Emerging Markets Debt:

Is It What Your Asset Allocation Needs?

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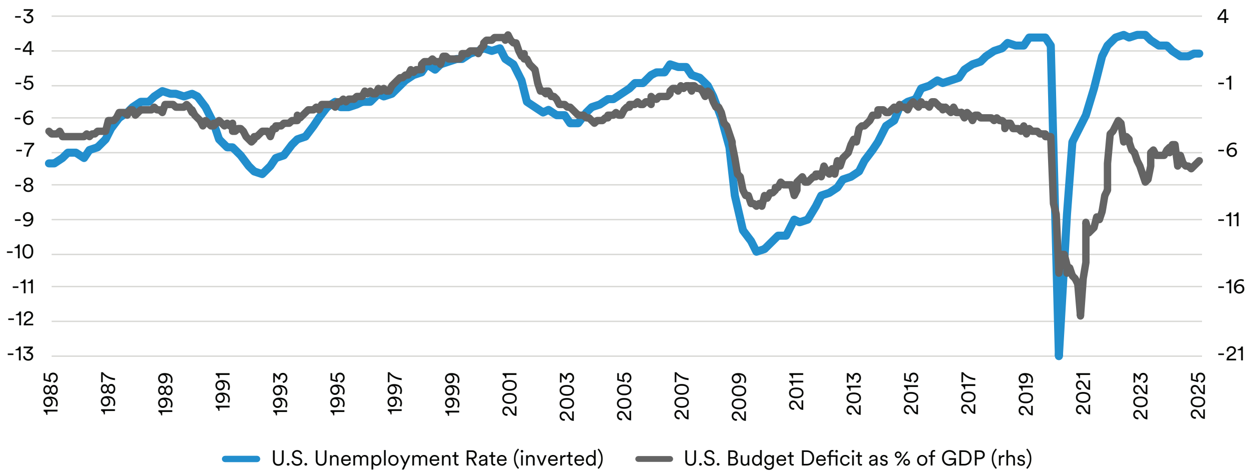
Emerging Markets (EM) may be uniquely positioned to help portfolios with income and return potential within a world of many changes. One supportive tailwind for Emerging Markets Debt (EMD) is the fading of U.S. exceptionalism — a period when U.S. economic growth and asset returns attracted enough of the world's capital to more than compensate for the potential negative effects of large trade and fiscal deficits. Additionally, slower U.S. growth can prompt investors to seek higher yields elsewhere, increasing capital flows into EM. In our opinion, the diversification characteristics of EMD in all its forms, from sovereign, corporate and local, should be considered as a useful tool in portfolio construction.

MetLife Investment Management

At present, the U.S. growth outlook is being stifled by new and evolving secular forces including the limitations of deficit-financed growth policies, increasing tariff rates and declining rates of immigration. The combined effect means that U.S. growth is more likely to slow, converging toward other Developed Market (DM) economies once the full effects of these policies are reflected in the economic data. The chart below illustrates a concerning and unsustainable dynamic: Sustained high federal deficits have become decoupled from declining unemployment, suggesting that the period of pro-cyclical fiscal impulse has reached its limitations. This, combined with increasing tariff rates and reducing immigration initiatives, points in the direction of a slower growth rate in the U.S. as these changes are digested. In such scenarios, the U.S. dollar often weakens, reducing the debt burden for EM countries that have borrowed in dollars and making their assets more attractive. Enhancement of unilateral trade relations, stabilizing commodity prices and ongoing structural reforms within EM economies can further enhance EMD's relative appeal during these periods.

