

Positioning for growth

2026 Outlook for Emerging Markets
Equities and Fixed Income



UBS

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Demystifying emerging markets

Emerging markets (EM) include countries that span the whole gamut of policy quality, growth dynamics and political cycles, leading to a diverse and dynamic investment universe. Many EM countries currently have stronger monetary credibility, healthier balance sheets and better inflation control than some developed markets. EM investment opportunities span multiple return drivers from domestic consumption and digitalization to sovereign credit reforms and local interest rate cycles.

Due to their heterogeneity, deep local markets and idiosyncratic risks, active management is essential for many emerging market investors to manage the broad array of opportunities and risks.

The resilience of emerging markets

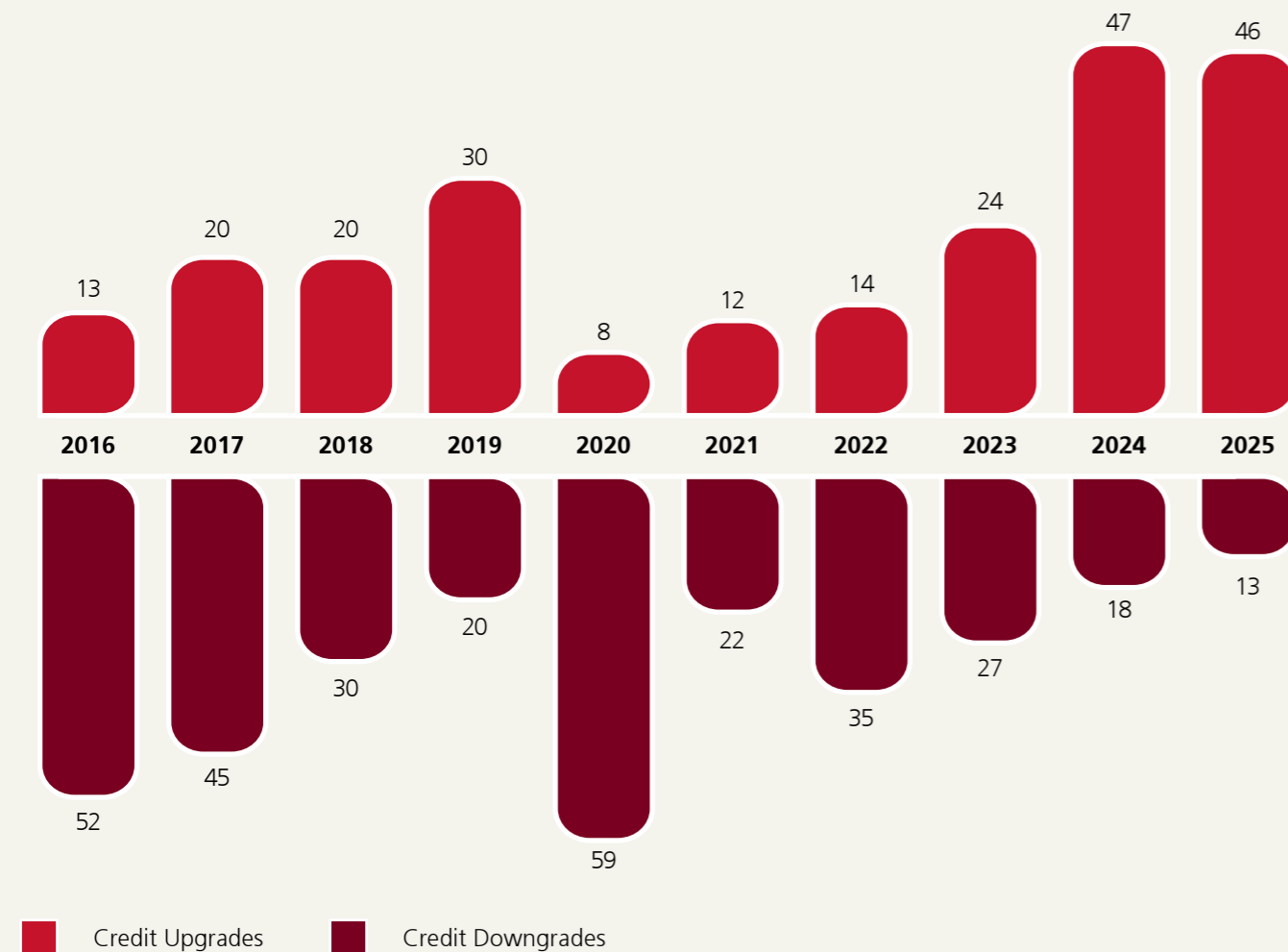
In its annual World Economic Outlook, the IMF highlighted the resilience of emerging markets, even devoting a chapter ([Good Policies \(and Good Luck\) Helped Emerging Economies Better Resist Shocks](#)). The article argues that improved policy frameworks have played a critical role in supporting macroeconomic stability, and that EM countries now appear to be more resilient to global shocks. EM countries have been able to navigate shocks due to stronger macro stability and central bank actions that lend them increased credibility. For EM debt, this foundation underpins sovereign credit strength, tighter spreads in many reforming countries and lower default risk. For equities, we believe stable macro conditions are supporting earnings visibility and growth sustainability.

