

The Allocation Shift

Emerging Market Debt in a Multipolar Credit System



Investment
Management

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A Structural Break in Portfolio Construction

For most of the past three decades, global fixed income portfolios have been constructed around a relatively stable framework: developed-market government bonds as the primary risk anchor, developed-market credit as the core income engine, and emerging market debt as a satellite allocation. We believe that framework is now being challenged at its foundations.

The shift is not cyclical. It reflects a structural divergence in fiscal dynamics, economic capacity and capital deployment. Across developed markets, persistent deficits, rising debt burdens and reduced policy flexibility are gradually eroding the reliability of traditional portfolio anchors. At the same time, capital is being redirected by forces largely independent of financial markets: energy transition, supply chain reconfiguration and technological competition. These forces are not evenly distributed. They are disproportionately concentrated in emerging markets, where investment is being deployed into infrastructure build-out, industrial capacity expansion, and resource extraction at scale. The consequence is a gradual but meaningful redistribution of economic relevance.

What has changed is not simply the opportunity set, but the underlying system in which portfolios operate. In a multipolar world, institutional investors' benchmarks are being reset with EMD becoming a core anchor of investors' fixed income portfolios.

A Market That Has Already Adjusted

Within this shifting landscape, emerging market corporate debt has undergone a transformation that is still underappreciated (figure 1). The asset class now exceeds USD 2.6 trillion and encompasses more than 700 issuers across 65 countries (source: JP Morgan). However, the defining feature of this evolution is not its scale, it is the improvement in credit quality and financial discipline that has accompanied its growth.

Leverage across both investment-grade and high-yield segments remains contained relative to developed-market peers. Maturity profiles have extended, funding sources have diversified and refinancing risk have declined. These are not incremental improvements, but a structural evolution in how EM corporates manage their balance sheets and access capital markets.

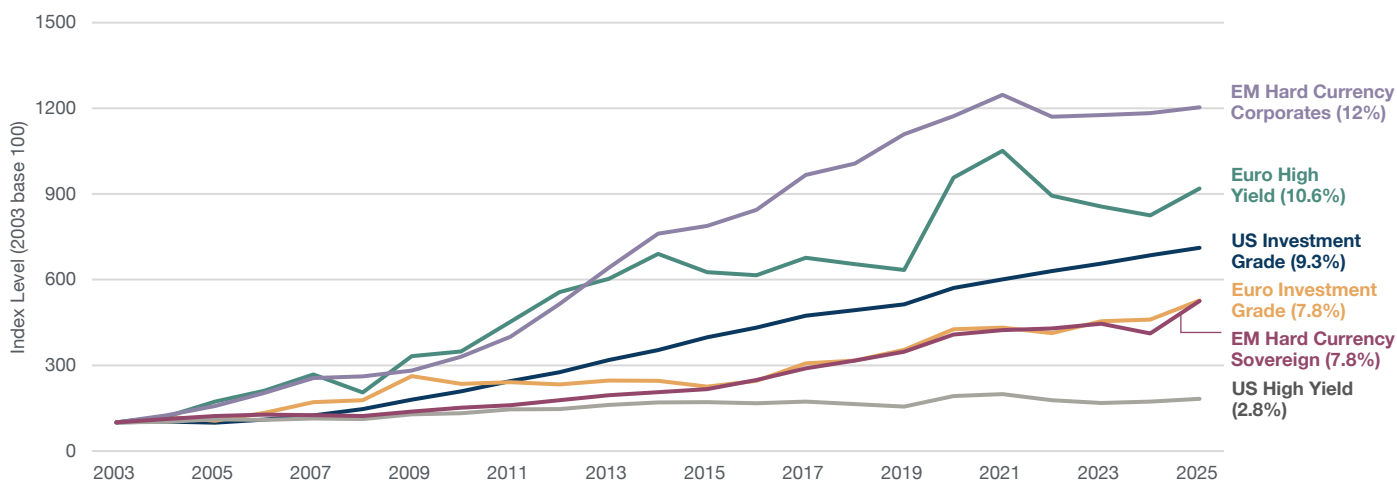
Default cycles corroborate this shift. Recent periods of below-average default rates in EM are less indicative of benign conditions than of greater issuer resilience and discipline (source: JP Morgan).

Yet valuation has not fully adjusted. Spreads continue to embed a persistent geographic premium. Even when controlling for rating and maturity, EM corporates typically offer excess yield relative to developed-market equivalents. In parts of the investment-grade universe, this persists despite comparable, and in some cases, stronger fundamental metrics.

The implication is not merely that value exists in EM, but that the repricing of EM credit risk remains incomplete.

