

Emerging Markets Debt: Strength, Resilience, and Opportunity

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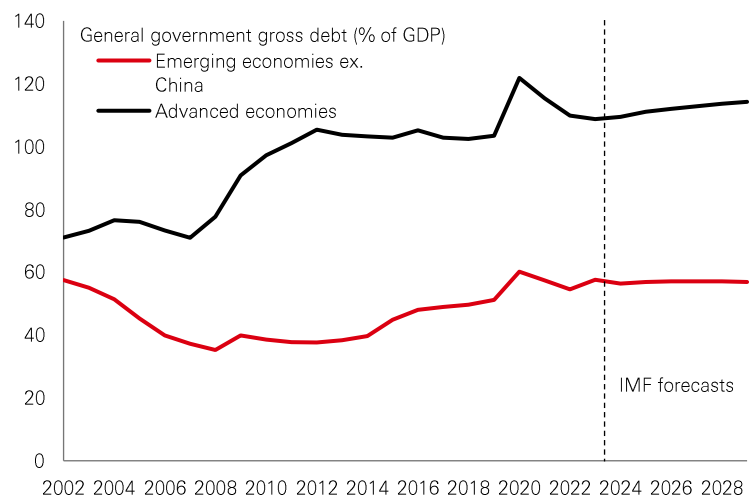
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Following an impressive performance in 2025, (EMD) continues to offer a compelling investment opportunity. As the global economic landscape shifts, EMD stands as a pillar of prospect, offering potentially attractive yields, solid credit quality, and a compelling risk-reward profile. This segment remains well-positioned for growth in a shifting macroeconomic environment, providing investors both return potential and diversification benefits.

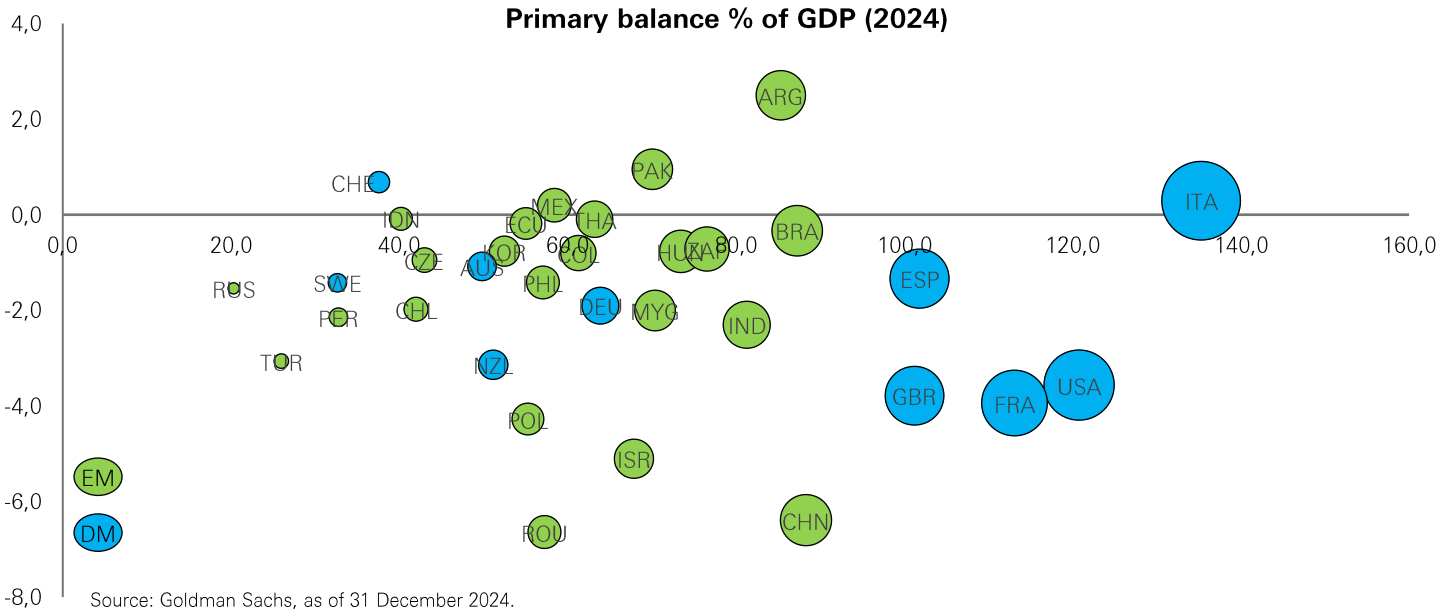
1. Improved fundamentals combined with attractive valuations