A stable macroeconomic backdrop is likely a necessary, but not sufficient, condition for companies (in an EM country) to perform well. Our deep bench of seasoned portfolio managers and research analysts are able to develop a nuanced view of the complex emerging markets opportunity set, which is necessary given all of the variables in the EM universe.

Growth, inflation and interest rate dynamics in emerging markets

Growth in emerging markets GDP over the last few years has been stable at around approximately 4% growth despite slowdowns in China and US growth in the past year. EM countries are avoiding, as well as emerging from, default while fundamentals are improving rapidly as a result. Rating activity in emerging market debt has become more positive than negative since 2023, with ratings upgrades significantly exceeding downgrades as indicated below.

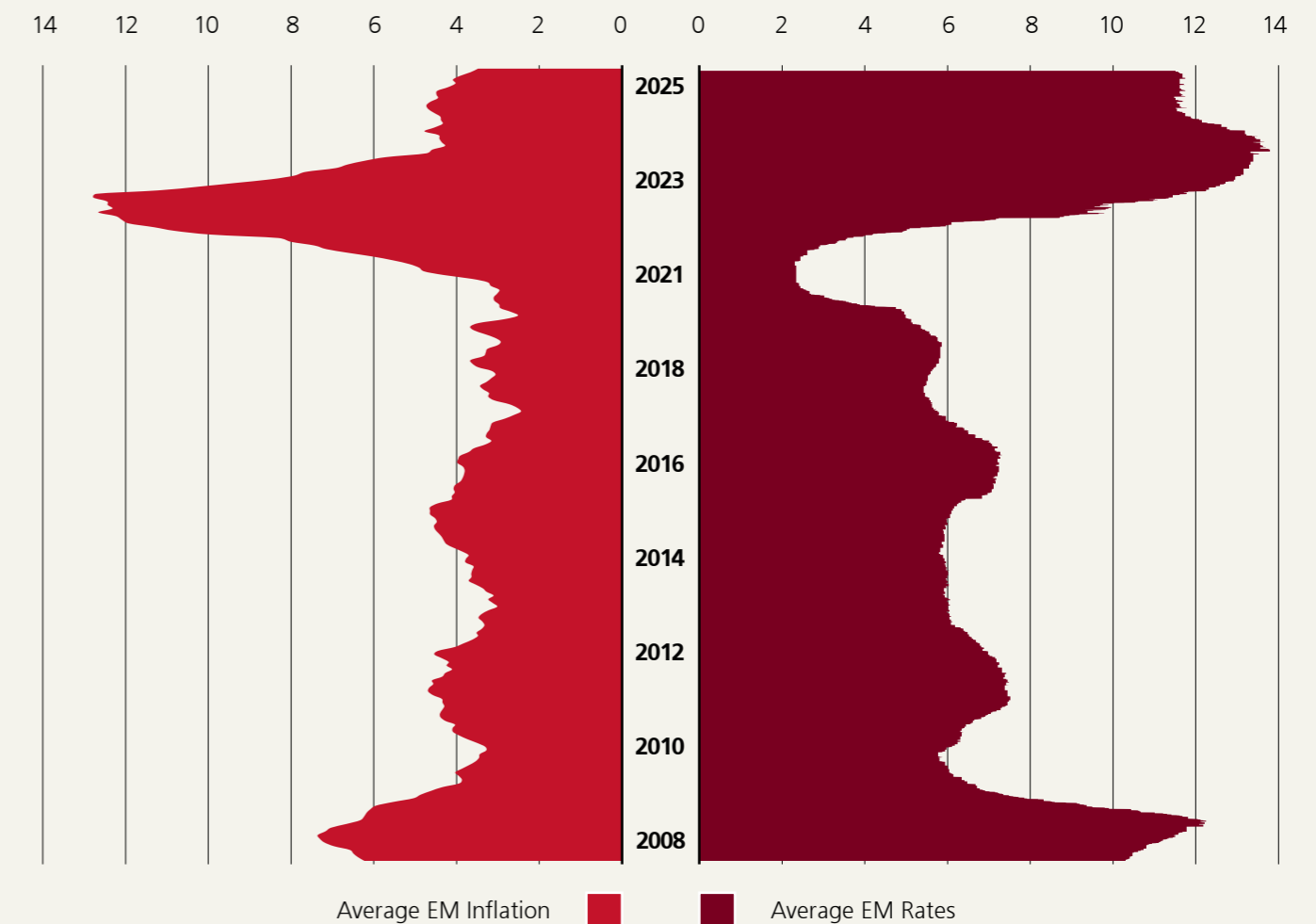
Figure 1: EM Sovereign upgrades vs. downgrades