Figure 1: From Niche to Core: The Structural Expansion of EM Corporate Credit

Asset class growth



EM corporates have been one of the fastest-growing segments of global credit, without a commensurate re-rating in spreads.

Data as of December 31, 2025. EM Hard Currency Corporates = The JPM Corporate Emerging Market Broad Index; EM Hard Currency Sovereign = The JPM Emerging Markets Bond Index; Euro High Yield = Bloomberg Pan-European High Yield (Euro) Index Value Unhedged USD; Euro Investment Grade = Bloomberg Pan European Aggregate Corporate Total Return Index Value Unhedged USD; US Investment Grade = The Bloomberg US Corporate Bond Index; US High Yield = The Bloomberg US Corporate High Yield Bond Index. See disclosures for index descriptions. Source: J.P. Morgan, Bloomberg.

The Persistence of a Perception Premium

The structural case for EM credit increasingly rests on a disconnect between fundamentals and perception.

Historically, EM credit carried a premium for weaker institutions, higher macroeconomic volatility and less developed capital markets. While dispersion remains, many of these structural constraints have moderated. Policy frameworks have strengthened, inflation targeting has improved and corporate governance has advanced (figures 2 and 4).

At the same time, developed-market credit has moved in the opposite direction: higher leverage, tighter spreads and reduced compensation for risk. The result is a misalignment. Investors are still often paid for geographic association rather than for actual credit risk.

For institutional allocators, this reframes the debate. The question is no longer whether EM is riskier. It is whether risk is being assessed and priced correctly across regions.

Multiple Engines of Return

A defining strength of emerging market debt is its internal breadth and diversity. Local-currency sovereigns are driven by domestic policy cycles and

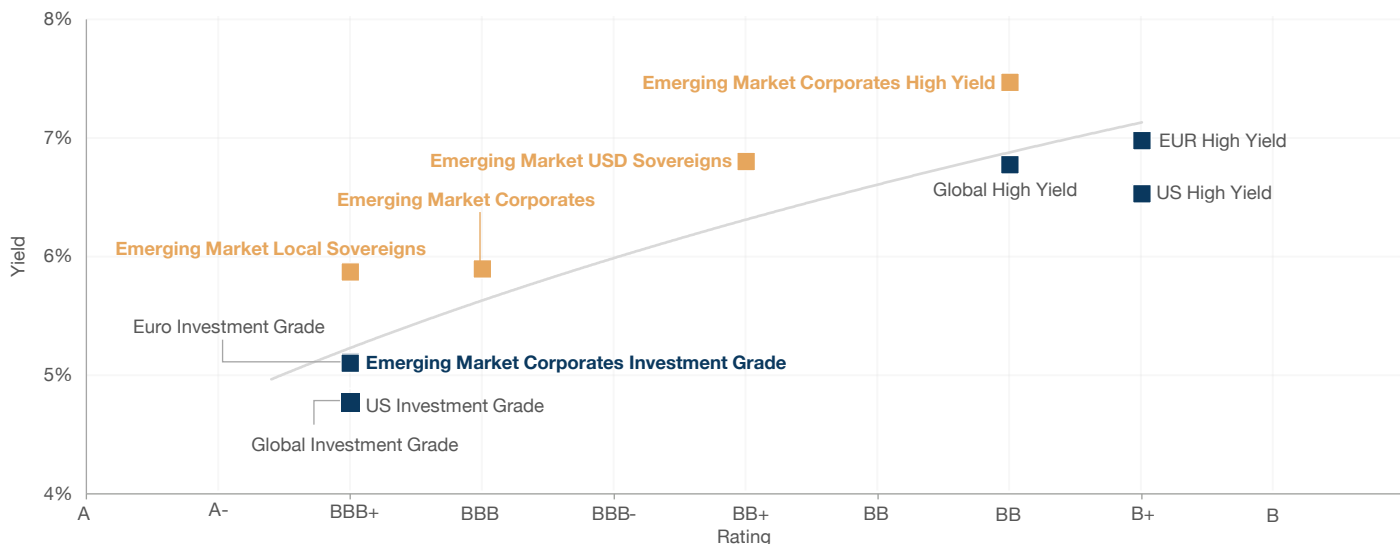
currency dynamics. Hard-currency sovereigns reflect external balance sheet and credit conditions that, in many cases, are further advanced in adjustment and repair. EM corporates offer exposure to a wide range of industries, across multiple geographies with differing economic cycles, and broadly benefit from solid bottom-up fundamentals including strong balance sheets and capital discipline.

