JANUARY 2026 | 2026 EMERGING MARKET DEBT OUTLOOK

Is 2026 the new 2006? Continue to pick your nickels, the steamroller remains far enough!

The anticipated disruption of 2025 under the second Trump administration duly materialized through aggressive tariff policies, geopolitical realignments, and challenges to institutional norms. Despite these event risks—from conflicts in Ukraine and the Middle East to U.S. domestic uncertainty—emerging market debt (EMD) demonstrated notable resilience, supported by renewed inflows and improving investor sentiment, now at its highest level since late 2021. Entering 2026, the fundamental backdrop for emerging markets (EM) remains constructive, underpinned by stable commodity dynamics, sound credit profiles, and manageable fiscal positions. While systemic risks persist—stemming from the sustainability of the artificial intelligence (AI)-driven growth narrative, vulnerabilities in private credit markets, and fiscal credibility concerns in developed economies—these remain largely external to EM and difficult to time. Current market conditions suggest a continuation of the "grind tighter, grind higher" environment, reminiscent of 2006, characterized by tight valuations but robust technical support. Although episodic volatility is expected, such dislocations should still present attractive entry points. With a softer U.S. dollar and ongoing Federal Reserve (Fed) rate cuts, EM foreign exchange (FX) and spreads are poised for incremental performance, while returns will increasingly depend on income generation and selective "Alpha" opportunities across frontier local markets, corporate event-driven situations, and targeted sovereign exposures. Despite intermittent global risk aversion, EMD remains under-owned and offers compelling diversification and value in the year ahead.

U.S. growth, inflation, and policy impact on the dollar and U.S. rates: The first quarter of 2026 holds the key to the year's outlook

We were bracing for an eventful and disruptive 2025 in the first year of Trump 2.0, and we were clearly not disappointed! Whether through the unilateral imposition of punitive tariffs against trade partners, to upending the geopolitical world order with a blend of aggressive pressure and deal-making or testing the limits of such democratic pillars as the separation of powers and conflicts of interest avoidance, investors have been rewarded with event risks and disruptive policies. Yet, except for a quickly fading "liberation-day" drawdown for risk assets on April 2, EMD assets have experienced a relatively smooth year overall. Incremental flows returned to the asset class, and the most dramatic headlines on tariffs, geopolitics (Ukraine, Iran, Gaza, and Venezuela), or U.S. domestic developments, never entailed any lasting negative market consequences.

We feel this was largely due to some unintended consequences of "Trumponomics", namely a global economy and the investing community eventually deciding to shrug off tariff risks and U.S. geopolitical gesticulations (amidst a lack of retaliation by all except China, and constant indecision by the U.S. administration—the famed "TACO" acronym). This was helped by a broad USD weakening trend on a blend of self-inflicted wounds on the U.S. economy (tariffs, immigration, universities) and its policy credibility (attacks on the Fed and other institutions' independence, the One Big Beautiful Bill Act (OBBBA) and the absence of any fiscal consolidation plans). This helped maintain a constant flow of capital and liquidity towards emerging countries. Finally, the consensus had to backtrack from predicting a U.S. recession, as the negative impacts of those policies took more time to materialise, while the AI investment spree and a healthy high-end U.S. consumer helped mask the negative side effects.

Going into 2026, the U.S. policy mix and its impact on the USD, U.S. Treasury (UST) yield, and curve shape will remain a key driver of EMD's fortunes. Indeed, a slowing job market and lingering inflation will keep the Fed's mandate dilemma alive. This is complicated by perception issues around the upcoming leadership change, and the suspected intention by the White House to influence monetary policy in order to ultimately force long term yields lower. A lot of the outlook for risk assets in 2026 hinges on key binary events materializing early in the year.

First is the direction of U.S. monetary policy. The mandate of the current Fed Chair Jerome Powell ends in February 2026. As we type, Trump still seems to hesitate between the two "Kevins", Hassett and Warsh, to succeed him. Hassett is widely seen as Trump's man and his perceived dovish political alignment would likely reignite a bout of USD weakness and UST curve steepening. Warsh is still seen as relatively orthodox and would initially lead to the opposite moves in a welcome relief of fears around U.S. policy orthodoxy. Then comes the Supreme Court decision on the fate of Gov. Lisa Cook, which could also mark a pivot towards a board dominated by Trump loyalists, possibly forcing rates down despite persistent inflation, or willing to reignite quantitative easing (QE) to keep long-term yields low.

Fiscal concerns could also quickly come back to the fore, with the expected Supreme Court decision on the use of International Emergency Economic Powers Act (IEEPA) tariffs as a national emergency (which, if cancelled, may create a short-term fiscal gap that will take time to plug with other measures). This should also happen early in the first quarter of 2026, which is also the period where we'll see a return of a maximum fiscal thrust. Fiscal policy is projected to boost GDP growth by about 2.3 percentage points in the first quarter of 2026 (Hutchins Center estimate) as delayed federal spending resumes after the end of the government shutdown and the OBBBA tax cuts come into effect. The government's full reopening post shutdown should add another 0.2% to first quarter growth, transferred from the fourth quarter of 2025.