Figure 1 | U.S. Federal Budget Deficit as % of Nominal GDP vs. U.S. Unemployment Rate (%)

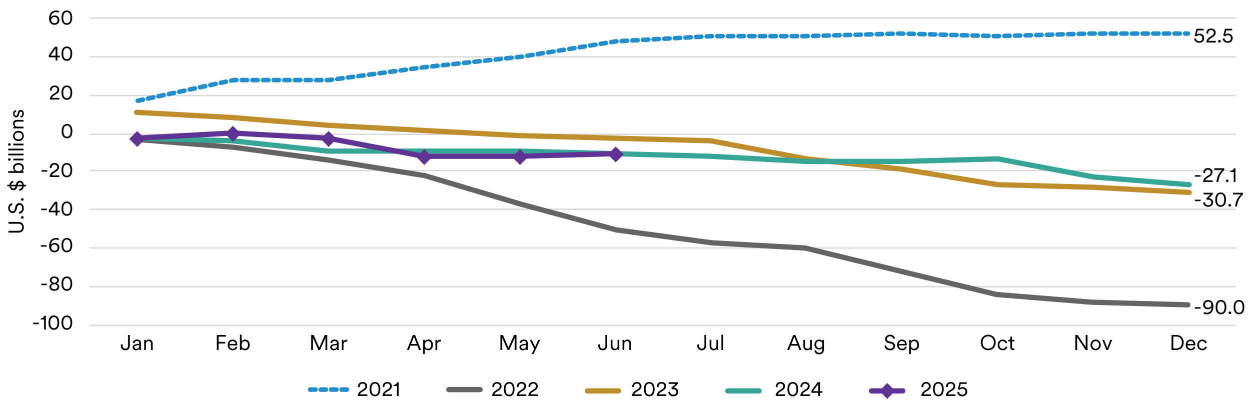


Source: Bloomberg LP as of May 31, 2025.

Supportive Technicals for EMD

EMD has been generally underowned by investors in recent years, as asset allocators have maintained an underweight due to the asset class's underlying complexities. This gap in ownership, coupled with improving fundamentals, creates a potentially favorable environment for capital inflows. Additionally, the potential for a weaker U.S. dollar in 2025 could further support inflows into local currency-denominated debt and more dynamic hard currency funds. With supply remaining subdued, P&I payments remaining high, and crossover investors increasing allocations to the asset class, issuers across the ratings spectrum have maintained market access or are in the process of regaining it, offering potential down-in-quality convergence and attractive new issue premiums.

Figure 2 | Cumulative EM Bond Fund Flows (Retail + Strategic)

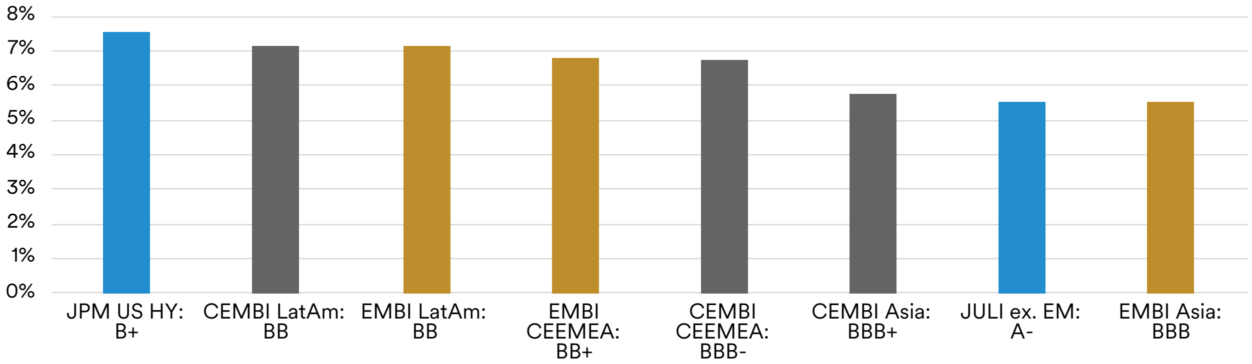


Source: JP Morgan as of June 13, 2025.

Sovereign Debt

The EM sovereign space offers investors a liquid option to diversify away from DM. It provides the potential for additional spread pickup, historically strong returns through cycles and the opportunity for more duration in high-yield assets. DM sovereigns are experiencing challenged fundamentals, lower growth rates and uncertain defense spending; meanwhile, EM economies are demonstrating stronger fiscal discipline and enhanced monetary policy frameworks. Based on a recent study conducted by our sovereign analysts evaluating current fundamentals, 68 of the 81 EM countries (84%) have stable or improving ratings trajectories over the next two to three years. We also see the potential for six to eight countries to be Rising Stars over the next two to three years, given positive momentum. Given this analysis, we believe improving sovereign fundamentals, coupled with the supportive technicals backdrop, will help generate positive spread returns over the near term.