These are not overlapping expressions of the same macro view. They are distinct sources of return, with different sensitivities to rates, inflation, economic growth and global liquidity conditions. In a multipolar system, where macro cycles are less synchronized, this internal diversification is not incidental. It is a structural and valuable advantage.

Against this backdrop, it is our view that EM corporates increasingly represent an essential core allocation, rather than an opportunistic trade. They combine, in most cases, strong fundamentals with a persistent spread premium, while providing exposure to sectors directly linked to long duration global capital deployment: energy infrastructure, natural resources, telecommunications and logistics. These sectors are not cyclical overlays; they are central to the current investment cycle, which increasingly resembles a heavy industrial cycle. In many cases, EM corporates are the entities executing the physical build-out of global economic transformation.

Figure 2: Yield vs Credit Quality Across Global Fixed Income

Yield vs rating



EM credit continues to deliver excess spread for comparable, or improving, credit quality.

Data as of December 31, 2025. Emerging Market Corporates = J.P. Morgan CEMBI Diversified Broad Index; Emerging Market Corporates High Yield = J.P. Morgan CEMBI Broad Diversified High Yield Index; Emerging Market Corporates Investment Grade = J.P. Morgan CEMBI Broad Diversified High Grade Index; Emerging Market Local Sovereigns = J.P. Morgan GBI-EM Global Diversified Index; Emerging Market USD Sovereigns = J.P. Morgan EMBI Global Diversified Index; EUR High Yield = ICE BofA Euro High Yield Index; Euro Investment Grade = ICE Bank of America Euro Investment Grade Index; Global Investment Grade = ICE Bank of America Global Investment Grade Index; Global Broad Markets Bonds = ICE BofA Global Broad Market Index; Global High Yield = ICE BofA Global High Yield Index; US Investment Grade = ICE Bank of America US Investment Grade Index; US High Yield = ICE BofA US High Yield Index. Source: Bloomberg.

From Yield Enhancement to Portfolio Efficiency

The case for EM debt is often framed primarily in terms of yield. The more relevant lens is portfolio efficiency. Empirical analysis shows that incorporating EM corporates into global investment-grade portfolios improves return per unit of volatility. Similar benefits are evident within high-yield allocations (figure 3).

This improvement is not a function of carry alone. It reflects the interaction of structural spread premium, differentiated economic exposure and lower correlation to developed-market credit cycles.

In practical terms, EM exposure has consistently shifted the efficient frontier outward (figure 2). In an environment characterized by compressed spreads and elevated duration risk, this is not marginal, it is consequential to portfolio construction.

Figure 3: Enhancing the Efficient Frontier with EM Corporate Credit

Adding EM IG and HY to developed market IG and HY mandates respectively improves return per unit volatility.

Based on 10 years of monthly returns, ending December 2025

DM IG + EM IG		
EM IG weight	Volatility-adjusted return ¹	Annualized return
0%	0.14	0.94
10%	0.20	1.34
20%	0.25	1.75
30%	0.29	2.16
40%	0.33	2.57
50%	0.36	2.97
60%	0.38	3.38
70%	0.40	3.79
80%	0.42	4.19
90%	0.44	4.60
100%	0.45	5.01

EU IG + EM IG		
EM IG weight	Volatility-adjusted return ¹	Annualized return
0%	0.22	2.12
10%	0.25	2.41
20%	0.27	2.70
30%	0.30	2.99
40%	0.33	3.28
50%	0.35	3.57
60%	0.37	3.85
70%	0.39	4.14
80%	0.41	4.43
90%	0.43	4.72
100%	0.45	5.01

Based on 10 years of monthly returns, ending December 2025

DM HY + EM HY		
EM IG weight	Volatility-adjusted return ¹	Annualized return
0%	0.76	6.06
10%	0.78	6.10
20%	0.79	6.15
30%	0.8	6.20
40%	0.81	6.24
50%	0.82	6.29
60%	0.82	6.34
70%	0.82	6.39
80%	0.82	6.43
90%	0.81	6.48
100%	0.80	6.53

EU HY + EM HY		
EM IG weight	Volatility-adjusted return ¹	Annualized return
0%	0.45	5.01
10%	0.48	5.16
20%	0.52	5.31
30%	0.56	5.47
40%	0.6	5.62
50%	0.63	5.77
60%	0.67	5.92
70%	0.71	6.07
80%	0.75	6.22
90%	0.78	6.38
100%	0.80	6.53

EM exposure has historically improved portfolio efficiency, not just income.

¹ Volatility-adjusted return = Annualized Return / Annualized Volatility.