Such policy concerns will also increasingly be tied to market expectations about the upcoming mid-term elections in November 2026. With Trump currently polling close to the lowest level of any president over the past 40 years, especially on economic policy and inflation, one year into his mandate, we wonder how desperate he could become to win the mid-terms, possibly through policies that deliver visible near-term growth outcomes, even at the expense of higher deficit and inflation pressures. Here again, the first quarter fiscal boost looks like a key test on whether the administration's popularity recovers.

If Hassett becomes chair and/or Lisa Cook is removed we would therefore expect further USD weakness through the first quarter of 2026, until possibly mid-year, with the EUR rising through 1.20 again, possibly exceeding 1.25 at some point. This would come with further U.S. curve steepening into the first half of 2026, led by 2-10s. We caveat that a Warsh nomination and Lisa Cook staying on board would lead to the opposite scenario in the short term (first quarter), but that longer term structural policy credibility issues, especially on the fiscal side if IEEPA tariffs are removed, could still play against the USD and lower 10-year yields. Given all the above headwinds on fiscal financing and credibility, and risk of some inflation persistence, we expect U.S. 10-year yields to struggle to durably trade below 3.80% and would expect them to end 2026 at roughly similar levels of around 4%.

That said, a broadly satisfactory U.S. growth picture avoiding recession, would remain an acceptable scenario for non-U.S. risk assets. We add that, even without an all-out weak USD environment, EM currencies in particular would remain in that middle of the "dollar-smile", and still be expected to perform, alongside the EUR.

Eurozone: Light at the end of the tunnel? Positive for Central Europe

Europe has not been a happy place during this first year of Trump 2.0, constantly bashed as incapable of growing, assailed by U.S. tariffs and cheap, duty-free Chinese imports, risk-averse consumers who preferred saving rather than spending despite elevated real incomes, and a threatening Russia forcing it to reinvest massively in defence while supporting its expensive social model. Its German locomotive has also lost all the attributes of its strategic success over the past three years: cheap Russian natural gas feeding a high value-added industry, supplying the Chinese consumer with high-end cars and capex-hungry Chinese businesses with state-of-the-art capital goods and heavy chemicals, and acting as exporter of last resort for a European union of subcontractors.

The new reality couldn't be grimmer on paper, yet we find reasons for optimism however harsh the wakeup call has felt in the past year. The 500 billion EUR German infrastructure and defence fiscal spending package has started to be disbursed and will act as a powerful anchor for EU growth expectations. We note that, at 62.4% debt to GDP as of mid-2025, of all the large, advanced economies, Germany is the one to retain full fiscal credibility to spend, given their past track record to rein in debt and deficits when necessary. For all its woes, political instability and the lack of budget for France didn't dent the country's growth too much in 2025 (fast growing Spain hasn't had a budget either since 2023). Adding to that, the sentiment relief that a potential ceasefire in Ukraine could provide, the solid consumer balance sheet and real income starting points, and the EU growth consensus points to a progressive recovery in 2026 from 1.1% in the first quarter of 2026 towards 1.5-1.7% later in the year. Central Europe activity in CE4 is highly tied to EU and should benefit from a stronger EU. Key elections in Hungary in April 2026 could see Orban go, which would open new avenues for foreign investments and EU relations, while Romania's welcome fiscal adjustment and Poland's key role in rearming Europe will continue to provide a good base for growth sustainability and EU transfers. Although the Czech Republic has seen a shift to a euro-sceptic government, its strong institutional base and advanced economy, coupled with a looser fiscal stance which will nonetheless not exceed 3% of GDP deficit, should keep growth healthy and investment flowing in.

China: The impasse of external surpluses requires policy adjustments

The Chinese trade surplus exceeded the $1 trillion mark in 2025, undeterred by U.S. tariffs, as a lot of exports simply diverted to other countries, chiefly the EU and EMs. At close to 28% contribution as a share of GDP growth, net exports were a key contributor to the 4.9% 2025 real GDP growth number.