Central to EMD's appeal is the marked improvement in the fundamentals driven by fiscal discipline exhibited by many emerging market (EM) countries. Over the years, a commitment to sound fiscal management has bolstered their resilience, allowing these nations to weather geopolitical uncertainties, tariff pressures, economic slowdowns, and external shocks more effectively than some developed markets (DM). Credit rating agencies have increasingly recognized these improvements, with the average rating for EM sovereigns rising and issuers enjoying favorable outlooks and a high likelihood of rating upgrades in upcoming reviews. This trend, combined with improving fundamentals, underscores the growing strength of EM economies.

EM ex-China Debt Level Unchanged

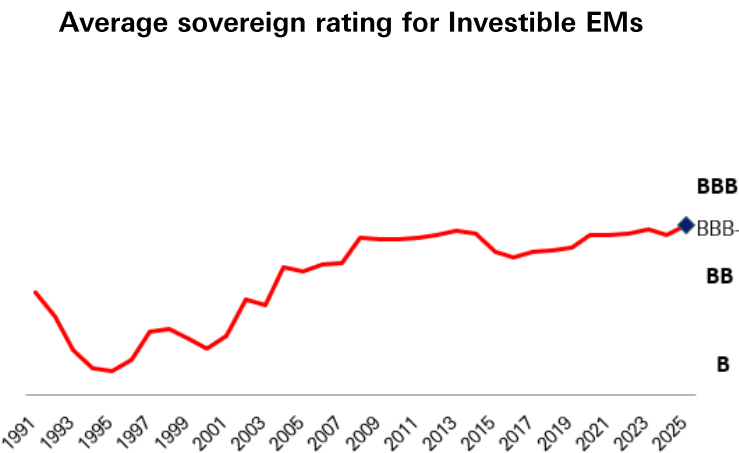
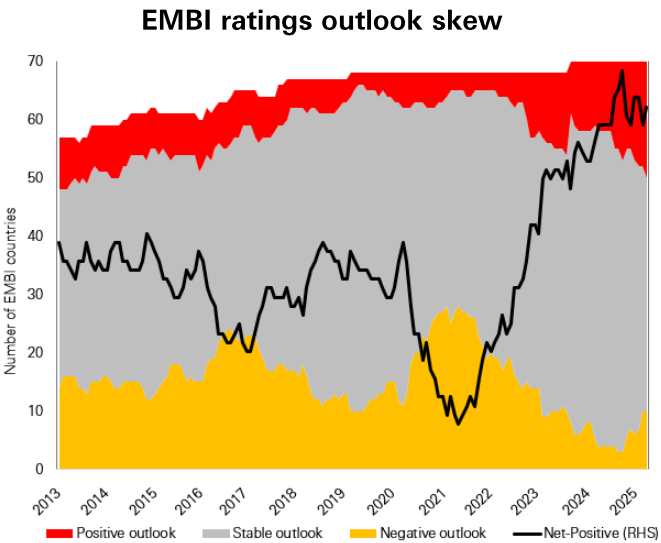


Source: IMF World Economic Outlook, and HSBC Asset Management, as of 30 April 2025.



2. EM Hard Currency Debt

EM credit spreads remain well behaved, reflecting the positive ratings story of EM countries, with upgrades across major economies like Argentina, India, Saudi Arabia and Turkey. Looking ahead, several smaller frontier countries are poised to gain investment grade status, including Costa Rica, Dominican Republic, Ivory Coast, Morocco, Paraguay and Serbia. EM corporates also benefit from the same constructive ratings context, with the 12-month rolling net credit ratings actions in EM corporates running at all-time highs and having turned net positive now in all EM regions. The carry of EM bonds remains attractive thanks to a higher-for-longer rates environment in the US, meaning asset allocators are not too late to join the EMD trade.

