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EM corporate debt: A misunderstood asset class

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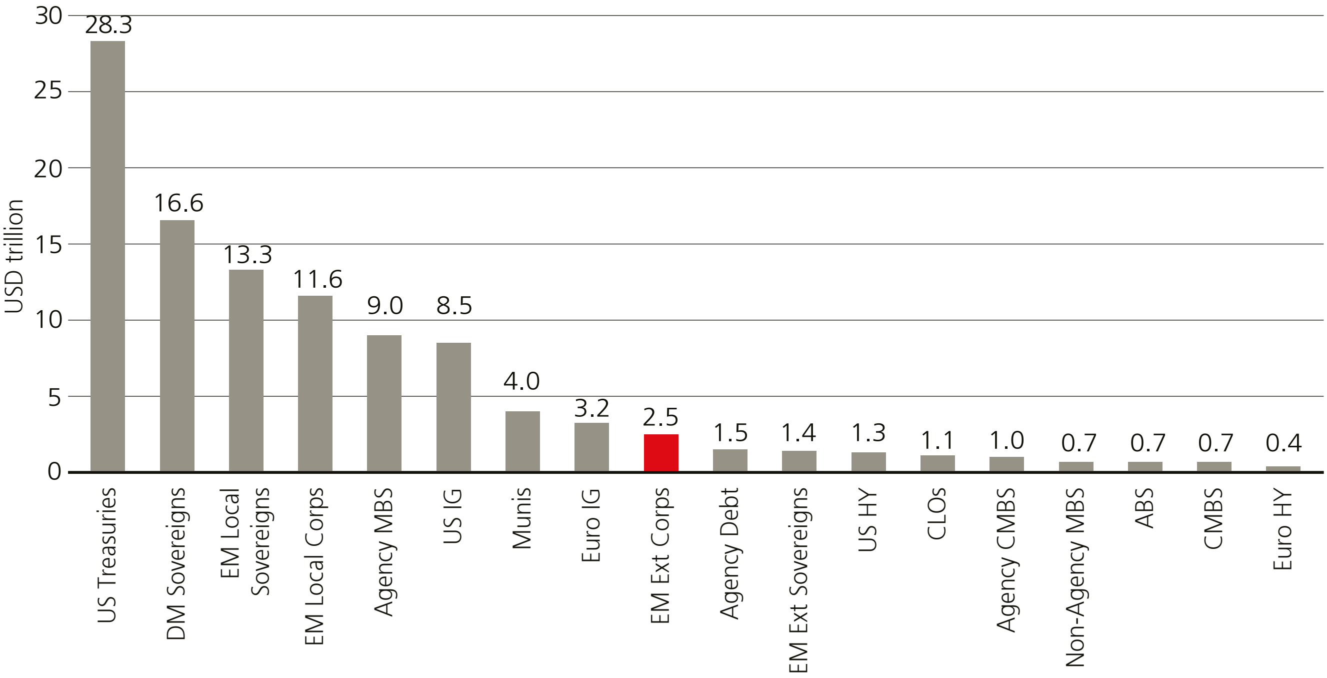
Emerging market corporate debt is a largely misunderstood asset class as general perceptions have not kept up with reality. Our Emerging Markets Fixed Income team looks at how the asset class has evolved over recent years and dispels some of the key myths surrounding it.

When it comes to investing in emerging markets (EM), there are long held assumptions and biases that often go unchallenged. And with defaults likely to rise in high-yield corporate credit markets over the next 12-18 months, investors will need to be clear-headed and sighted.

EM corporate debt, which has grown out of the shadows of the EM hard-currency sovereign bond market, has expanded significantly since the global financial crisis. From a starting base of approximately USD 500 billion in 2008, the asset class has grown five-fold to USD 2.5 trillion and is between euro investment grade and US agency debt in terms of market size.

