Pulse on EM

UBS Asset Management | August 2026

Pulse on EM is UBS Asset Management's regular emerging-market insights series, featuring expert views on EM equities, debt and multi-asset opportunities, with on-the-ground perspectives from our global investment teams.

Highlights

– Emerging equity and fixed-income markets faced shifts in sentiment and uncertainty in July following strong performance in the second quarter.

– Signs of renewed conflict in the Middle East led to rises in oil prices and fears of further disruption of energy supplies.

– Uncertainty around the future path of monetary policy from the US Federal Reserve led to a sell-off in US duration and drove long-term Treasury yields to new highs.

– A sharp correction in AI-related technology stocks led emerging-market (EM) equities to underperform developed markets in July. The MSCI Emerging Markets Index returned -3.1% over the month having risen by more than 20% in the second quarter.

Active Multi-Asset: APAC team

Multi-asset portfolios navigated a more volatile APAC backdrop in July as markets rotated within the AI and technology complex, while geopolitical risks, oil prices and shifting US policy expectations continued to influence risk appetite.

In equities, the region continues to benefit from structural AI investment and selective earnings improvement, although strong prior performance in parts of the semiconductor supply chain argues for greater attention to valuation, positioning and liquidity. Within China, the opportunity set remains uneven: offshore equities have been supported by improving earnings discussion and broader benchmark exposure, while selected onshore segments continue to offer access to AI supply-chain themes.

Fixed income continued to provide useful diversification within APAC portfolios. Asia high yield and China credit remained relatively resilient, while China government bonds offered portfolio ballast given low inflation, softer domestic demand and relatively low correlation to global risk assets. However, low yields and limited standalone upside argue for continued selectivity rather than a more directional allocation.

Outlook and key risks

We continue to see Asia as a differentiated opportunity set within EM, supported by AI-related investment, selected earnings improvement and the diversification role of regional fixed income. At the same time, we are mindful of valuation, positioning and liquidity risks, particularly after strong performance in parts of the technology supply chain. This argues for diversified exposure, disciplined profit-taking and a focus on areas where fundamentals, liquidity and portfolio contribution remain aligned.

Key risks include renewed oil or geopolitical shocks, a stronger US dollar and a sharper reversal in AI-related positioning.

Emerging market equities

Returning risk appetite supports Q2 performance
EM equities recorded their strongest performance since 2009 in the second quarter, returning 23.3% in US dollar terms over the three months. This was supported by a resurgence in global risk appetite following the initial impact of the US-Iran conflict, as well as ongoing enthusiasm around the AI trade.

Among the best-performing companies over the quarter were Korea's SK Hynix and Samsung Electronics as well as Taiwan's MediaTek, all of which benefited from continued demand across the AI and semiconductor ecosystem.

The third quarter started on a negative note, with EM equities underperforming their developed-market counterparts due to a correction in AI-related stocks. This was caused by a mixture of concern around the sustainability of capital expenditure, financing conditions and increased competition from China. However, Latin American equities rebounded in July following two challenging months.

Why are we positive on EM equities?

We believe the medium-term outlook for EM equities is favourable, based on resilient earnings across most regions, ongoing AI-related investment and a broadening set of structural growth drivers. However, there are a number of potential headwinds, from uncertainty around global interest-rate expectations and US dollar strength to geopolitical turbulence.

- The AI investment cycle remains a central pillar of our positive outlook, particularly within North Asian technology markets. Companies across semiconductors, memory, advanced packaging and broader AI infrastructure remain well positioned to benefit from continued investment by global technology leaders and hyperscalers.

- China remains a key opportunity, in our view, supported by an increasingly differentiated opportunity set and attractive valuations in selected sectors. While softer domestic activity and property-related headwinds remain a challenge, we believe a K-shaped recovery is more likely, with technology, AI, advanced manufacturing and globally competitive industrial companies demonstrating greater resilience than traditional economy and consumption-related segments.

- India's long-term structural investment case also remains compelling to us. While growth is moderating from post-pandemic highs, policy support, infrastructure investment and a gradual recovery in private capex should continue to underpin economic activity.

Emerging market fixed income

The renewed conflict between the US and Iran widened the performance gap between countries that are oil importers and those which are net exporters in July. But EM assets exposed to higher oil prices have remained resilient, supported by favourable technicals and positive sentiment.