Figure 3 | Regional EM vs. DM Yield to Worst

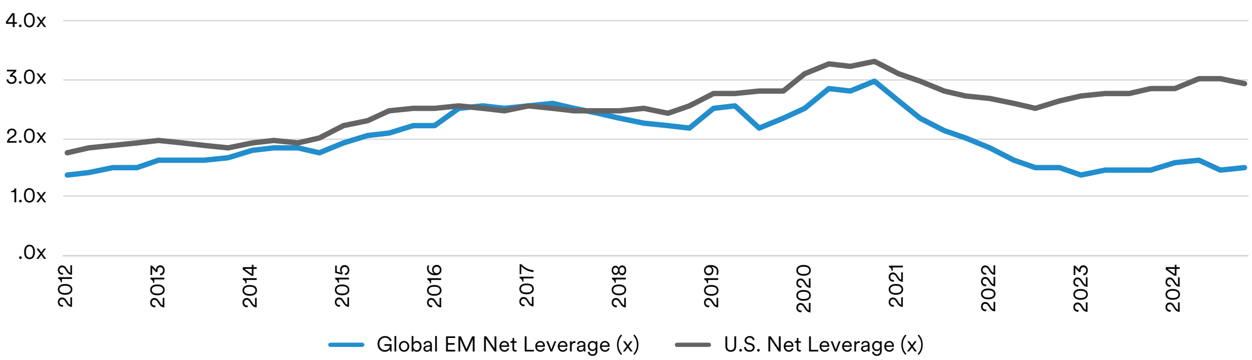


Source: MIM, Blackrock Solutions, JP Morgan as of June 16, 2025. Ratings provided represent average credit quality.

Corporate Debt

Strong fundamentals also continue to be a theme among EM corporates, and the space provides potential opportunities to invest in stable companies with strong cash flows across the globe, at an attractive pickup over DM corporates. Therefore, despite EM valuations toward the tighter end of the historical range, EM corporate fundamentals remain durable. Positively, spread-per-turn of leverage continues to screen attractive across EM assets and remaining over double, 44 bps/x for U.S. credit versus 114 bps/x for Global EM.[1] Additionally, since the Global Financial Crisis, EM defaults have been on average lower than within DM.

Figure 4 | EM vs. U.S. Net Leverage

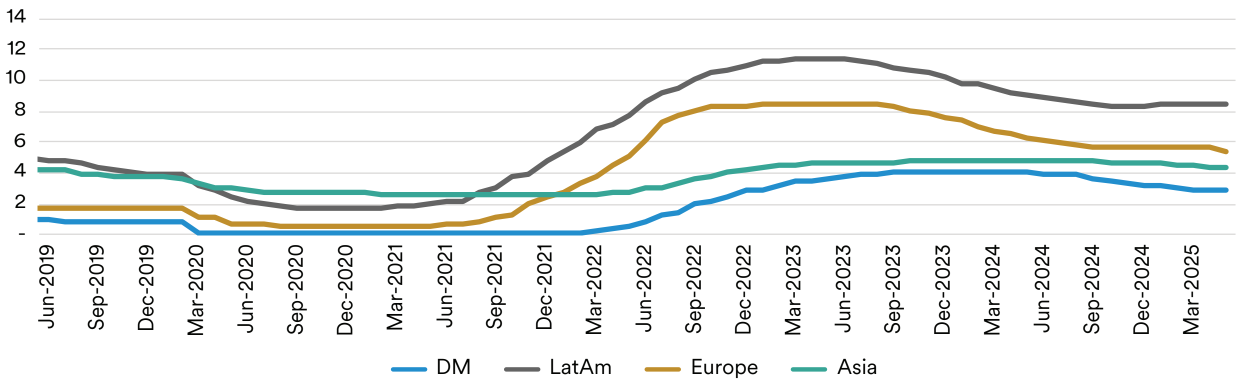


Source: BofA Global Research. Fundamentals Data as of December 31, 2024.