Figure 1: EM corporate external bonds are a sizeable asset class



Source: JP Morgan, end of 2024

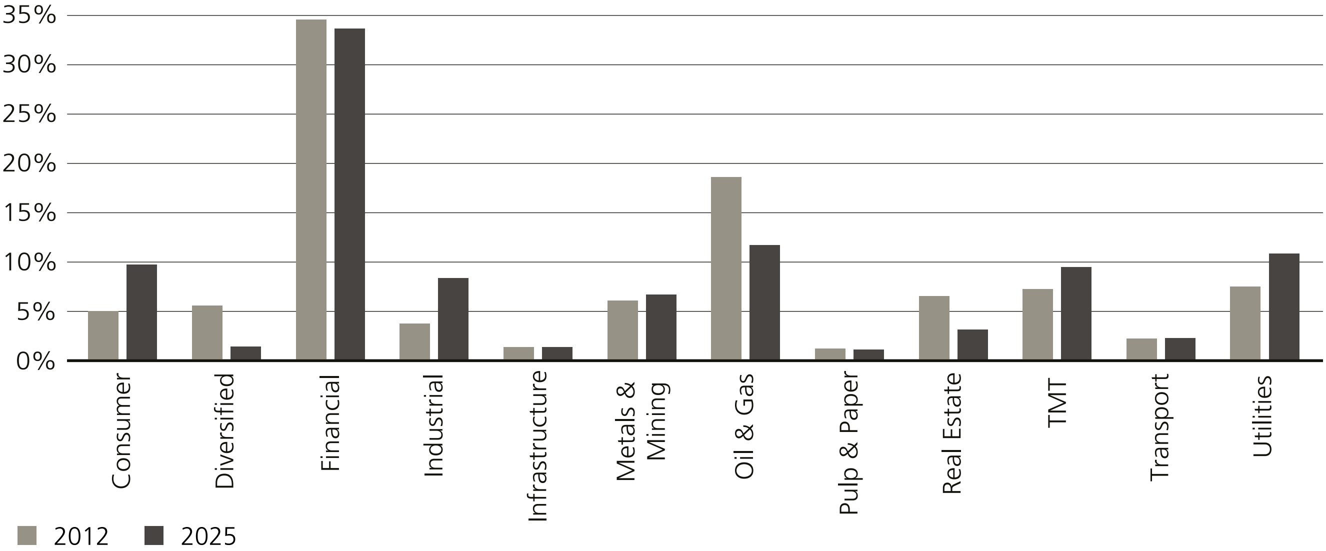
Strong fundamentals, attractive valuation and improving secondary market trading volumes have all led to a broadening of the investor base. However, many investors still incorrectly ascribe certain weak market dynamics, factors and considerations to an asset class that has clearly evolved. Below we tackle these myths head on.

High quality?

True. Almost 60% of the debt issued by emerging market companies in the JPMorgan Corporate Emerging Markets Bond Index is rated investment grade, validating fundamental improvements and refuting historical assumptions of being a niche lower-rated market. Investment grade rated EM companies have been on an improving ratings trajectory over the past decade and are now rated higher than US investment-grade companies as per Bank of America data. Indeed, recent spread data shows EM IG corporates moving more in line with their developed market US investment-grade peers and that is also reflected in the correlation between the two asset classes.

Financial and oil and gas sectors have traditionally made up a large proportion of the benchmark. However, as the asset class has matured the concentration risk from these sectors has been mitigated by increased weightings of consumer, industrial, TMT (Technology, Media and Telecom) and utilities sectors.