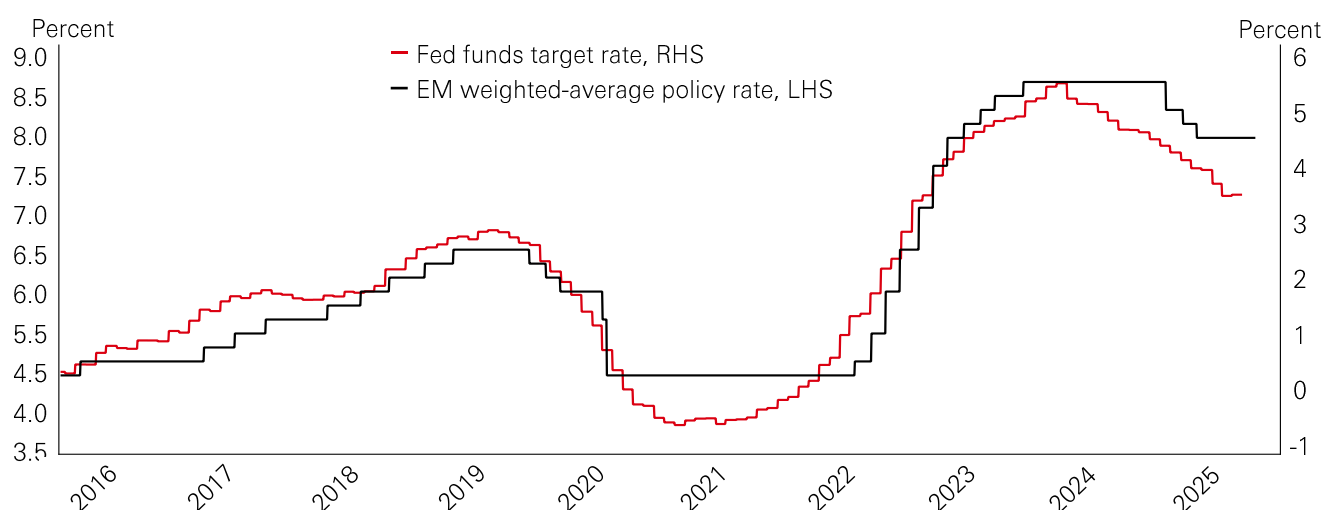


Source: HSBC Asset Management, Moody's, S&P, Fitch, September 2025.
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3. EM Local Debt

One of the things that stands out in this strong cycle for emerging markets is the fact that monetary policy has been so independent from the Federal Reserve. For the first time in history, EM central banks cut interest rates ahead of and faster than the Fed, owing to a more favorable inflation environment in EM relative to the US. The environment remains constructive given these factors, coupled with the likelihood that EM central banks to continue reduce interest rates regardless of the Federal Reserve policy stance. We expect that many EMs will continue to lower rates in 2025 and 2026. This is not an isolated phenomenon but rather represents the maturation of the asset class and the growing strength and credibility of EM currencies and local bond markets.

Average EM policy rate vs the Fed funds target rate



Additionally, a weaker US dollar, partly driven by questions around the safe haven status of US assets and US exceptionalism, could further boost EM currency returns.