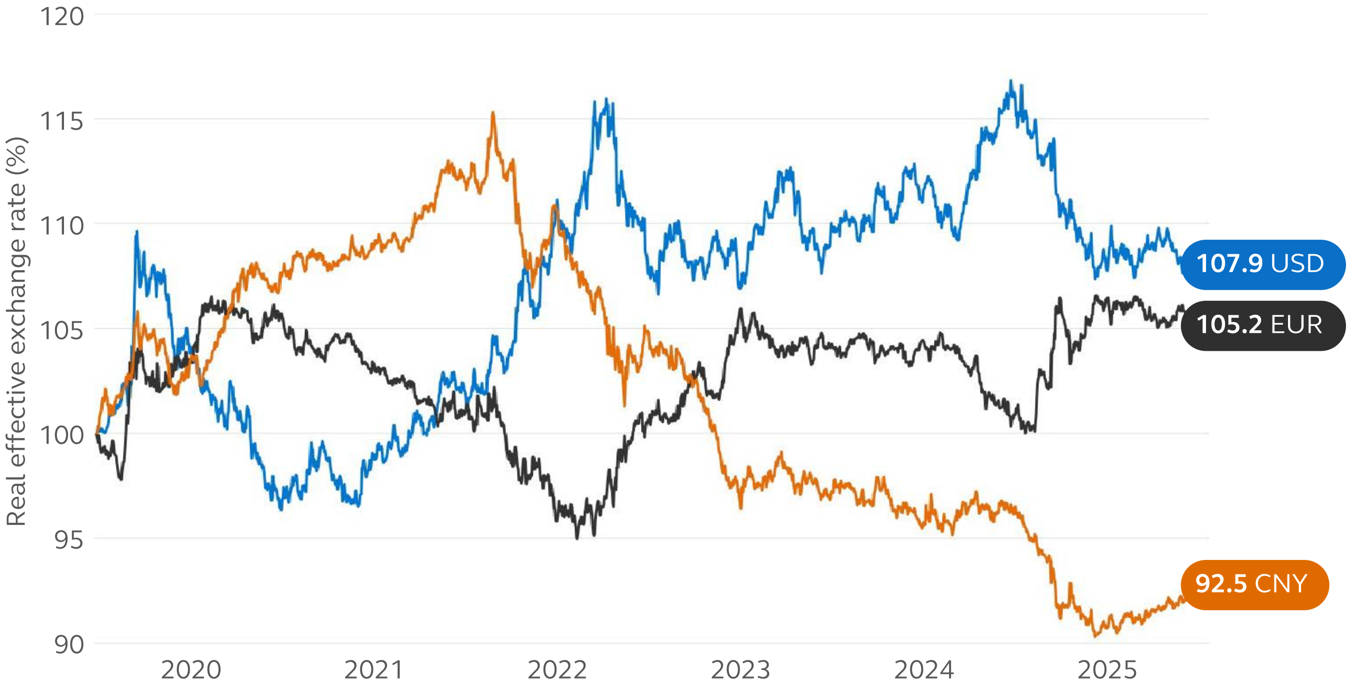
Yet this no longer looks like a viable long-term model to China, and the leadership starts to realise this, as non-U.S. trade partners are now complaining about RMB cheapness and the likes of Mexico, and increasingly the EU, have already moved to impose tariffs on Chinese goods. The most recent party plenum, beyond a continuing focus on AI and tech leadership, and an even greener economy, also pushed for a more significant support for consumption and a more orderly domestic market. This is amidst a desperate fight for domestic market share by local private sector industries in excess capacity, from electric vehicles (EVs) to clean energy (the so called “involution” phenomenon).

Although consumption continues to generate the bulk of China's growth, it has been undermined by this deflationary drive which negatively impacts employment. This has likely delayed the purging of the 2022 property sector crisis, which continues to contract and weighs on the system, amidst increased financing challenges for local governments. We know that Xi Jinping is averse to a consumption-led growth model, so this remains a tactical adjustment to us. That said, we find it encouraging that China realises that the export dumping model is an impasse, and that policy discussions around a potential RMB appreciation are now allowed to happen. This is good news for many EMs, especially in Southeast Asia, who suffer from direct competition from Chinese goods, undermining domestic production and growth.

We continue to assume that China itself will remain a benign driver of EMs fortunes into 2026, just meeting their diminished growth targets (4.3-4.5% expected in 2026), but at a lower incremental competitive and deflationary cost for its EM trading partners.

We note in Exhibit 1 that the RMB remains significantly undervalued versus the USD in real effective terms and we continue to see more scope for a further downward USD adjustment in the months to come.

EXHIBIT 1: Citi USD, EUR, and CNY real effective exchange rates since December 31, 2019 (base 100)



Source: Bloomberg, Citi, Principal Finisterre, Macrobonds. As of January 5, 2026.

Are EMs the last bastion of policy orthodoxy and fundamental stability, offering yield, diversification, liquidity, and "value for money"?

The question may sound provocative or at the very least hubristic, but not totally unfounded in the light of EMD's behaviour and resilience to exogenous shocks since late 2023.

In many ways, EMs have already seen the trough of their own macro and credit cycle during that "perfect storm" of 2022: the Russian invasion of Ukraine, China's extended lockdown and property crash, Ukraine's debt moratorium, the sovereign defaults of Zambia, Sri Lanka, Ukraine, and Ghana, and the near death experience of several others from Argentina, to Ecuador, Egypt, Pakistan, and Tunisia. From June 2022 onwards, the final nail in EM's coffin was provided by a "behind the curve" scramble by the Fed and other developed market (DM) central banks to accelerate policy tightening in the face of massive post-COVID inflation, leading to a surging USD and a global liquidity retrenchment. This translated into massive portfolio outflows from EMD assets. Between late 2021 and late 2024, global EMD portfolios lost about 50% of all assets raised since 2004.

