2026 EMD OUTLOOK

A TALE OF TWO HALVES

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GlobalEvolution

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Constructive outlook, diverging cycles: The business cycle is rumbling on, buoyed by investments, the lagged impact of past monetary easing and fiscal stimulus. The market cycle, however, is prone to setbacks in the near-term. Sentiment is elevated, volatility low and market pricing on the rich side. Meanwhile, monetary conditions are as easy as they get and the regional growth mix is not a one-way street towards EM outperformance. Sound fundamentals and growth resilience should result in the fourth year of solidly positive EMD returns but a repeat of last year's stellar returns looks like a high bar to clear.

By Witold Bahrke, Senior Macro and Allocation Strategist

2025 proved to be the best year for Emerging Market debt (EMD) since 2012[1]. Downbeat sentiment towards the asset class and geopolitical fears lowered the bar for positive surprises. This proved to be an excellent starting point for EMD investors, particularly in the local currency space. A powerful cocktail of a resilient economy, easing monetary conditions and high, but declining geopolitical uncertainty led to an 11-year low in EM sovereign debt spreads and the best year for EM currencies since 2009.

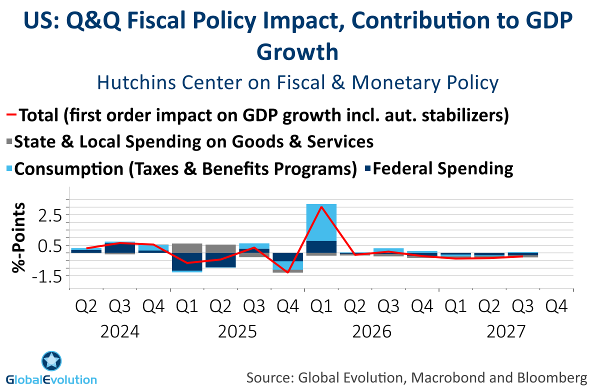
Fast forward to today, overall sentiment as well as sentiment towards EM assets is almost the mirror image of what it was as year ago. After a stellar 2025, the market mood is bulled-up. The consensus has all but fallen in love with EM as the global business cycle remains steadfast. 2025 marked the first year of EMD inflows after 3 consecutive years of outflows.

The business cycle: Fiscal first

Now what? From an economic perspective, the good news is that the business cycle should continue largely unabated. In fact, we see upside risk to the consensus 2026 world GDP forecast, which currently stands at 3% Y/Y according to Bloomberg.

First, fiscal policy in the US (see chart 1) is set to be more stimulative than last year. The "one big beautiful bill act" is set to lift GDP growth by up to 3% annualized in the first quarter as deficit spending is frontloaded, while spending cuts are backloaded. Germany's fiscal spending package is set to kick in the second half, delivering a fiscal impulse of about 1% on a national level. In Japan, things are not set in stone, yet but the new prime minister Takaichi also seems on course for more fiscal stimulus. China might be the biggest question mark at the time of writing. An economy firing on one (export) cylinder amid lackluster domestic demand makes a renewed fiscal stimulus push likely as the year progresses. Although the fiscal impulse in 2026 is expected to be driven out of DM, it should spill over to EM countries, as well.

Chart 1: Fiscal impulse to lift DM growth Q1…



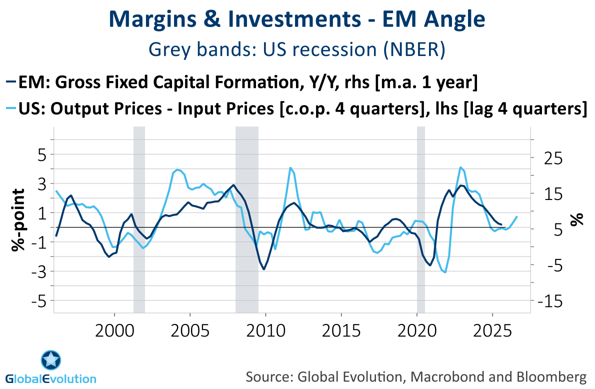
Secondly, investment spending – traditionally one of the main swing factors of the business cycle - is expected to broaden beyond AI related capex spending in the US. Strong productivity growth is supporting corporate profits, keeping unit labour costs low. At the same time, companies' output prices are rising at a healthy clip, resulting in solid margins notwithstanding US tariffs. Wider margins and sturdy profit growth tend to lead investment activity higher.