Post the pandemic in 2020, EM central banks, in general have done a better job of controlling inflation by hiking interest rates as shown in the chart below. Real rates are generally high in EM, giving central banks the capacity to reduce rates aggressively to support domestic growth, if global growth were to slow down.

These dynamics also improve the backdrop for equity valuations, financing and corporate margins.

Figure 2: Emerging markets inflation has been contained by interest rate hikes



Source: UBS Asset Management, Macrobond, Bloomberg. Data as of December 2025.



Renewed flows into EM equity and debt

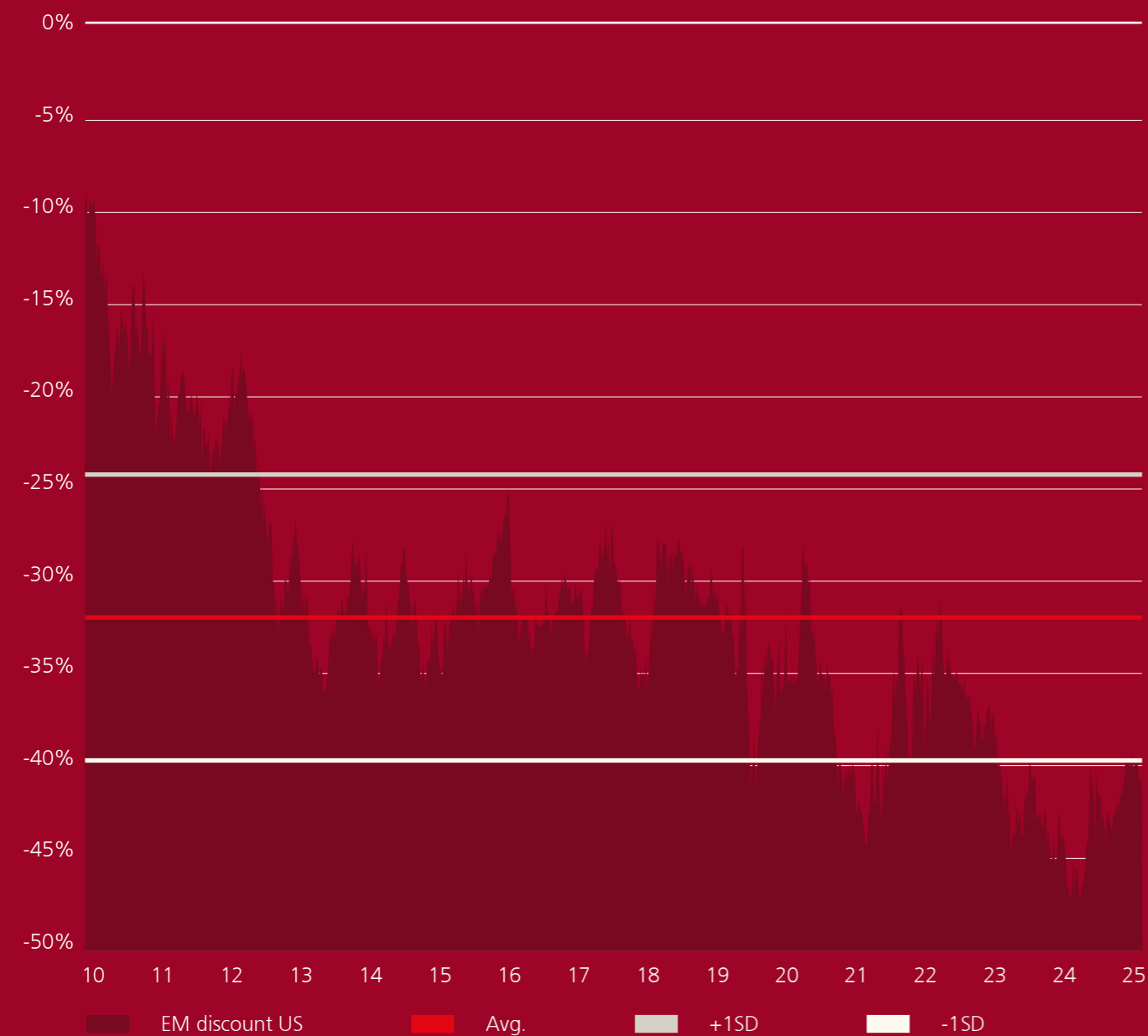
Data from JPMorgan showcases the turnaround in flows across EM equities and EM fixed income with FY2025 inflows of **USD 63 billion**.

