

Emerging Markets Debt Q1 2026 Outlook with Cathy Hepworth, CFA

After a high performing return year in 2025 for EM markets, we need to ask, “what's in store for 2026?”

We expect modest spread tightening and attractive carry conditions to continue. Economic growth and improving fundamentals will still attract flows into the sector despite tighter spread levels.

Many of the drivers that were relevant last year can matter this year: decent global growth, a weaker U.S. dollar, still healthy global liquidity, and the continued reframing of the new world order. The latter takes into consideration how EM countries fit into the global trade patterns, spheres of influence alliances, and the increased development of domestic markets, along with varied capital flows into EM countries.

Clearly, there are tail risks, either emanating from policy developments in the U.S. or China, EM specific risks related to imbalances or election outcomes, and, as always, geopolitics. Volatility, particularly in EMFX, was subdued last year, leaving EM vulnerable to a selloff. However, given our base case, “muddle through” global macro outlook, we would look to add risk on a sell off as we had reduced risk throughout 2025.

So, let's break down what we are thinking in the short term by EM sector.

EM hard currency returns can still arrive in the high single digits, with dispersion of performance and idiosyncratic opportunities in lower-rated or distressed issuers. The return trajectory of EM corporates is also likely to remain positive. Due to stretched valuations, we're somewhat cautious on EM rates and expect the U.S. dollar to maintain its weakening bias as the U.S. focuses less on statecraft and more on economic priorities.

With that, there are EMFX carry opportunities. Many relative value opportunities remain in these EM local markets. In the near term, we will focus on hard currency supply and are monitoring events in Venezuela, Ukraine, and Iran, along with any developments on tariffs.

We look forward to identifying attractive, bottom-up alpha opportunities as 2026 unfolds.

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