DM IG = Bloomberg Global Aggregate - Developed Markets; EU IG = Bloomberg Pan European Aggregate Corporate Total Return Index Value Unhedged USD; EM IG = The JPM Corporate Emerging Market Broad Diversified Investment Grade Bond Index. Returns are unhedged, expressed in USD. For illustrative purposes only. Based on BLOOMBERG and JP MORGAN DATA and asset allocation percentages determined by MacKay Shields and/or New York Life Investment Management. The returns shown above do not represent the returns of any client portfolio or strategy actually managed by MacKay Shields and should not be construed as such. The returns shown are index-based and mathematically calculated based on the percentages shown; MacKay Shields' portfolios are actively managed and would vary from any applicable or benchmarked index. Therefore, the returns shown are not indicative of investment skill. Actual portfolios would be subject to fees and expenses. No fees or expenses were included in the results above. No representation is made as to the accuracy and completeness of information contained in this presentation that has been obtained from third parties. **It is not possible to invest directly in an index. Past performance is not indicative of future results.** Please see the disclosures and index descriptions at the end of this presentation. Data Source: JP Morgan, ICE BofA, Bloomberg.

Balance Sheets: The Underappreciated Shift

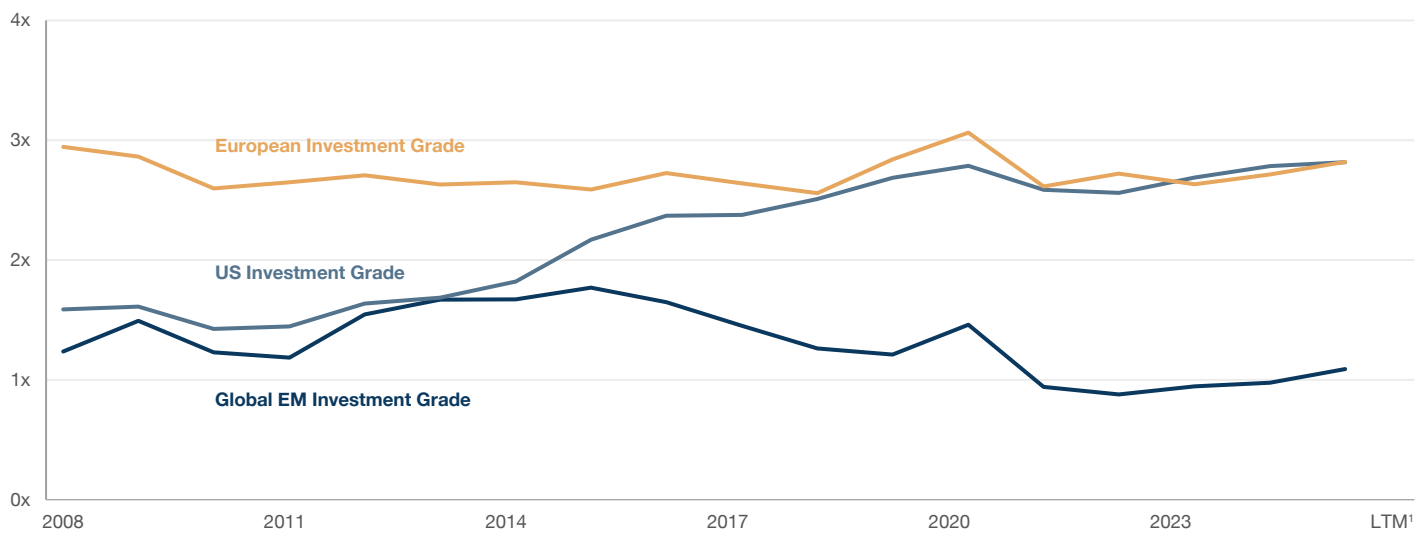
One of the more underappreciated developments in global credit is the divergence in balance sheet trajectories. Across EM corporates, leverage remains structurally lower than in many developed-market counterparts. Sovereign balance sheets, while heterogeneous, have also improved following a decade of adjustment, reform and more disciplined fiscal management.

By contrast, developed-market balance sheets have expanded, both at the sovereign and corporate level. This divergence is gradual but persistent, and increasingly relevant for long-term allocators. This divergence challenges the assumption that risk is inherently higher in emerging markets. Increasingly, risk is better understood through balance sheet structure and funding dynamics than through geography alone.