Figure 2: Outstanding EM hard-currency corporate debt by sector

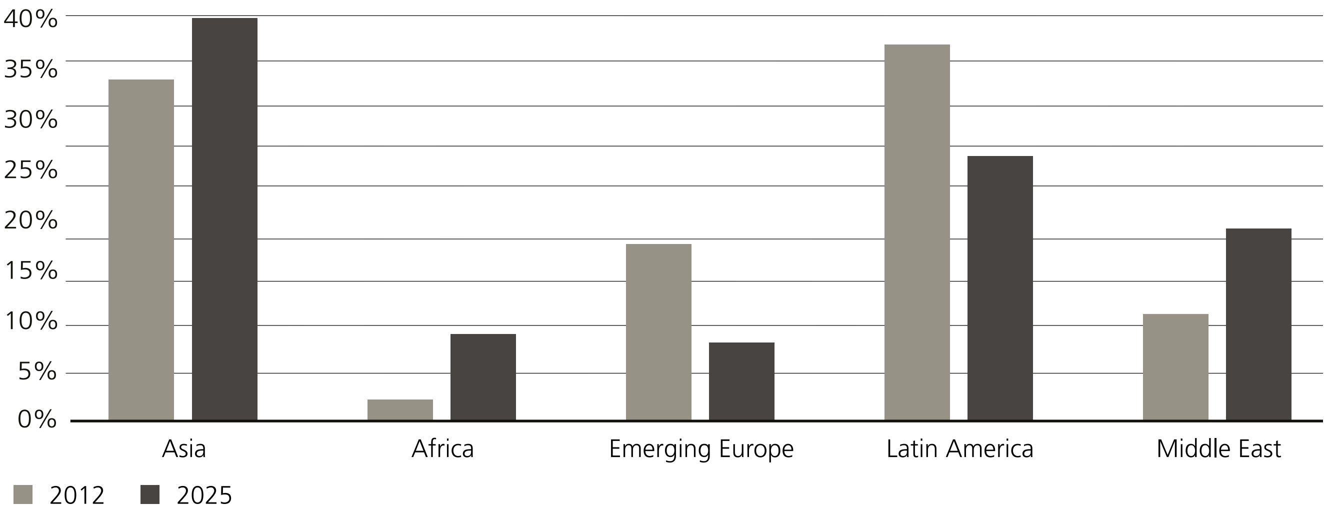


Source: JP Morgan 2025 data as of 31 December 2025

Emerging economies including smaller, less developed frontier countries have on average grown by more than 4% over the past decade and companies domiciled in these countries have generally diversified their funding sources by tapping into the hard-currency corporate debt markets. In terms of the regional breakdown, issuers from Asia have grown in prominence the most with Asian corporates now accounting for over a third of the total debt stock in the JPMorgan Corporate Emerging Markets Bond Index.

This is perhaps unsurprising given the region's relatively strong economic growth over the period from 2012 onwards. The increased issuance from companies in Africa and the Middle East nearly matches the reduction in share of issuance from Latin American companies. Development and growth of domestic capital markets within emerging Europe has led to local currency bonds and bank credit replacing issuance of hard-currency US dollar corporate debt.

Figure 3: EM external corporate debt issuers by region

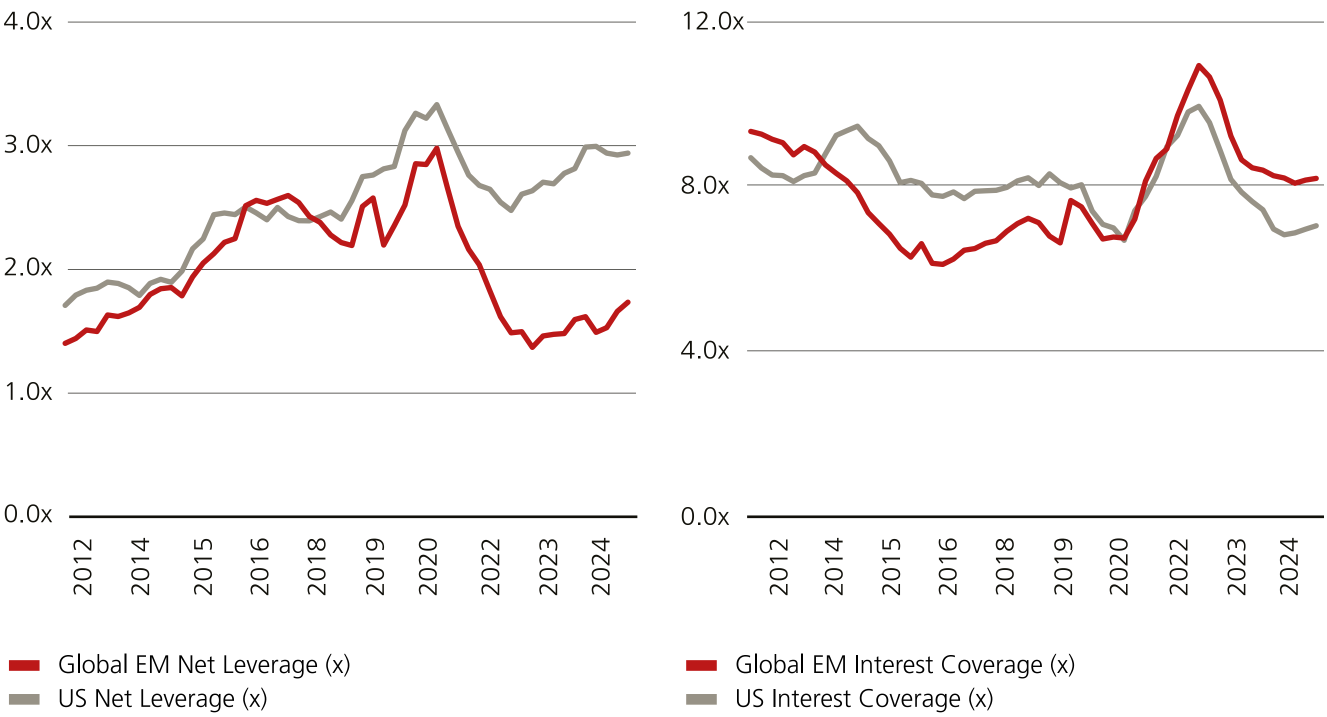


Source: JP Morgan 2025 data as of 31 December 2025

Strong fundamentals?