Local Debt

While we understand that the local currency portion of the market has underperformed in recent years due to the strong dollar environment, if investors can buy into the U.S. slowdown story, the case for a weak dollar and therefore supportive backdrop for EM local can be made. Considering elevated dollar valuations over the previous several years, we believe that the U.S., with more constrained fiscal policy and potentially higher inflation, will have lower growth and lower real rates, therefore challenging the dollar's longstanding outperformance. EM countries have managed to keep inflation under control more effectively than DM, partly due to more measured fiscal and monetary responses to the COVID-19 pandemic. This has resulted in lower inflation rates and reduced pressure on central banks, allowing for more accommodative monetary policies and enhancing the attractiveness of local currency debt. This has also allowed for appealing real rates in many EM countries, providing opportunities in the space as the narrative shifts.

Figure 5 | Average Rates by Region (%)



Source: Bloomberg LP as of May 31, 2025.

Conclusion

It should be no shock to investors that EM securities typically have a higher beta response to global events, ranging from the trade war in 2016, COVID-19 and its aftereffects in 2020, and in 2022 following the Russia/Ukraine war. From both an excess return and risk-adjusted return perspective versus other asset classes, EM assets have performed well through market cycles, often offering attractive opportunities to investors. EM excess returns have tended to outperform U.S. markets, notably in the investment-grade space, during these periods of shock to the markets. Further, investors generally are compensated for the additional risk they may take in EM, with a historically higher return-per-unit of risk versus the U.S. market.

Annualized Excess Return*,**

		Investment Grade			High Yield		
Period	**Theme**	**US Corp**	**EM Sov**	**EM Corp**	**US HY**	**EM Sov**	**EM Corp**
1Q 2002 - 1Q 2025	**ENTIRE PERIOD EX-RUSSIA**	**1.07%**	**2.90%**	**2.73%**	**3.67%**	**6.06%**	**6.11%**
1Q 2002 -2Q 2007	Global melt-up	0.89%	4.27%	4.11%	4.95%	11.32%	9.47%
3Q 2007 - 2Q 2013	DM crises	0.29%	1.76%	1.49%	2.87%	2.30%	3.92%
3Q 2013 - 2Q 2016	Taper and energy downturn	0.73%	2.03%	1.57%	1.24%	3.06%	4.45%
3Q 2016 - 4Q 2019	Reflation, populism, trade war	3.02%	3.52%	3.02%	6.45%	5.32%	3.07%
1Q 2020 – 1Q 2025	Covid Pandemic & Recovery (ongoing) ex-Russia	1.23%	1.80%	1.95%	3.15%	4.59%	3.28%

Annualized Return/Standard Deviation

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*Excess return is the annualized quarterly spread return component of each index, calculated as index total return reduced by the duration neutral Treasury return. The indices represented are as follows: U.S. Corp = Bloomberg US Corporate IG Index; EM IG Sov = JP Morgan EMBI Global Diversified; EM IG Corp = JP Morgan CEMBI Broad Diversified; US HY = Bloomberg US Corporate HY Index; EM HY Sov = JP Morgan EMBI Global Diversified; and EM HY Corp = JP Morgan CEMBI Broad Diversified.
**Ex-Russia data is included due to the country being removed from the index at a price of 0 during Q1 2022, skewing index returns for that time period.
Sources: MIM, Bloomberg LP, JP Morgan as of March 31, 2025.

EMD offers the potential a combination of diversification, yield potential and resilience, making it a compelling option for investors seeking to navigate shifting global economic landscapes. Across sovereign, corporate and local debt, the asset class provides potential opportunities to leverage improving fundamentals, favorable technicals and attractive valuations — especially in an era when DM faces increasing headwinds.

Endnote

[1] Source: BofA Global Research. Fundamentals data as of 12/31/2024, Spreads data as of 5/31/2025.

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