While EM markets saw outflows in 2022, 2023 and 2024, the data from JPMorgan showcases the turnaround in flows across EM equities and EM fixed income with FY2025 inflows of USD 63 billion. We believe inflows into the asset class are probably at an early stage as investors in general have low allocations to EM given the previous outflows. We believe this rotation has room to run. And, these positive flows should support tighter credit spreads, higher equity valuations and a broader rerating for EM risk assets.

It appears that investors are increasingly shifting away from the US exceptionalism narrative, with a current less favorable view on the US dollar seen as a potential supportive factor for EM, reversing a previous headwind. Meanwhile, EM external debt net issuance for corporates is expected to be negative, which could create additional upward pressure on existing bond prices.

EM continues to have relatively attractive valuations

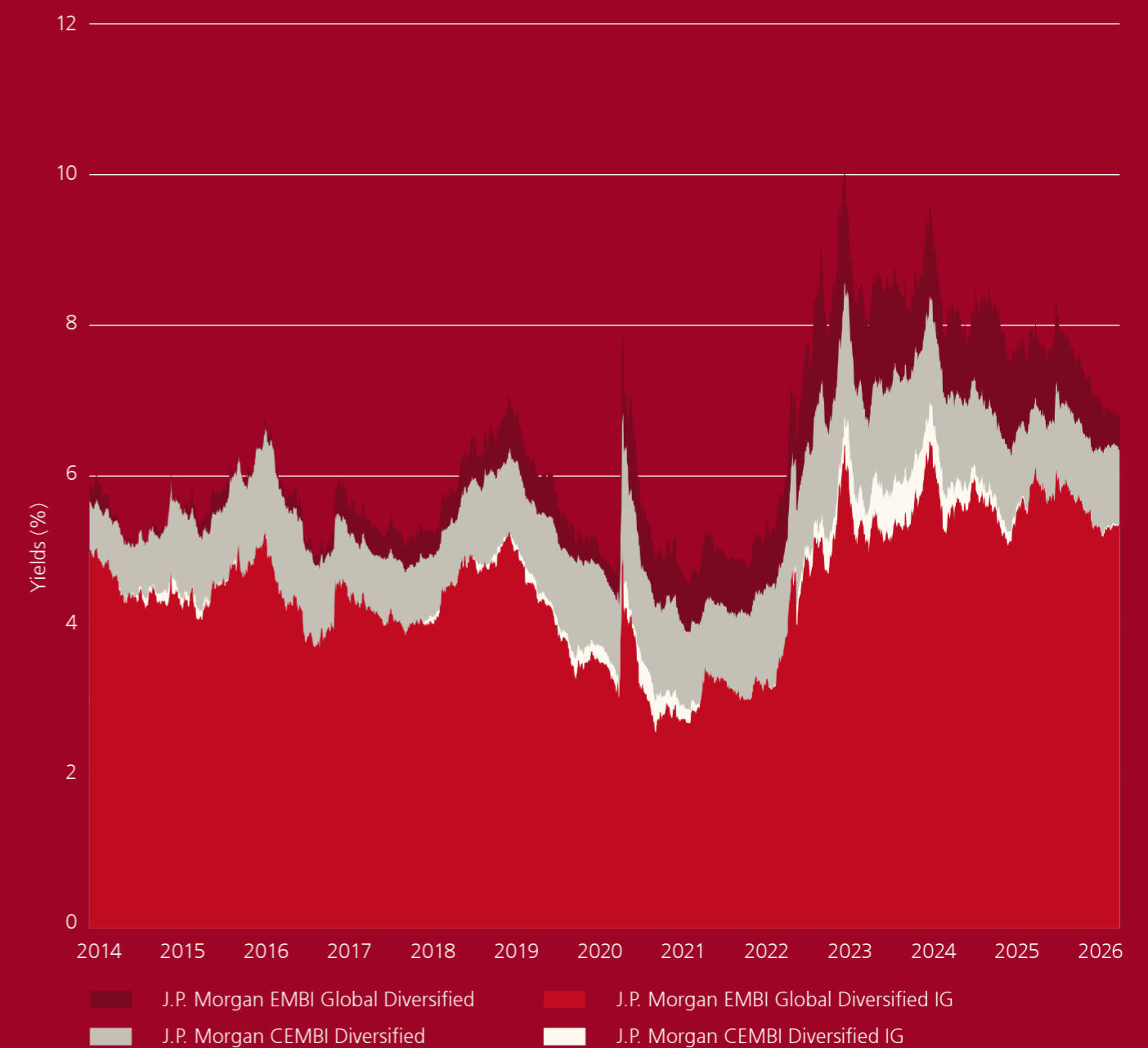
Figure 3: MSCI EM 12m forward PE - discount to MSCI US (%)