[1] Based on the average return of hard currency EMD, local currency EMD & corporate EMD, see Appendix 1

On top, the deregulatory push from the White House serves as an additional incentive to ramp up investment spending this year. Unsurprisingly, US business surveys already hint at rising appetite to spend on capex.

These developments are difficult to track in the EM universe due to more limited data availability. However, Chart 2 indicates that whenever improving margins support the DM profit cycle, thereby resulting in upside risk to investment spending, it also tends to lead the EM investment cycle higher. At the current juncture, the drivers behind higher DM margins suggest that the EM investment cycle is about to inflect higher after several years of trending lower.

Chart 2: … while EM growth should benefit from a broadening investment cycle later in 2026



Third, global trade has not only dodged the tariff bullet in so far as both EM and DM export growth has held steady. Leading trade indicators are indicating EM export acceleration over the coming months. This is partly a result of trade rerouting with the aim of lowering tariff costs. But it also reflects declining trade policy uncertainty as well as robust DM growth demand.

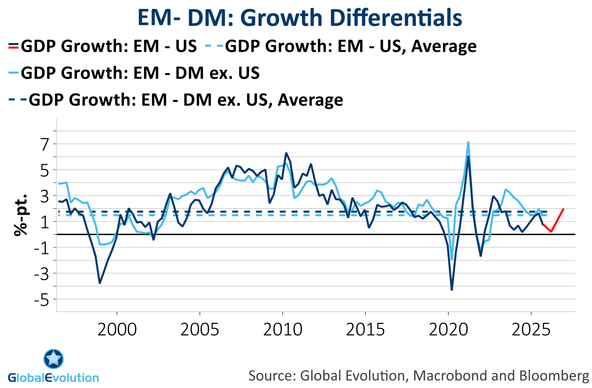
Lastly, loose financial conditions and the lagged impact of the rate cutting cycle in EM as well as DM are supporting growth, adding to the upside risks to global GDP growth in 2026.

Shifting balance of power

From an EM perspective, it does not only matter what overall global GDP growth is doing in 2026. The composition of growth matters, as well. Here, 2026 will look somewhat different relative to 2025. For much of last year, the gap between EM and US growth moved in EM's favour (chart 3). Beyond the pure growth aspect, this also played in the hands of EM's as it was a key explanation behind the US Dollars descent and therefore a key contributor to easing monetary conditions.

In 2026, the picture looks more fractured. Primarily due to the strong fiscal impulse out of the US in the first part of this year and China's fiscal impulse kicking in later in the year, we expect the growth gap between EM and the US tighten in the beginning of 2026. In the second half, however, the US fiscal impulse will fade somewhat and the growth gap between EM and DM should move in EM's favour, as highlighted by the red line in Chart 3. The changing trajectory has important implications for monetary conditions in 2026.

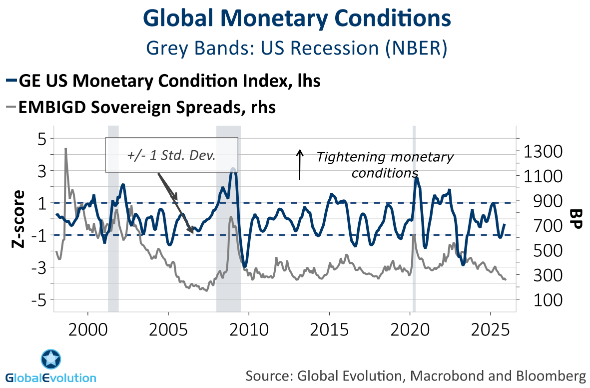
Chart 3: EM-DM growth gap - a year of two halves



Besides the growth compositions, the monetary backdrop differs from last year. Last year, slowing inflation allowed for central bank cuts across EM and DM, contributing to substantial USD weakness. Monetary conditions eased meaningfully, as our monetary conditions index (chart 4) illustrates.

But as so often in the world of economics and finance, there is no such thing as free lunch. The flipside of a surprisingly resilient global economy are moderating monetary tailwinds in 2026. The global rate-cutting cycle has already slowed substantially as both EM and DM inflation seem to level off above most central banks' targets. Crucially, we believe the world's most important central bank, the Fed, to potentially cut less than expected by market participants in 2026. In addition, US exceptionalism might face a bit of a revival in the beginning of 2026, causing the Greenback to recover some ground early in the year. Dollar strength in itself adds to the net-tightening of monetary conditions in 2026.