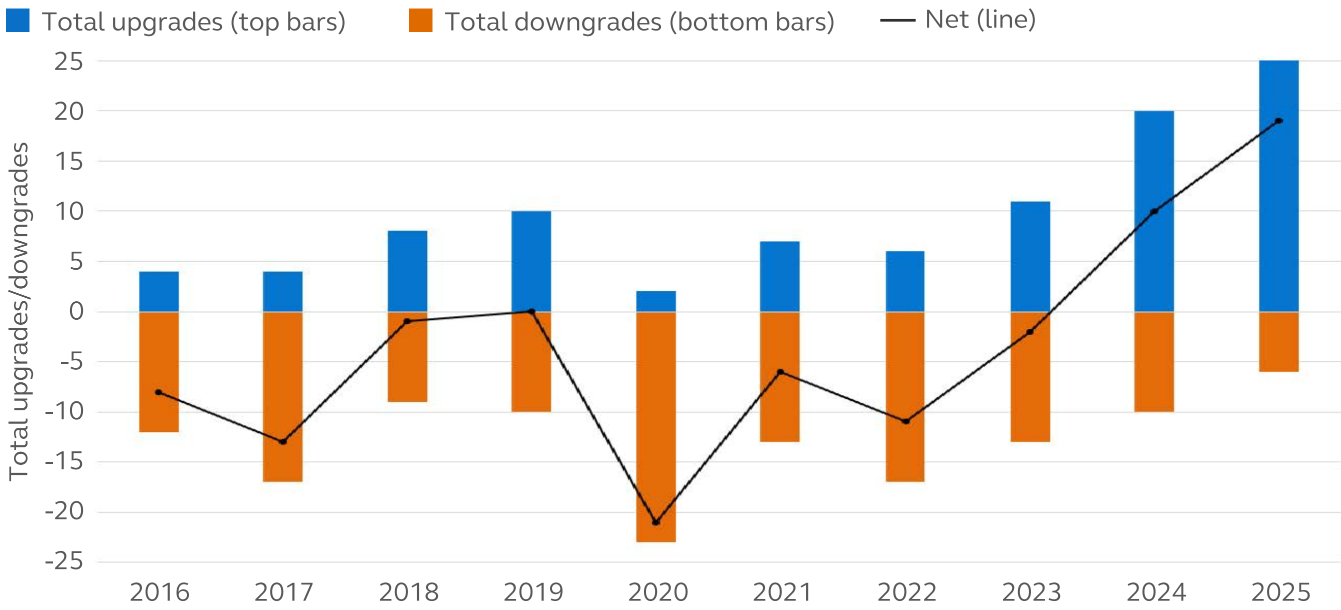
Although EMD portfolio flows started to recover in the aftermath of April 2, 2025's "liberation day", and as incremental flows accelerate on the back of 2025's outperformance against all major fixed income asset classes, our perception remains of a deeply under-owned EMD asset class, in sharp contrast to most other global fixed income segments.

As we enter 2026, we continue to feel quite relaxed about EM fundamentals, whether regarding the outlook for commodities, EM credit dynamics, the EM growth/inflation trade-off, balance of payments stability, or even fiscal risks.

As we have often repeated before, the global macro environment remains favourable to most emerging economies. It is marked by a stable to weaker USD regime, an overall dovish bias by global central banks—which may be nearing its end but is not close to reverse—ample global liquidity chasing more diversified asset returns, and relatively positive commodity terms of trade amidst moderately declining food and oil prices, versus rising industrial and precious metals. It is also notable that, against all tariff odds, global trade volumes have not contracted much, and intra-EM trade has continued to develop.

We also argue that, despite several exceptions which warrant scrutiny (Senegal, Colombia, and to a lower extent Hungary, Brazil, or Indonesia) and a lower overall ability than DMs to sustain high debt levels for a typical EM economy, the policy credibility argument favours EMs more than many DMs at this juncture. After demonstrating their proactiveness in hiking rates as early as 2021 to pre-empt rising inflation, way earlier than the Fed and other DM central banks, they have remained particularly vigilant on exogenous trade and geopolitical risks, as well as endogenous fiscal risks, retaining rates higher for longer in order to maintain sufficient real risk premia and retain capital onshore and force policymakers to consider fiscal discipline. It is symptomatic that despite the advent of various waves of left- or right-wing populist governments across EMs, policy initiatives have tested but broadly remained within the boundaries of fiscal credibility (Brazil, Mexico, Turkey, Egypt, and Indonesia), while others have surprised positively on fiscal consolidation (Argentina and South Africa). Institutional stability and/or preservation of Central Bank's independence have for the most part been respected. As a result, EM growth is expected to remain near 4% in 2026, and 3.2% ex-China. EMs fortunes should also be supported by a more synchronized growth cycle with a (K-shaped) U.S. economy delivering progress from 2% in 2025 to 2.5% in 2026, and the Eurozone shaking off some of its earlier gloom thanks to fiscal stimulus and/or more favourable terms of trade. The rising ratio of rating upgrades versus downgrades by the three main rating agencies is a witness to this cyclical EM improvement (see Exhibit 2).

EXHIBIT 2: Number of sovereign EM upgrades versus downgrades by Moody's, S&P, and Fitch since 2015



Source: Bloomberg, Principal Finisterre, Macrobond, rating agencies. As of December 2025.

Our assessment of balance of payments risks is similarly benign, as few of the mainstream EM countries exhibit current account deficits in excess of 3% of GDP, and financing of those is not seen as problematic, thanks to renewed foreign portfolio inflows from a low historic base and continuing foreign direct investments (FDIs). The structural current account issues of the "fragile five" of 2013 (Brazil, India, Indonesia, South Africa, and Turkey) are now distant memories. Some outliers like Romania are on the mend thanks to significant policy adjustments and remain funded by EU funds. We are still wary of double deficit Colombia however, but even there, the government has demonstrated creativity in engineering repo financing trades, which allows to buy time until the March-June 2026 election cycle.