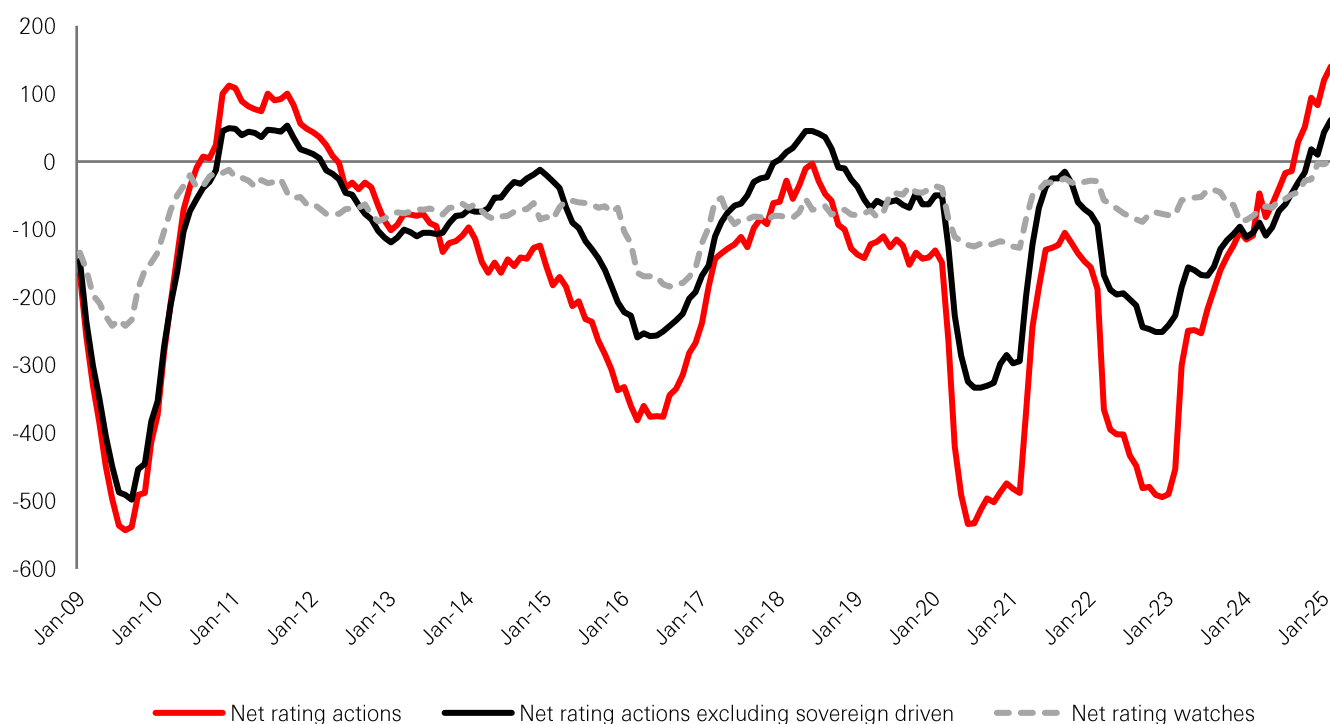
We see three primary drivers for the weakening US dollar trend and continued support of the EMD currency trade:

1. A Federal Reserve that is biased to ease policy, maintaining downward pressure on front end US yields;
2. The relative quality differential between EM and DM with regard to lower debt ratios and more sustainable debt service capacity, external account improvements, and positive credit ratings momentum; and
3. Ongoing negotiation of bilateral trade deals between the US and its major trading partners that increasingly offset tariffs in exchange for currency appreciation.

4. EM Corporate Debt

EM Corporate debt's value proposition is multifaceted, offering diversification, resilience, and attractive yields. Unlike U.S. corporates, which are heavily influenced by domestic economic cycles and Federal Reserve policy, EM corporates are not beholden to a single economic narrative. This diversification reduces the correlation risk, making them a stabilizing force in global portfolios. In addition, EM companies demonstrate stronger financial discipline compared to their DM peers, on average. They tend to have lower leverage, greater debt prudence, and more consistent currency risk hedging.