True. Net leverage for the asset class has gone from 1.4x in 2012, to a peak of almost 3x which was largely driven by idiosyncratic events in Latin America in 2015-2016 and the pandemic in 2020. Net leverage for EM corporates has now settled back to 1.7x at the end of June 2025 with emerging market investment-grade corporates even lower at 1.4x. A reduction in global interest rates will, for some emerging market issuers especially those rated sub-investment grade, likely reduce refinancing challenges thereby further supporting the fundamentals.

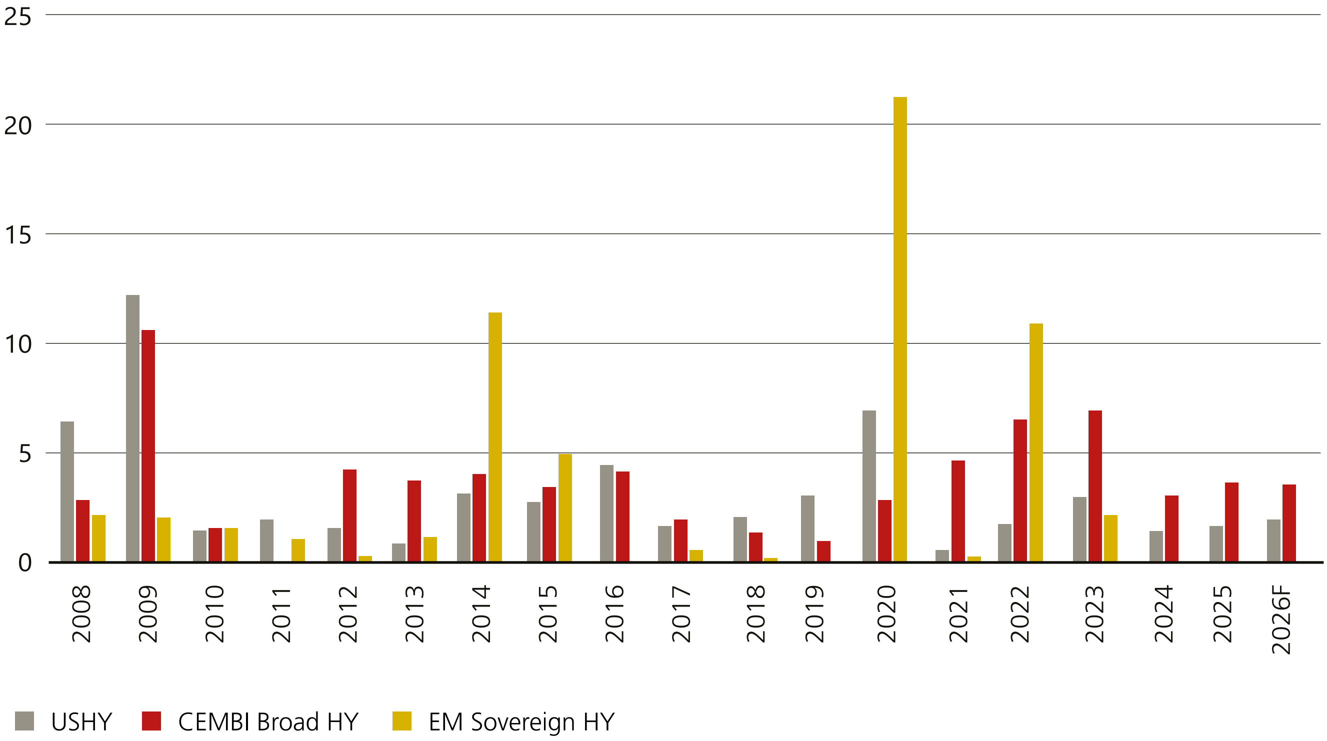
Figure 4: Lower leverage and better interest coverage than US peers



Source: Bank of America, June 2025

Gross margins for EM corporates have been stable in the mid to high-20% range and interest-coverage ratios are now stronger than US peers as shown above. Default expectations have come off the elevated levels seen in the 2021 – 2023 period, which was dominated by idiosyncratic stories such as China property and the Russia-Ukraine war, and are now more in line with long-run historical rates as indicated below.

