EMD's Second Chance?

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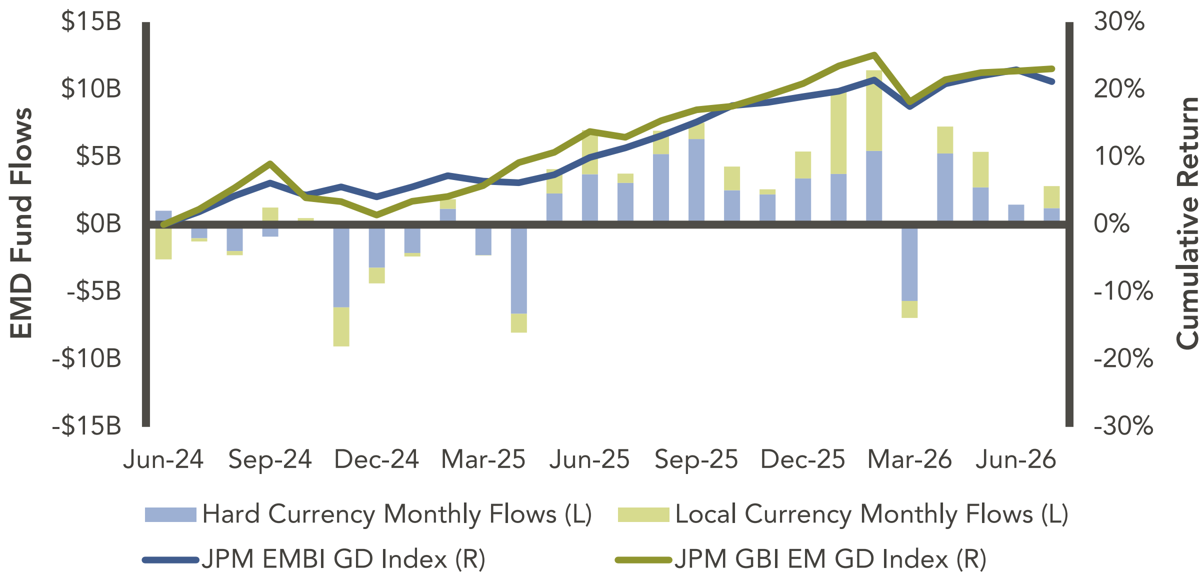
Improving fundamentals, strong recent performance, and renewed investor interest suggest that emerging market debt may deserve a fresh look despite its inherent risks



Source: eVestment, JP Morgan as of July 31, 2026

Over the last several years, emerging market debt (EMD) has faced several headwinds, with rising yields across other fixed income sectors narrowing the traditional yield advantage of the space. While many investors have overlooked or even exited EMD funds as result of these challenges, recent developments have driven some investors back to the asset class. For instance, many emerging market countries have implemented meaningful structural reforms, particularly following the economic challenges associated with the COVID-19 pandemic. These countries have made progress in reducing inflation, managing government spending, and strengthening monetary and fiscal policy frameworks. Additionally, the continued development of domestic investor bases for local-currency debt has improved countries' ability to withstand external shocks and reduced their reliance on foreign capital flows. Sovereign credit fundamentals have also improved, with credit upgrades gradually outpacing downgrades across the emerging market universe.

As some of the traditional risks associated with emerging market bond investing have moderated, performance has improved. To that point, EMD was the top-performing major fixed income asset class in 2025, and this momentum has continued so far this year. As of July 31, hard- and local-currency EMD indices have both returned roughly 1.8% on a year-to-date basis, respectively, outpacing high yield and core bonds over the same

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timeframe. Additionally, since the end of 2024, these indices have returned 10.1% and 13.1%, respectively. For context, the key difference between these indices is that local-currency debt exposes investors to both interest rate and currency movements, whereas hard-currency debt largely eliminates direct exposure to the issuing country's currency.

Improving fundamentals have also supported renewed capital flows into the asset class. According to EPFR, cumulative EMD fund inflows for 2026 surpassed $31 billion as of the end of July. It is important to note that the composition of those flows is evolving. Historically, hard-currency debt has dominated investor allocations, but more than 50% of EMD fund flows have been directed toward local-currency strategies in 2026. Several factors could be contributing to this dynamic, including a weaker U.S. dollar, attractive local interest rates, improving macroeconomic fundamentals, and growing confidence in the stability of emerging market currencies.

All of this being said, EMD remains a complex asset class that poses risks related to interest rates, currencies, sovereign credit quality, and capital flows. Foreign investment flows can also introduce volatility during periods of market stress and risk-off environments. Nevertheless, the recent outperformance of EMD indices has clearly not gone unnoticed by investors, and the improving fundamentals and diversification benefits offered by the asset class suggest that it may deserve a second chance.

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