In EM local currency, carry has dominated this year, led by Latin American and high-yielding countries in central and eastern Europe, the Middle East and Africa. Conversely, EM duration has underperformed due to the continued pressure from higher oil prices and uncertainty around potential monetary tightening from the Fed. Markets have struggled to reconcile Fed chair Kevin Warsh's hawkish rhetoric on inflation with his deliberate omission of forward guidance.

EM hard-currency sovereign debt, as measured by JP Morgan's EMBI Global Diversified Index, was down 1.42% over the month of July. By credit spectrum, high yield was down 0.86% and outperformed investment grade, which ended the month down 2.04%. On a year-to-date basis, EM sovereign debt is up 1.84% with high-grade down 0.88% and high-yield up 4.47%.

Emerging market corporate debt, as measured by the CEMBI Diversified Index, was down 0.50% over the month. By credit spectrum, high yield was down 0.18% and outperformed investment grade, which ended the month down 0.74%. On a year-to-date basis, EM corporate debt is up 1.60% with high-grade up 0.18% and high-yield up 3.55%.

	Ticker	1-Month	YTD
Rates (yield net change)			
US 5-year	USGG5YR Index	+22bps	+72bps
US 10-year	USGG10YR Index	+27bps	+57bps
German 10-year	GDBR10 Index	+35bps	+35bps
UK 10-year	GUKG10 Index	+29bps	+57bps
Credit (total return)			
USD investment grade	LUACTRUU Index	-1.67%	-0.83%
EUR investment grade	LECPTREU Index	-0.97%	0.35%
US high yield	JUC0 Index	-0.28%	1.58%
European high yield	HEC0 Index	-0.34%	1.56%
EMD Sovereigns (USD)	JPEIDIVR Index	-1.42%	1.84%
EMD Corporates (USD)	JCMDCOMP Index	-0.50%	1.60%

Source: Bloomberg Finance LP

Key developments in bond markets

Indonesia hit the headlines after Bank Indonesia (BI) governor Perry Warjiyo's surprise resignation. While officials cited personal reasons for the decision, market participants speculate that the move may have occurred due to tension over the Finance Ministry's recent liquidity injections into state-owned banks, aimed at boosting credit growth, vs. BI's preference for tighter conditions. Interim governor and former BI deputy governor Destry Damayanti is seen as Warjiyo's most likely permanent replacement. Her appointment would probably be well received by market participants as she is thought to lean towards orthodox monetary policies.

South Africa's central bank surprised investors by keeping its main lending rate unchanged, arguing that policy remains restrictive enough to return inflation to target within two years. The rand weakened initially, while rates were modestly stronger. Our medium-term constructive view remains intact, supported by improving fiscal trends, political stability and potential future ratings upgrades. Higher oil prices remain the key risk.

Policymakers in **Kazakhstan** delivered another unexpected interest-rate cut, lowering the benchmark to 16.75%, with central bank governor Timur Suleimenov signalling scope for further easing as inflation cools and policy remains tight. The move follows June's cut of 100 basis points. Kazakhstan also scrapped mandatory FX sales by state firms, reflecting confidence in the stability of the Kazakh Tenge (KZT), while drone attacks on Black Sea tankers disrupted a key crude-oil pipeline and forced temporary output cuts. Despite higher oil prices, it is possible that KZT will underperform given stretched valuations.

Credit rating updates

Moody's upgraded **Argentina** to B3 from Caa1 with a positive outlook, marking its third sovereign ratings upgrade in less than three months. The agency cited lower default risk, stronger exports and rising foreign investment in energy and mining. This followed earlier upgrades by Fitch and S&P that have put Argentina firmly into the B-rating category.

S&P upgraded **Pakistan** to B from B-, citing stronger institutional stability and IMF-backed reforms that have restored macro stability, rebuilt FX reserves and eased fiscal as well as external pressures. Tax reforms and foreign inflows strengthened buffers, while Pakistan seeks further external financing, including a proposed USD 10 billion exchange-stabilization facility.

Fitch affirmed **Romania** at BBB- as expected, although this was only after authorities provided additional documentation. Romania is expected to defend its investment-grade ratings in the near term as the country continues to consolidate its fiscal position and takes the necessary steps to unlock key EU funding, despite having an interim government.

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