Figure 5: Default rates across US High Yield and EM High Yield



Source: JPMorgan as at end January 2026

Several companies in Brazil and in other emerging markets have demonstrated that sovereign ratings no longer act as a ceiling and that EM companies can indeed be rated higher than the sovereign. For example, the biggest paper and pulp producer in Latin America is a Brazilian company which has an investment grade rating that is above Brazil's sovereign rating which is sub-investment grade.

Furthermore, the asset class has even been robust even in cases of sovereign defaults. Take Argentina and Ukraine in 2020 and 2022, respectively. While corporate bonds sold off in line with the respective sovereign initially, the companies in these countries either avoided default or restructured with generally higher recovery rates when compared to their respective sovereigns. Additionally, almost half of the issuers in the EM hard currency sovereign bond markets are rated investment grade, which reduces the risk premium for particular industries and sectors domiciled in those countries.

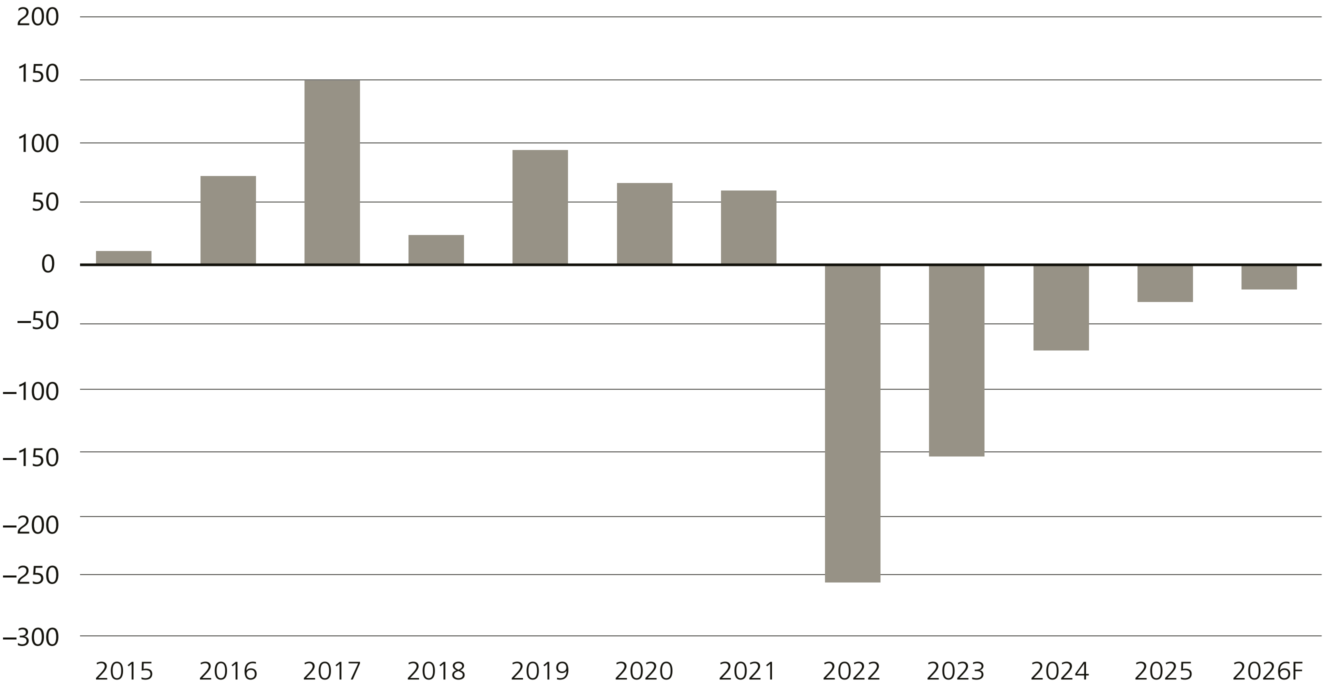
Attractive valuations?