Source: Jorgan, IBES as of 11 December 2025. This does not constitute a guarantee by UBS Asset Management.

EM Debt is still attractive relative to historic valuations

Figure 4: EM Debt is still attractive relative to historic valuations



Source: Bloomberg Finance L.P., JP Morgan. Data as at December 2025.

EM debt 2026 outlook:

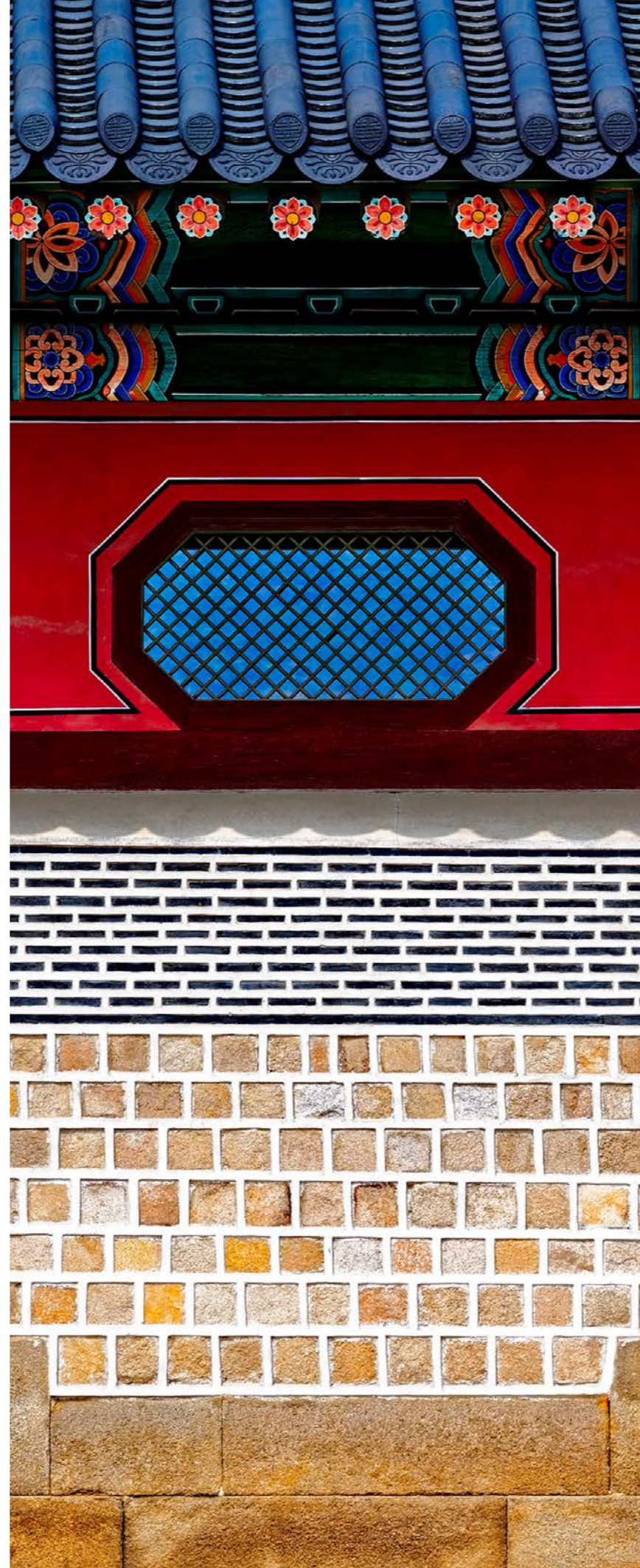
hard currency and local
currency opportunities