We remain acutely focused however on fiscal sustainability issues, especially in places where populist pressures are high or rising, and key elections are around the corner (mainly Senegal, Hungary, Peru, Colombia, and Israel in chronological order in 2026). Some other countries like Turkey, Indonesia, or Egypt also deserve monitoring although the current situation remains satisfactory. And in "frontier land", we continue to see occasional idiosyncratic risks largely centred around Senegal, which may be one of the only countries needing a debt restructuring in 2026, while Lebanon continues the long road towards restructuring its defaulted debt. Lower oil should also warrant extra scrutiny of the likes of Angola, Gabon, or Bahrain. Against that, we retain a strong confidence in the structural improvement at play in Argentina, Ecuador, Nigeria, and South Africa, while sentiment-driven trades in defaulted Lebanese and Venezuelan debt still have legs into 2026. The Ukrainian situation is more binary, but we can still see a silver lining, either through a ceasefire, or a continued funding of the war effort by the EU over the next two years. Ukraine's external bond debt, which was restructured in 2024, remains a very small part of its overall indebtedness. Venezuela's potential regime change is obviously a new consideration too, which resembles the earlier Lebanese situation, for now seen as a sentiment and positioning-driven trade on a potential debt restructuring.

Any significant systemic risks we can think of remain largely exogenous to EMs, largely focusing on the sustainability of the AI craze, creeping credit quality worries in the private credit landscape, or DM fiscal credibility issues potentially leading to a bond buyers' strike one day. Alas, we are no better than anyone else to assess both timing and probability for these issues to become systemic. We simply must be aware of them, and plan for some contingency strategies or hedges.

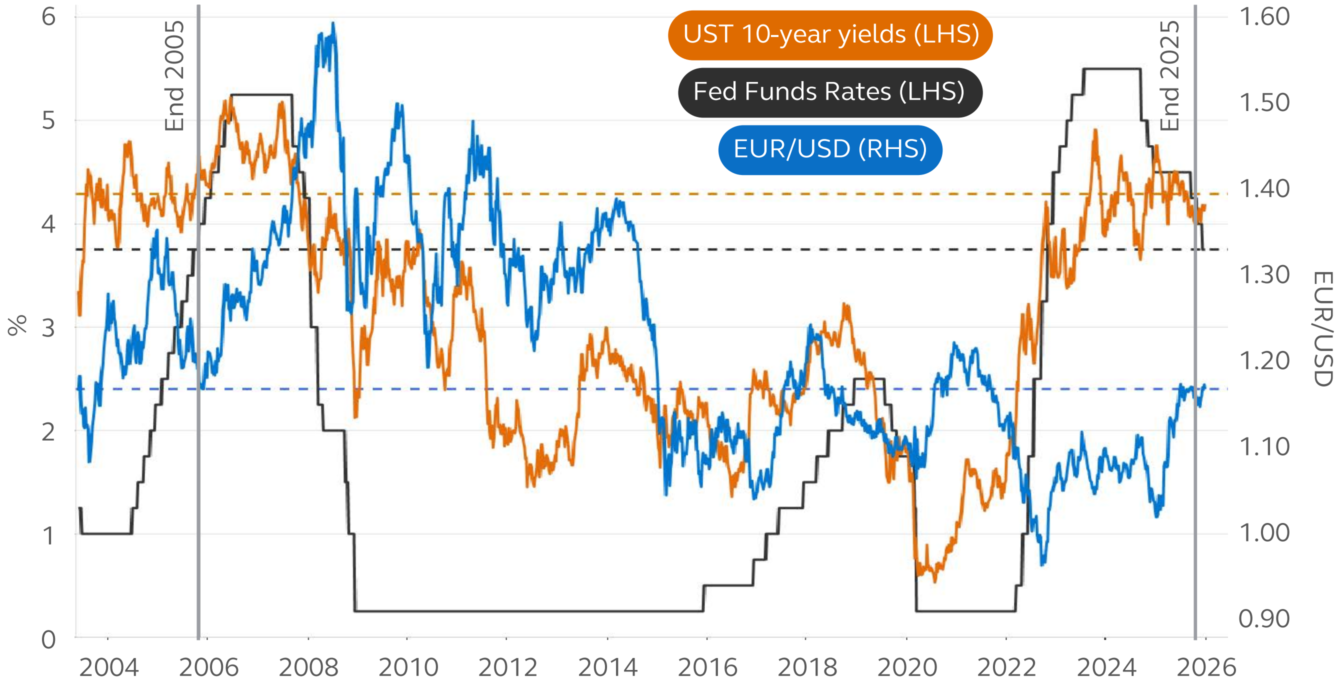
2026 versus 2006—A historical template for the coming year?

Yet, we somehow feel that the global "grind tighter, grind higher" environment of the past three to six months, will carry us through into 2026 at least. As the title of this piece suggests, we see quite a few similarities between today's environment and the one we faced in 2006.

It started as a joke, but we were trying to identify the last time where yields and spreads were at similar levels, noting that the whole post Global Financial Crisis (GFC) era of zero interest rates of the past 15 years made historical comparisons irrelevant from both a market level and policy mix standpoints. In a striking comparison, 20 years ago was the last time we had almost exactly similar levels on so many key market variables: U.S. Fed Funds were exactly at 3.75% 20 years ago, and U.S. 10-year yields were wrapped around 4%. The EUR was also trading with a 1.17 handle. When it comes to EMD assets, EM local index bond yields (J.P. Morgan GBI-EM Index) were at 6.3% versus 5.95% today (but with a higher share of lower yielding Asian markets today than then), EM sovereign spreads (J.P. Morgan EMBIG Div Index) were around 260 basis points (bps) versus 255 as we type, and EM corporate spreads (J.P. Morgan CEMBI Broad Div Index) were tighter, at 190bps versus 240bps today.