True. Despite better fundamentals, EM corporate bonds tend to trade at a discount to their developed market peers. EM IG companies offer a spread pick up vs. US investment grade on an absolute spread, on a spread per turn of leverage and a spread per turn of duration basis. High-yield rated EM corporates offer an even greater spread pick-up over US high-yield.

Credit rating agencies have almost always been more conservative with their ratings for EM corporates which suggests that adjusted for the overabundance of caution from ratings agencies, the spread differential is even more favourable. EM corporates have been penalized on most metrics for simply being in the wrong post code.

In addition to appealing valuations and lower default rates, technicals also have been favourable of late. For each of the years from 2022 onwards and including current forecasts for 2026, per JPMorgan data, bond issuance net of amortizations, coupon payments and corporate actions has been negative, thereby creating an upward bias on existing bond prices.

Figure 6: Negative bond issuance for EM Corporates



Source: JPMorgan, December 2025

Improving liquidity?

True. It used to be the case that once a bond issued by an EM corporate was purchased it had to be held to maturity as the secondary market did not have much depth or in some cases the market simply did not exist. As the market and investor base has matured, trading volume for EM corporate bonds, at USD 137 billion in the third quarter of 2025 per EMTA (Trade Association for Emerging Markets) data, has certainly improved but is still not at levels commensurate with the developed market. The rise of electronic trading platforms such as MarketAxess and TradeWeb which offer a diversified pool of liquidity is also helping to boost trading volumes.

Strong risk-adjusted returns?

True. The Sharpe ratio, which describes how much excess return you receive for the volatility of holding a riskier asset, for EM corporates is significantly above comparable assets. The EM corporate universe, as represented by JPMorgan Corporate Emerging Markets Bond Index, has the highest Sharpe ratio over the past 20+ years when compared to a broad range of asset classes. The return profile is attractive but what makes it even more interesting is that it has been achieved with lower volatility especially for investment-grade rated EM corporates.

Asset Class	Return	Risk	Sharpe
EMD Corporate	5.99%	5.14%	1.16
EMD IG Corporate	5.12%	4.46%	1.15
EMD HY Corporate	8.26%	7.88%	1.05
EMD Sovereign	6.85%	8.25%	0.83
EMD Local	5.86%	10.51%	0.56
EMD Local FX-Hedged	3.86%	3.58%	1.08
US IG	4.49%	6.08%	0.74
US HY	7.61%	7.54%	1.01
S&P-500	12.16%	17.15%	0.71
MSCI World	8.81%	16.91%	0.52
MSCI EM Equities	8.88%	20.45%	0.43
US Treasuries	2.87%	4.53%	0.63
Global Treasuries	2.63%	6.83%	0.38

Source: Bloomberg, UBS Asset Management. Data from January 2003 - December 2025
Bloomberg indices: EMD Corporates: JBCDCOMP Index, EMD IG Corporate: JBCDIGIG Index, EMD HY Corporate: JBCDNOIG Index, EMD Sovereign: JPEIDIVR Index, EMD Local: JGENVUUG Index, US IG: LUACTRUU Index, US HY: LF98TRUU Index, US Treasuries: LUATTRUU Index, Global Treasuries: LGTRTRUU Index, All indices are in US dollar terms.

True positives, but not without risks

Fundamentals for companies in emerging markets are robust with net leverage ratios at historic lows, strong profit margins, and healthy interest coverage ratios. Returns from the asset class have been attractive and current valuations appear to offer a good entry point.

Emerging economies already account for more than 60% of world GDP based on a purchasing power parity (PPP). The macroeconomic backdrop also seems benign: major central banks have either started or close to kicking off a rate-cutting cycle and additional Chinese stimulus cannot be ruled out. Inflation which has been a key issue earlier this decade seems to be trending lower across the world and that trend is even more pronounced in certain emerging markets. Low inflation in EM combined with high rates and strong currencies allows EM Central Banks to reduce rates which is supportive of growth. Current economic conditions as indicated by the purchasing managers indices (PMI) indicate expansion across regions which is likely to provide growth opportunities for emerging markets companies.

However when viewing EM investment opportunities, investors should judge credits on the underlying merits and not their post code. There are still idiosyncratic risks, like those in the high-yielding E&P (exploration and production) and China property sectors which is why it is prudent to invest with an active investment manager that has in-depth experience through the credit cycle. A deep bench of seasoned portfolio managers and research analysts is vital to developing a nuanced view of the emerging markets corporate opportunity set.

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