EM hard currency sovereign and corporate debt outperformed similarly rated US corporate debt in 2025, including during and after the tariff announcements, and that trend is expected to continue into 2026. Valuations in hard-currency debt for both sovereigns and corporates is attractive versus other comparable rated sectors in fixed income and yields are trading at the top end versus historical ranges.

If policy rates decline globally, as expected, it may provide EM debt with important duration tailwinds over the coming year. Many EM sovereigns have improved fiscal positions and reduced external vulnerabilities. We believe default rates have peaked for EM sovereigns, which should be a tailwind for performance. The outlook from credit rating agencies for emerging market debt has become more positive than negative, with ratings upgrades on an improving trajectory, and we have even seen a few 'rising stars' in sovereign markets. In addition, improving corporate balance sheets in a number of countries, as companies de-levered after COVID, offer potentially improved carry and spread compression. For local currency EM debt, the rate-inflation differential makes it attractive as well, as it offers strong real yields and potential for duration gains if rate cuts materialize, while foreign exchange conditions in some markets are also supportive.

Local EM markets are also less correlated with global credit markets, which can add to portfolio diversification.

For those seeking lower volatility investments, Emerging Market investment-grade corporates and sovereigns (dollar-denominated) present an appealing spread advantage over US investment-grade corporates and is also rated higher than US IG corporate debt.



EM equities 2026 outlook:

supportive materializing
global themes

Looking into 2026, we believe certain materializing global themes are increasing the attractiveness of emerging market equities.

In Asia, technology manufacturing regions in the north are well positioned to benefit from expected multi-year expansion in artificial intelligence and semiconductor investment, particularly in Korea and Taiwan. And China's push for technology self-sufficiency reflected in fiscal stimulus towards the AI supply chain, and a broad push to deploy AI should continue to support the sector. Despite a short-term cooling off, we expect long-term tailwinds for Indian equities.

Outside of Asia, given generally high interest rates in Latin American, companies stand to benefit from potential rate cuts and an attractive foreign exchange outlook. Countries such as Brazil and Mexico currently have among the highest real rates globally. Additionally, successful renegotiation of the United States-Mexico-Canada Agreement and near-shoring supply chains should be supportive in Mexico. Momentum in economic reforms, especially in the United Arab Emirates and Saudi Arabia, and inflows of foreign direct investment across the Middle East, as they seek to diversify their economies away from oil, should support companies in the region.

Meanwhile, in the US, market concentration continues to suggest a strong case for global diversification. The Magnificent Seven currently account for ~35% of the S&P 500 by market capitalization. And, about half of the index is either directly in the technology sector or loosely linked to it through business models and infrastructure.

China's innovation and technology self sufficiency



The recent developments in China have been significant, with the past decade-plus of capex and research and development spending now bearing fruit. The innovation we have seen domestically in both the manufacturing and services industries is increasingly incorporated in exports. While these innovations may benefit consumers and businesses that are end users, we expect other countries may retaliate to protect key domestic industries. While the macro economy and real estate woes are still weighing on consumption, we continue to find attractive valuations in selected parts of the universe and see further rerating potential for segments that had been weighed down previously by overly bearish sentiment. Concerns about domestic policies and geopolitics look priced in while the weak economy could keep policy mildly supportive or at the very least less restrictive.