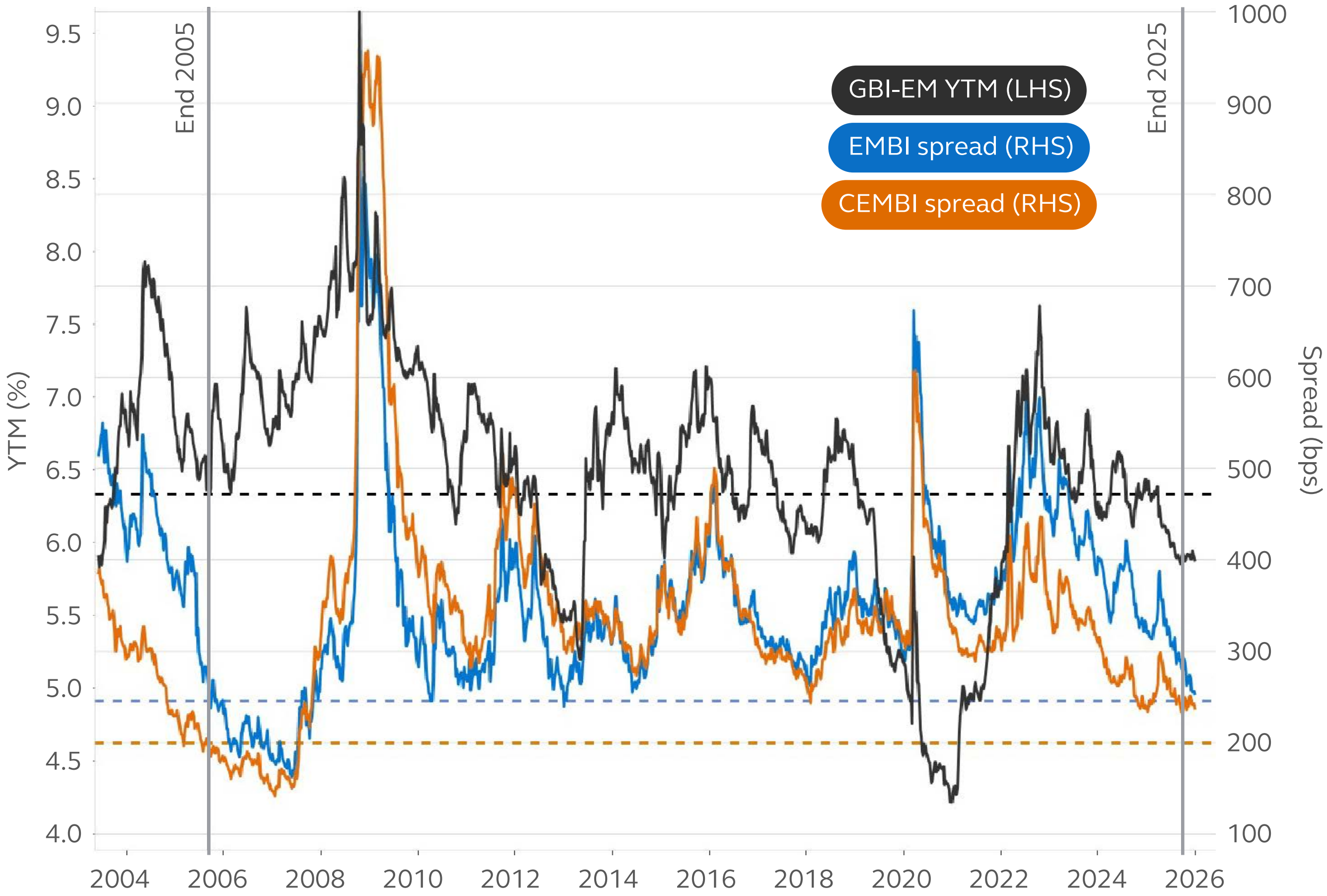
Exhibit 3 and 4 highlight in dotted lines the level of 20 years ago versus today, for U.S. Fed Funds rates, U.S. 10-year yields, EUR versus USD, EMBIG sovereign EM spreads, CEMBI Corporate EM spreads, and GBI-EM local bond yields.

EXHIBIT 3: End 2005 versus end 2025: 20-year history of U.S. 10-year yields, Fed Funds Rate, and EUR versus USD



Source: Bloomberg, Principal Finisterre. As of January 5, 2026.

EXHIBIT 4: End 2005 versus end 2025: 20-year history of EMBIG sovereign spreads, CEMBI corporate spreads, and GBI-EM local bond yield to maturity (YTM)



Source: Bloomberg, JP Morgan Research, Principal Finisterre. As of January 5, 2026. See disclosures for index descriptions.

We were similarly moaning about tight valuations after a massive 18-month rally in a very strong technical environment supported at the time by surging systemic leverage and strong risk appetite. These were booming times for financial engineering in the form of collateralized debt obligations (CDOs), collateralized loan obligations (CLOs), "CDO squared", and other structured products, together with the surge of proprietary trading desks at major banks and macro hedge funds.