EM corporate credit – overall rating trends

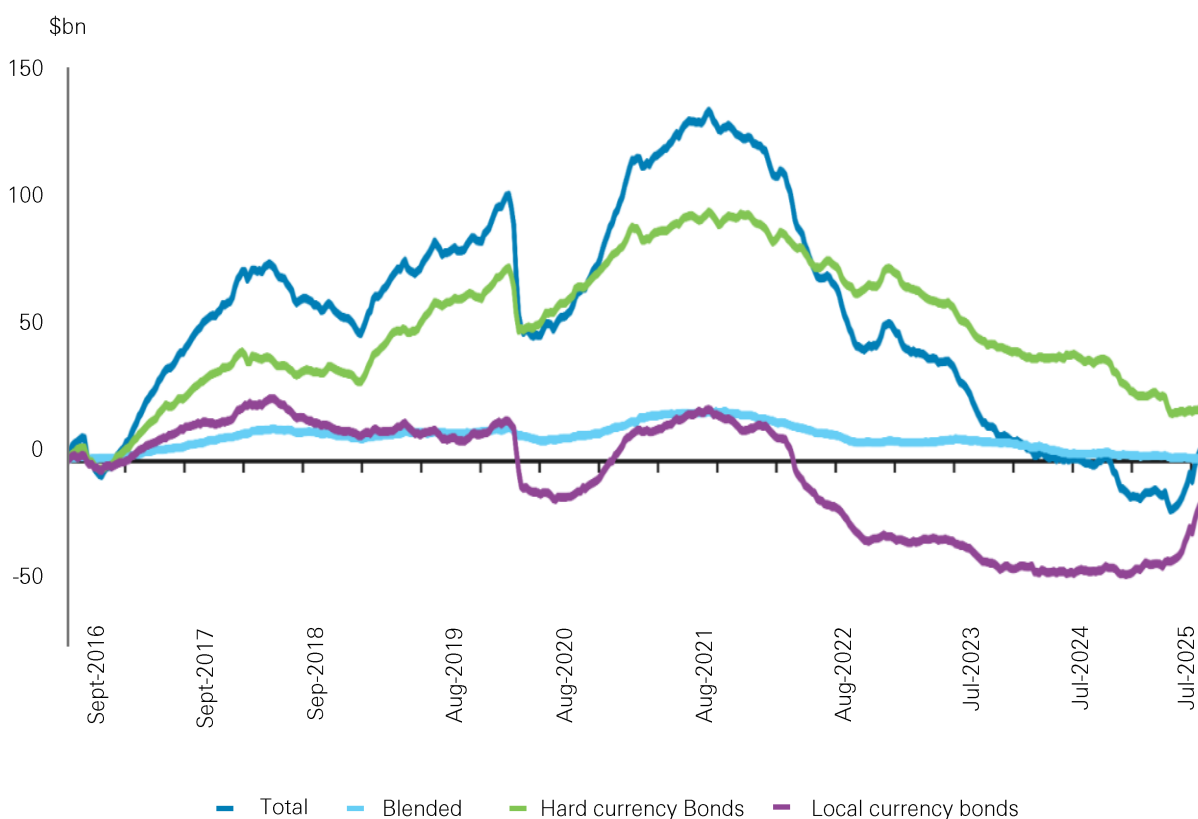


EM Corporate debt has a lower duration profile, and as a result, performance is less correlated to US Treasuries than other asset classes. With this lower correlation, higher yields, lower duration, and investor base differences, EM corporates can help diversify and stabilise a portfolio's risk-adjusted returns over the longer-term.

The outlook for EM corporates is particularly encouraging. Their higher yields, coupled with the prospect of capital gains from cyclically declining interest rates, present a prospect for strong returns. This convergence of favorable macroeconomic trends, country-level improvements, and corporate strength positions EM corporates as an attractive investment opportunity.

5. Under-Allocation Creates Room for Growth

Despite these strengths, EMD remains under-represented in global portfolios driven by a legacy of cautious investor sentiment since the pandemic years. This under-allocation presents a significant opportunity for institutional and retail investors alike, as renewed focus on EMD is expected to drive substantial inflows into the asset class. Flows are starting to come back to the asset class in a meaningful way, with the most significant allocations wave underway in over a decade. Also of note, a higher percentage of allocations are coming from local EM regional investors directly. For example, the percentage of EM new issue allocations going to local investors in the Middle East and in Eastern Europe are at all-time highs, underpinned by strong economic growth stories and wealth creation.



Conclusion

Emerging Markets Debt stands out as a strategic opportunity, combining resilient fundamentals, potentially attractive yield opportunities, and ongoing improvements in credit quality. With the improvement in fundamentals, the EMD asset class has transformed. In the past, the universe was seen as dominated by lower rated, high volatility names – a segment to invest when chasing yields. Today, the asset class has matured with the majority of the top weighted countries in the index Investment-grade rated (JPM EMBIG Div). These are countries with strong balance sheets, credible policy frameworks, and real growth engines. Even for the high yield sector, many of these countries now have in place robust policy settings, solid external buffers, and improving credit metrics. Investors no longer need to sacrifice credit quality for yield, EMD offers investment-grade balance sheets with premium spreads.

With strong fundamentals, potentially attractive yields, diversification benefits, and higher credit quality, EMD continues to be a strategic allocation for investors aiming to balance risk, reward, and opportunity in an ever-evolving global market.

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