The 15th Five Year Plan extends China's recent trend of focusing on supply-side improvements, particularly enhancing technological capabilities and achieving greater self-reliance. Consumption, on the other hand, appears to be a secondary priority with limited policy support. Economically, the real estate sector looks to be bottoming, especially in the top tier cities, though we expect recovery to remain polarized between top/low-tier cities, luxury/mass segments, and state/private-owned enterprises.

India's cyclical headwinds are balanced by longer-term growth expectation



In India, geopolitical risks appear to be calming. Trade negotiations with the US appear to be progressing. India's domestic growth momentum is coming off post-covid recovery highs and showing signs of a slowdown. In response, the government has stepped up support measures including income tax cuts, rate cuts, easing liquidity and Goods and Services Tax system reforms. We sense that the government is placing its focus on reviving the economy and mitigating any impact from the additional US tariffs. We are cautious for the near-term but remain structurally positive on India's long-term growth story, which is underpinned by an expanding middle class, improving infrastructure, rapid digitization and favourable demographics. This is a foundation for continued performance and the pause in demand this year may provide investors with a better entry point.

We are excited by our joint venture with HDFC Asset Management who is one of the top three asset managers in Indian equities and the sub-adviser on our Indian equity capability. There continues to be strong domestic demand for India equities, and it is a key area for active investing due to the tremendous breadth of opportunities across the market.

Brazil and Mexico
offer best EM exposure
to falling interest rates



Our base case for Mexico remains continued nearshoring, with a stable economic outlook. We believe the market remains attractive and offers defensive characteristics.

Brazil now faces more than 50% tariffs on some of its exports to the US, the highest rate of any country except India. The threat gave current president Lula a rare political win as he used Trump's aggressive posture to rally nationalist sentiment, shift the focus from domestic woes and frame himself as a defender of sovereignty. However, we maintain the view that countries such as Brazil and Turkey are more insulated given their trade with the US as a percent of GDP is low. The World Bank expects Brazil to post stronger growth than other LatAm countries in 2025, up 2.4% yoy. Brazil could potentially outperform if it enters into a cutting cycle, given its current high interest rates. This could support equity valuations and also encourage domestic investors to move into the equities market. Meanwhile, former president Bolsonaro's conviction and the upcoming 2026 presidential election elevate political uncertainty for the country. Nevertheless, strong external balances and the likely start of an easing cycle in Brazil and supportive flows will probably limit the degree of the sell-off.

1 Reforms in the Middle East

In the Middle East and North Africa, we are closely monitoring the impact that lower-for-longer oil prices, a potential Russia-Ukraine peace deal and US dollar peg might have on economies. While investor focus has rotated away from the Middle East recently, the Saudi's decision to open its markets to all foreign investors, removing eligibility requirements, is likely to encourage relocation of investment in the region and attract significant inflows into Saudi equities.

2 Artificial intelligence capex cycles and semiconductor (technology) demand

We believe that AI investment can continue to drive stocks, especially when funded by cash-rich companies such as the large US tech companies. However we are watching for signs of overheating, especially with circular vendor financing on the rise. In the longer-term, semiconductor growth should be well supported by trends such as 5G and high-performance computing (AI, internet of things, edge computing, etc.).

Why active management matters for EM investments?

With country divergence increasing, being able to separate reformers from non-reformers is becoming more important. This creates alpha opportunities in duration, curve positioning, FX and credit selection. In uncertain times, we believe actively managed investment strategies can provide advantages over passive investments in navigating liquidity, policy shifts and geopolitical risk. An active investment manager can focus on downside risk mitigation through proactive, forward-looking stress testing designed to identify and avoid adverse events in specific countries and industries before they occur. Further, active managers can generate alpha using scenario analysis to systematically examine a spectrum of potential future developments, rigorously assessing risk convexity.

A deep bench of seasoned portfolio managers and on-the-ground research analysts of a global professional investment manager is vital to developing the nuanced views that are required for navigating the complex emerging markets opportunity set.



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