Some differences are worth noting though and working in our favour: while today's technicals are equally strong, they may feel somewhat healthier, as most asset demand is now from excess cash in retail and institutional hands. Although it may be a shallow one, we are today in a Fed easing cycle, while the Fed was in the midst of hiking until mid-2006. Finally, 2005 had seen the USD rising, in a reprieve from three years of sharp weakening post the dotcom bubble. It entered renewed weakness from April 2006 as concerns about U.S. deficits and the end of the Fed tightening weighed on expectations (the EUR moved from 1.18 in early December 2005 to 1.30 at end 2006).

Beyond just market levels, we can also draw some structural parallels which make us think that, despite more challenging valuations in global fixed income, the "grind tighter" in spreads/yields is more likely than not to continue.

The AI bubble, private debt, or DM fiscal "steamrollers", any of which could be a trigger for the next global crisis, are unlikely to flatten us in 2026, given a still very solid technical and risk appetite environment, especially for EMD. Significant but occasional market wobbles will likely occur during 2026 on specific events, which we should interpret as early signs of those future risks, but we would still be buying those dips next year.

A market and portfolio strategy scenario for 2026

We remain convinced that 2026 will be a year where EM FX, yields, and spreads continue to grind against a background of weak-ish USD and continuing Fed cuts, so that duration helps marginally, but eventually, EMD returns will be increasingly driven by income maximization and the continuing search for "Alpha" idiosyncratic opportunities in the local frontier space, corporate event-driven ideas, or around a few specific sovereign stories. Later, we provide a list of key portfolio themes driving our views across each EM sub asset class.

Any significant "Beta"-driven uptrend is more likely be provided by potential FX appreciation versus USD, whereas credit spread and local yield contraction should slow to more of a grind. We caution that it may not be a uniform FX appreciation move along the whole of the year.

Across EM regions, high-carry Latin currencies, EUR-related Eastern European FX, idiosyncratic frontier FX, whether commodity related or not, or low yielding, capital flow-sensitive Asian currencies will likely exhibit different trading patterns and may not be synchronized all year. This will require clear and distinctive macro themes to be enacted at different times. We would however expect the bulk of EM FX appreciation potential to be frontloaded into the first quarter of 2026, with mounting uncertainties in the run-up to the U.S. mid-terms potentially acting as a dampener of risk appetite.

If 2026 is unlikely to see the repeat of a 15%-odd 2025 performance, given much lower global yields and a less clear-cut outlook for the dollar, it should remain a solid year for EMD. The main return expectations of any EMD portfolio should be wrapped around its current yield stream (6-9% depending on the mandate of the portfolio), to which we may be able to add 1-2% of tactical "Alpha" generation across a range of lingering sovereign and corporate situational credits, or specific local macro stories. We caution that the path will be less linear, as clouds on the horizon become darker whether from AI valuation and adoption concerns, the likely accrual of losses in the private debt sector, and the persistence of DM fiscal sustainability worries.

We should therefore brace for occasional risk drawdowns (lower FX, equities, and wider spreads) on global fears of such major events, but we feel that any of those will likely not be THE big thing in 2026. Such episodes could continue to provide entry opportunities into an EMD asset class which remains deeply under-owned, and an important provider of diversifying income and "value for money".

Seven proposed EM/global investment themes to start 2026

#1: Highest 2026 stakes for the U.S. economy, the USD, and U.S. rates will play out in the first quarter

- Fed orthodoxy hinges on first quarter leadership transition (which "Kevin?"), SCOTUS decision on Lisa Cook, and any signal from the "new" Fed on possible quantitative easing/yield curve control to lower 10-year yields.
- Fiscal credibility to be tested by SCOTUS IEEPA tariffs decision, expected first quarter fiscal thrust from OBBBA, and any potential pre "mid-terms" extra spending.
- Questions remain about the K-shaped U.S. economy: corporate earnings cycle, labor market's apathy amidst tariffs, inflation, and geopolitical uncertainties, even if the higher-end consumer still appears resilient.
- Trump's popularity now at the lowest for any mandate since before Ronald Reagan, amidst the Epstein files challenge, cost of living issues, and sluggish job market: attempts at deflecting electors' attention with spectacular external operations (Venezuela, Cuba, Greenland, and Iran), and extra fiscal measures in the run-up to mid-terms?
- EUR could trade through 1.20, and towards1.25 in the first quarter of 2026.
- 10-year yields: expected first quarter of 2026 range 3.8-4.2%. Bias for long end to steepen.

#2: EMD enters a more mature part of its rally

- Structurally positioning for income maximization and Alpha generation for 2026.
- More event risks to trade on sovereigns (Venezuela, Iran, key elections amidst fiscal pressures in Hungary, Colombia, Brazil, and Peru), or corporates (cyclical pressures in oil/commodity related sectors?).
- Yet technical strength amidst rising demand for EMD (on diversification and "value for money" arguments) will continue to support prices on weakness, and limit reactions to global events.
- Position portfolios for income maximization in credit and local bonds, with moderate duration profile, and some FX appreciation opportunities, but more selectively than in 2025.