Chart 4: Monetary conditions as easy as they get



The upshot here is that the balance of power between fiscal and monetary stimulus is shifting away from the monetary side and towards fiscal policy. From a growth perspective, this might not make a big deal. However, from a market perspective, monetary stimulus is the preferred option as fiscal stimulus can have quite detrimental effects on the balance between real growth and inflation.

The main scenario here is one of sideways inflation dynamics. But amid the shifting balance of power between fiscal and monetary stimulus, it might not come as surprise that the biggest downside risk arises from stagflation. If strong productivity growth fails to extend into 2026, the fiscal impulse collides with supply constraints in the labour market could quickly result in accelerating wage growth. Inflation and interest rates would break out of recent ranges, causing monetary conditions to tighten. Such an end-cycle boom scenario would ultimately result in a bust, causing the business cycle to roll over. Due to the substantial amount of DM fiscal stimulus already in the pipeline (see above), such a stagflationary boom/bust tail risk scenario has a higher probability than an outright disinflationary recession, in our view.

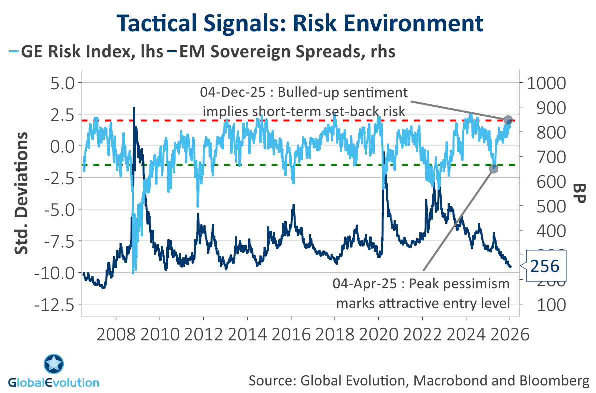
The market cycle: Not so fast

In the grand scheme things, the economic outlook for 2026 seems like a continuation of last year's trajectory. The business cycle rumbles on and could even accelerate in the near-term. That said, the implication of a changing growth and stimulus composition is that the market cycle is set to slow. Further, it is our belief its overall trajectory might differ somewhat in the first half of 2026 as compared to much of last year. Here's why.

On the one hand, resilient growth and sound fundamentals should keep EM credit spreads tight, safeguarding solid returns for the whole year. However, a growth balance shifting in favour of DM in the first half of 2026 and reduced monetary easing implies a trickier macro backdrop. Although these headwinds are set to abate in the second half of 2026 as the EM-DM growth gap re-widens, it should result in lower returns this year compared to 2025. Granted, fiscal stimulus might compensate for more moderating monetary tailwinds from a growth perspective. But fiscal stimulus also deteriorates the trade-off between growth and inflation, which is why crowding out is a real risk.

Secondly, after strong EMD returns in 2025, sentiment appears stretched. In fact, the situation today appears like the exact opposite of the skepticism towards the asset class dominating 12 months ago. Heading into 2025, very few investors wanted to touch EMD due to the regime shift in Washington. 1 year into Trump's second presidential period, everyone seems to have fallen in love with the asset class. Consequently, the bar for positive surprises is much higher than a year ago. Together with lofty valuations and reduced monetary easing this results in elevated setback risks over the tactical horizon – both in the shape of EMFX depreciation and EM spread widening (see chart 5). Hence, the market cycle could turn out to be more vulnerable in the near-term than the business cycle resilience would suggest.

Chart 5: Bulled-up sentiment implies near-term setback risk



Amid sound fundamentals and business cycle resilience, the tactical stumbling blocks mentioned above don't suffice to derail the market cycle, ultimately leading to attractive entry points compared to today's levels. Nevertheless, investors should brace for a wobbly start to 2026 and more moderate overall returns in 2026 as compared to last year. Be prepared for more bouts of volatility, especially early into the year. Consequently, we enter 2026 with a cautious stance on overall EMD risk exposure.

