51	9.40	-0.24	3.99

Past performance is not a reliable indicator of future results.
Source: Vanguard and Morningstar, as at 30 September 2021. Peer group is IA Global Emerging Market Bond - Hard Currency. Performance figures include the reinvestment of all dividends and any capital gains distributions. The performance data does not take account of the commissions and costs incurred in the issue and redemption of shares. Basis of fund performance NAV to NAV. Basis of index performance is total return. All performance is calculated in GBP, net of fees, and the return may increase or decrease as a result of currency fluctuations.

[1]The Ongoing Charges Figure (OCF) covers the fund manager's costs of managing the fund. It does not include dealing costs or additional costs such as audit fees.

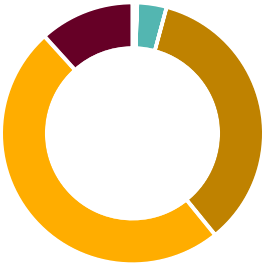
Fund breakdown (as at 30 September 2021)

Distribution by issuer (% of bonds)

Characteristics	Fund %
Sovereign	61.7
Agencies	19.6
Cash	11.7
Treasury/federal	6.2
Financial institutions	0.7
Industrials	0.2
Other	0.0
Utilities	0.0

The allocations are subject to circumstances such as timing differences between trade and settlement dates of underlying securities, that may result in negative weightings. The fund may also employ certain derivative instruments for cash management or risk management purposes that may also result in negative weightings. Allocations are subject to change. Cash includes physical cash on the account, cash like instruments (such as ultra-short term treasury bonds) and derivative instruments.

Distribution by credit quality (% of bonds)



AAA	0.5
AA	0.1
A	3.6
BBB	35.0
Less than BBB	49.2
NR	11.7

Credit quality ratings for each issue are obtained from Bloomberg using ratings derived from Moody's Investors Service, Fitch Ratings, and Standard & Poor's. When ratings from all three agencies are available, the median rating is used. When ratings are available from two of the agencies, the lower rating is used. When one rating is available, that rating is used.

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Investment risk information

The value of investments, and the income from them, may fall or rise and investors may get back less than they invested.

Past performance is not a reliable indicator of future results.

Reference in this document to specific securities should not be construed as a recommendation to buy or sell these securities, but is included for the purposes of illustration only.

Some funds invest in emerging markets which can be more volatile than more established markets. As a result the value of your investment may rise or fall.

Funds investing in fixed interest securities carry the risk of default on repayment and erosion of the capital value of your investment and the level of income may fluctuate. Movements in interest rates are likely to affect the capital value of fixed interest securities. Corporate bonds may provide higher yields but as such may carry greater credit risk increasing the risk of default on repayment and erosion of the capital value of your investment. The level of income may fluctuate and movements in interest rates are likely to affect the capital value of bonds.

The Vanguard Emerging Markets Bond Fund may use derivatives, including for investment purposes, in order to reduce risk or cost and/or generate extra income or growth. For all other funds they will be used to reduce risk or cost and/or generate extra income or growth. The use of derivatives could increase or reduce exposure to underlying assets and result in greater fluctuations of the Funds net asset value. A derivative is a financial contract whose value is based on the value of a financial asset (such as a share, bond, or currency) or a market index.

Some funds invest in securities which are denominated in different currencies. Movements in currency exchange rates can affect the return of investments.

For further information on risks please see the “Risk Factors” section of the prospectus on our website at https://global.vanguard.com.

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