#3: For global and EMD markets, it all feels like 2006 again

- Weak signals of simmering bubbles in AI, private debt, and DM fiscal risks but the burst still looks far away.
- Amazingly, many market levels (U.S. yields, EM spreads, Fed Funds, and local yields) and technical patterns are exactly similar to levels of 20 years ago.
- Meanwhile, the grind tighter/higher in spreads and currencies can and will continue, given technical strength and cash-rich investors, all financed by bloated governments' balance sheets.
- Occasional risk wobbles will occur in 2026 but should still be bought given very strong EMD technicals and continuing inflows on any dip.

#4: 2026 global growth convergence between EU, U.S., EM, and a steady China?

- Should support broad risk appetite for EMs and a continuing reduction in risk premia, both in external debt and local curves, except for those prone to fiscal slippage or election risks.
- Best hope for capital gains in EMD remains incremental EM FX appreciation via portfolio inflows (CE3, MXN, BRL, ZAR, MYR, IDR? INR?…).
- Carry trades remain in vogue and EM currencies with high real risk premia (TRY, EGP, NGN still, but also ZAR, BRL, COP, and MXN) retain appeal.
- Capital repatriation could play out for certain Asian currencies as they create incentives (Korea Pension Fund and Capital gains tax amnesty) or hedging costs cheapen as Fed cuts reduces the interest rates differentials with Asia.
- Expect China RMB to act as an anchor for Asia FX and still be biased to slowly appreciate.

#5: EM duration trade: From gentle disinflation to gentle reflation? Fiscal risks more in focus

- Most EM rates cuts are well priced as EM disinflation process is close to complete. Yet we see little in the way of structural upside price pressures, as food and oil prices remain benign and currencies are generally strong.
- Some EM central banks may hike once in 2026 (Chile and Korea), but, aside from 250bps expected in Colombia, it will not be a cycle.
- The local rates trade is more of a risk premia reduction trade partly based on fiscal credibility improvements (or not) and bond portfolio inflows.
- Could portfolio inflows lift local bonds over interest rate swaps, leading to opposite swap spreads dynamics between U.S. (wider on fiscal risks) versus EMs (tighter on portfolio bond inflow)?
- By default, we still prefer shorter duration local bonds for their attractive yields.

#6: Impact on EM investment grade (IG) credits of U.S. "hyperscalers" issuance

- AI-driven data center spend in the U.S. has gone parabolic, stoking concerns about cash flow pressures at some of the big tech names.
- Higher issuance needs in U.S. IG could compete with U.S. crossover demand normally directed to bigger EM IG cap stacks (Saudi Arabia, Mexico, Poland, and Chile).
- EM IG should be buffered in part by local demand, Asian preference for GCC issuers, and potentially an emerging status as a "safe haven" among global IG.
- Repricing in IG spreads globally would be healthy, and we stand ready to buy periodic dips.
- Mild repricing possible: +10bps in EM IG versus +15-20 bps for U.S. IG?
- EM names in focus: Latam IG sovereign and quasi-sovereigns, or Poland, held by DM investors? Asia-supported GCC names should be OK.

#7: Reduce exposure to cyclical/oil-related EM corporates

- We see spot oil prices as fairly priced relative to the large oversupply in the market; however, we are right at the fulcrum point for many of the high yield (HY) exploration and production (E&P) issuers in EM where things get more painful if Brent slips into the $50s.
- Coupled with only modest attractive valuations for most E&P issuers, we see risks as asymmetrically negative and have spent much of the last six months reducing our direct oil risks on the corporate side.
- Preference is to take oil risk in select HY sovereigns which have built up buffers (Nigeria, Angola, Ecuador, and Ghana) and in corporates that don't take direct oil price risk (Israel gas, Brazil floating production, storage, and offloading vessels).
- Geopolitics is likely to keep oil prices volatile (Venezuela, Russia, and Iran) and we expect at some point this year there will be an opportunity to step into oily corporates, but at meaningfully lower levels.

Risk considerations

Past performance is no guarantee of future results. Investing involves risk, including possible loss of principal. Fixed-income investment options are subject to interest rate risk, and their value will decline as interest rates rise. International and global investing involves greater risks such as currency fluctuations, political/social instability, and differing accounting standards. Risk is magnified in emerging markets, which may lack established legal, political, business, or social structures to support securities markets. Emerging market debt may be subject to heightened default and liquidity risk. Investment in foreign currency can result in losses and values may fluctuate based on foreign exchange rates, exchange restrictions, or other actions of governments or central banks.

Index descriptions

The **J.P. Morgan CEMBI Broad Diversified Index (CEMBIB Div)** tracks the performance of US dollar-denominated bonds issued by emerging market corporate entities. The diversification methodology limits the weights of the larger index countries by only including a specified portion of those countries' eligible face amount outstanding, thus reducing single issuer concentration and providing a more even distribution of weights.

The **J.P. Morgan Emerging Market Bond Index Global Diversified (GBI-EM Gl Div)** is a uniquely weighted local currency denominated emerging markets sovereign index. The diversification methodology limits the weights of the larger index countries by only including a specified portion of those countries' eligible face amount outstanding, thus reducing single issuer concentration and providing a more even distribution of weights.

The **J.P. Morgan Emerging Market Bond Index Global Diversified (EMBIGD)** is a uniquely weighted USD-denominated emerging markets sovereign index. The diversification methodology limits the weights of the larger index countries by only including a specified portion of those countries' eligible face amount outstanding, thus reducing single issuer concentration and providing a more even distribution of weights.

Important information

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