As the market cycle should prove less stable than the business cycle, it almost goes without saying that EMD asset allocation will not be a one-way street in 2026. We expect the trajectory of EM FX to largely resemble the trajectory of the EM-DM growth differential. Contrary to the current consensus, this means that EM FX should face headwinds at the beginning of 2026. The market's pricing of Fed's rate path implies two rate cuts this year, which seems out of sync with a robust growth outlook and sticky inflation. Hence, the cross-Atlantic interest rate differential should move in favour of the Dollar over the coming months. Lastly, elevated sentiment readings shown in chart 5 normally also preempt EM FX depreciation risk. Contrary to 2025, we are therefore entering this year with a preference for hard currency debt over local currency debt.

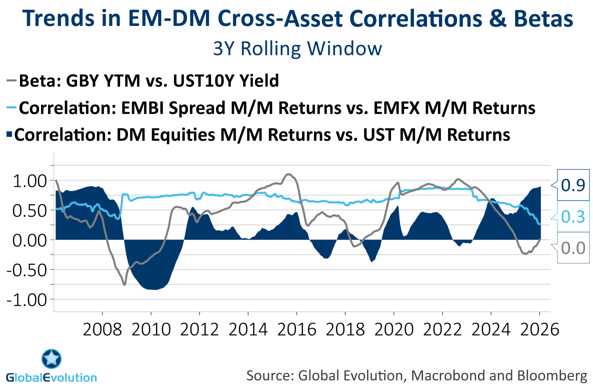
Asset allocation: Be nimble

As 2026 progresses, local currency debt should regain the upper hand in terms of relative performance. The EM – DM growth differential should widen again, supporting EM currencies. US fiscal stimulus will fade, while China is likely to ramp up its stimulus efforts amid a dearth of domestic demand. In addition, Fed rate cutting probabilities are set to increase anew in H2 as the inflationary impact of tariffs is fading and growth slows. In addition, EM currency exposure still is the preferred way to benefit from EM's macro outperformance over recent years. Namely, the structural shifts towards higher inflation, higher geopolitical uncertainty as well as higher fiscal deficits are all DM-centric in nature. EM's outperformance within these areas should continue to benefit EM FX, in particular, improving the risk-reward of local currency EMD (for more details, see here).

An important consequence of the structural shifts mentioned above is that market cycles have become shorter, emphasizing the importance of an active asset allocation approach to EMD investing. The good news is that EMD offers plenty of opportunities to diversify and to improve risk-adjusted returns through active allocation between main EMD segments. To a large part, this is reflecting a tightening inflation gap between EM and DM. Diversification opportunities within DM, on the other hand, are becoming scarce as the trade-off between growth and inflation is deteriorating in the DM universe. As chart 6 shows, the correlations between EMD risk premiums – credit risk and FX risk – has declined to the lowest levels since 2003. At the same time, the rolling beta between US yields and EM yields has declined to the lowest levels since 2009. Correlations between the main DM asset classes, on the other hand, have risen.

While we believe there may be high-single digit EMD returns for the whole year, the market cycle appears vulnerable in the short term. As opposed to 2025, where local currency debt outperformed almost throughout the year, the picture for this year looks much more nuanced. 2026 should turn out to be a brilliant example of the potential improvement of risk/returns emanating from an active asset allocation approach *within* EMD segments as well as *between* EMD and DM debt, described in-depth here. Be nimble.

Chart 6: EMD offers diversification alternatives amid rising correlations within DM bonds and equities



Appendix 1 – Relevant Indices – Definition and Performance

Index	Definition	2025	2024	2023	2022	2021
J.P. Morgan GBI-EM GD	is the **J.P. Morgan Government Bond Index for Emerging Markets Global Diversified (J.P. Morgan GBI EM GD), in the text also referred to as "local currency EMD"**: The index is comprehensive global local emerging markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. "EM FX Returns" mentioned in the text refers to the FX component of GBI EM GD total returns.	19.26	-2.38	12.70	-11.69	-8.75
J.P. Morgan EMBI GD	is the **J.P. Morgan EMBI Global Diversified Index (EMBI GD), in the text also referred to as "hard currency EMD":** The index is a market capitalization-weighted total return index of hard currency (USD, EUR, GBP) denominated Brady bonds, loans, Eurobonds and local market debt instruments traded in emerging markets. EM sovereign spreads mentioned in the text refer to the credit spreads of EMBI GD. "EM Sovereign Spread Returnk" mentioned in the text refers to the credit component of EMBI GD total returns.	14.30	6.54	11.09	-17.78	-1.80
S&P 500	is the 500 widely held stocks in US equity market. The index is market capitalization-weighted and includes stocks of industrial, financial, utility, and transportation companies.	16.39	23.31	24.23	-19.44	26.89
J.P. Morgan CEMBI BD	is the J.P. Morgan Corporate Emerging Market Bond Index Broad Diversified, **in the text also referred to as "corporate EMD",** which track USD denominated debt issued by emerging market corporations. CEMBI BD is a granular asset class with 1,331 bonds of 609 different issuers from 52 different countries. . "EM Corporate Spread Returns" mentioned in the text refers to the credit component of CEMBI BD total returns.	8.72	7.63	9.08	-12.26	0.91
US High Yield	is the Bloomberg US Corporate High Yield Bond Index, in the text also referred to as "US High Yield" or "US HY", measuring the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield I the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.	8.62	8.19	13.45	-11.19	5.28
G7 Government Bonds	Bloomberg Global G7 (DM Gov Debt) Total Return Index Value Unhedged USD measures investment grade debt from G7 countries (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States), in the text also referred to as "G7 Government Bond Returns".	5.59	-4.67	2.92	-18.06	-6.97
US Treasuries	is the Bloomberg US Treasury 7-10 Year Index, , in the text also referred to as "US Government Bond Returns", measuring USD-denominated, fixed-rate, nominal debt issued by the US Treasury with 7-9.999 years to maturity.	8.40	-0.70	3.58	-14.89	-3.07
Frontier Markets Composite, Gross of Fees	The strategy invests in both local and hard currency denominated debt and currency instruments from frontier markets globally, in the text also referred to as "Frontier Debt". To achieve the investment objective, Global Evolution's investment process focuses on investing early in countries where there is positive momentum towards improving fundamental underpinnings, where the political environment is stable or a catalyst for positive change is present, where the financial infrastructure supports external investment, and where well-compensated risk premium exists that represents good value. Strategies are well-diversified and designed to provide attractive risk-adjusted returns.	22.28	17.25	11.71	-7.52	11.78
Bloomberg Developed Markets Aggregate Total Return Index	Bloomberg Developed Markets Aggregate Total Return Index is a float market-cap-weighted equity benchmark that covers the top 99+% of market cap of the measured market, in the text also referred to as "Developed Market Bonds".	21.60	17.79	23.34	-18.05	21.20
MSCI World	The MSCI World Index is a free-float weighted equity index. It was developed with a base value of 100 as of December 31, 1969, in the text also referred to as "Developed Market Equities". MXWO includes developed world markets, and does not include emerging markets. MXWD includes both emerging and developed markets.	19.49	17.00	21.77	-19.46	20.14
MSCI World All Countries	The MSCI ACWI Index is a free-float weighted equity index. It was developed with a base value of 100 as of December 31 1987, in the text also referred to as "Global Equities". MXWD includes both emerging and developed world markets.	20.60	15.73	20.09	-19.80	16.80

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Frontier Blended Currency Sovereign Debt Composite

Composite Creation Date: December 31, 2016
Composite Inception Date: December 15, 2010

Investment Objective: The objective is to create an attractive return stream by utilizing a benchmark agnostic, conviction-based investment process that invests in frontier markets. The strategy invests in both local and hard currency denominated debt and currency instruments from frontier markets globally. To achieve the investment objective, Global Evolution's investment process focuses on investing early in countries where there is positive momentum towards improving fundamental underpinnings, where the political environment is stable or a catalyst for positive change is present, where the financial infrastructure supports external investment, and where well-compensated risk premium exists that represents good value. Strategies are well-diversified and designed to provide attractive risk-adjusted returns.

Benchmark: None. The Composite is presented without a benchmark as no relevant index is available that represents the asset class and composite objective.

Minimum Asset Level: USD 5 million.

Fee Description: The management fee schedule for segregated accounts is as follows: 0.85% for a mandate of $100 to $150mn, 0.80% for a mandate of $150 to $200mn, 0.775% for a mandate of $200 to $300mn, 0.75% for a mandate of $300 to $400mn, and 0.70% for a mandate of more than $400mn. 10% Performance fee is charged on positive performance subject to HWM. For the Frontier Markets UCITS Fund, which is included in the composite, the management fee and total expense ratio are 1.00% and 1.45% respectively. 10% Performance fee is charged on positive performance subject to HWM.

Illiquid securities
As of December 31, 2024, Funds within the composite held illiquid securities totaling less than 10% of the total assets in the composite. These securities were fair valued in compliance with our policies and procedures.

Derivatives Exposure:
Certain Global Evolution Funds in the composites may utilize derivative instruments to manage risk or to achieve timely and cost-effective implementation of the investment strategy. As of December 31, 2024, the number of accounts shown below held derivatives with the equivalent exposure as a percent of total net assets. The short derivative exposure is 0.00% and the long derivative exposure is 0.14%.

Year	Composite Return			Composite Dispersion* %	Accounts in Composite at End of Period	Assets in Composite		Annualized 3-Year Standard Deviation Net of Fees		Volatility** %	Sharpe Ratio**	Correlation Coefficient** %	Beta**	Tracking Error** %
	Gross of Fees %	Net of Fees %	Benchmark** %			USD million	% of Firm	Composite %	Benchmark					
2024	17.25	15.57	0.00	N/A	<5	3394	24.94	4.65	N/A	2.59	3.95	N/A	N/A	N/A
2023	11.71	10.78	N/A	N/A	<5	3144	32.82	4.57	N/A	4.29	1.40	N/A	N/A	N/A
2022	-7.52	-8.31	N/A	N/A	<5	2881	21.23	10.29	N/A	6.24	-1.37	N/A	N/A	N/A
2021	11.78	9.98	N/A	N/A	<5	3748	22.52	9.23	N/A	2.15	4.52	N/A	N/A	N/A
2020	3.10	2.07	N/A	N/A	<5	3307	21.12	9.34	N/A	6.02	0.03	N/A	N/A	N/A
2019	12.16	11.15	N/A	N/A	<5	3715	25.30	2.19	N/A	2.90	2.88	N/A	N/A	N/A
2018	-1.50	-2.54	N/A	N/A	<5	3100	32.45	2.62	N/A	2.86	-1.48	N/A	N/A	N/A
2017	17.22	15.06	N/A	N/A	<5	2621	41.78	2.95	N/A	1.89	7.43	N/A	N/A	N/A
2016	14.50	12.96	N/A	N/A	<5	1406	34.89	3.10	N/A	4.19	2.94	N/A	N/A	N/A
2015	0.26	-0.89	N/A	N/A	<5	1087	51.43	2.68	N/A	4.04	-0.28	N/A	N/A	N/A
2014	6.63	5.35	N/A	N/A	<5	1345	62.27	2.26	N/A	2.81	1.81	N/A	N/A	N/A
2013	5.01	3.81	N/A	N/A	<5	1059	52.50	2.40	N/A	2.69	1.30	N/A	N/A	N/A
2012	20.03	18.32	N/A	N/A	<5	452	39.13	N/A	N/A	2.61	6.80	N/A	N/A	N/A
2011	6.11	5.20	N/A	N/A	<5	124	15.22	N/A	N/A	3.29	1.49	N/A	N/A	N/A
2010***	0.59	0.54	N/A	N/A	<5	55	14.27	N/A	N/A	1.38	0.38	N/A	N/A	N/A

* Internal dispersion: A measure of the spread of the annual returns of individual Funds within a composite. The internal dispersion is calculated by the standard deviation equal weighted of Fund returns
** Additional risk and return statistics are shown as supplemental information to this compliant presentation. The risk measures are calculated net of fees. The risk-free rate of return is based on a 3-month USD Swap Curve. Benchmark returns are not applicable, as the composite does not have a benchmark. Please visit: https://www.globalevolutionfunds.com/fundrange for more information.
*** The period represents a partial calendar year as of the composite's inception date. Return and risk measures are cumulative for the period and has not been annualized.

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Valuation and returns are computed and stated in USD. Gross-of-fees returns are presented before management fees, performance fee, custody fees and administration fees, but after all trading costs, withholding taxes and direct expenses. Net-of-fees are presented before custody fees and administration fees, but after management fees, performance fee, all trading costs, withholding taxes and direct expenses. Performance is calculated based on mid-market prices, i.e., the average of bid and ask at 4pm CET or if none of these are available, last price. Calculations typically utilize foreign exchange rates at 4pm CET. Total returns of the benchmark are provided for each period depicted, expressed in USD. The composite performance may be presented for partial periods and be subject to final annual revision and recalculation where the result may be adjusted due to changes in management fees, performance fee, custody fees and administration fee. **Past performance does not guarantee future results.**
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