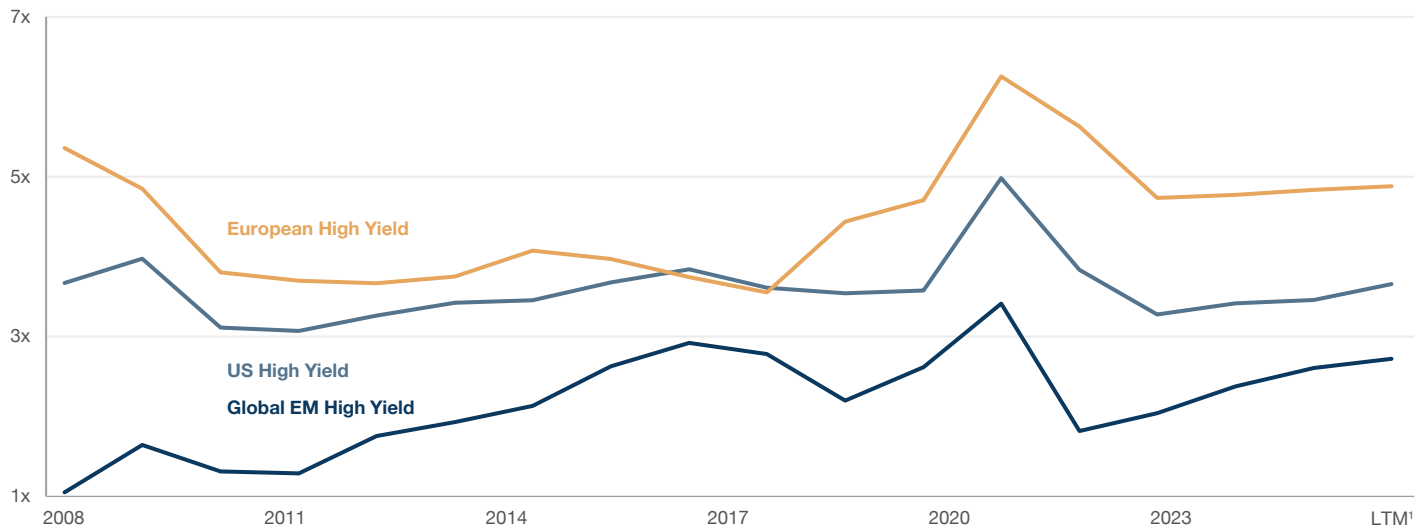
Figure 4: Leverage Discipline: EM vs Developed Market Corporates

Net leverage ratio | 1x

Emerging market vs developed market investment grade net leverage



Emerging market vs developed market high yield net leverage



Last 12 months ending June 30, 2025.

¹ LTM = Last 12 months.

Latest data point, as at end Q2 2025. Asset classes derived from proprietary classifications. Net leverage = (Debt – Cash) / EBITDA. Source: JP Morgan.

EM corporates now operate with structurally lower leverage than many developed-market peers.

The Allocation Gap

Despite these structural shifts, EM debt remains underrepresented in institutional portfolios. Benchmark compositions have evolved, and EM's share of global credit markets has increased meaningfully. Yet allocations remain structurally below what would be implied by economic importance, market size, fundamentals and return characteristics. This creates a gap between opportunity and allocation.

Historically, such gaps do not persist indefinitely. As fundamentals are in place, perceptions adjust and capital flows respond, repricing tends to follow. The timing is uncertain, but the direction is increasingly clear.

From Optional to Structural

The reconstruction of global fixed income is already underway. Economic activity, capital formation and balance sheet strength are becoming more broadly distributed, while portfolio allocations remain anchored to legacy structures. The divergence between where risk is priced and where fundamentals are improving is increasingly difficult to ignore.

For fixed income investors, the implication is not tactical. It is structural. Emerging market debt offers a combination that is increasingly scarce in global fixed income: improving credit quality, persistent spread premium and direct exposure to the sectors and regions driving incremental global growth.

The relevant question is no longer whether EM belongs in portfolios. It is whether existing allocations adequately reflect emerging markets' evolving, structurally embedded role in the global credit system. In a multipolar world, maintaining structural underweights to emerging markets increasingly reflects legacy positioning rather than forward-looking asset allocation—anchored in a world that has already passed, not one that is emerging.

Across sovereign and corporate segments, investment grade and high yield, emerging market debt is no longer a satellite allocation. It is part of the core.

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INDEX DESCRIPTIONS:

DM IG refers to the Bloomberg Global Aggregate Index, which measures global investment grade debt across local currency markets. EM Hard Currency Corporates refers to the J.P. Morgan Corporate Emerging Market Bond Index Broad Diversified, which tracks the performance of U.S. dollar-denominated bonds issued by emerging market corporate entities. EM Hard Currency Sovereign refers to the J.P. Morgan EMBI Global Diversified, which tracks liquid U.S. dollar-denominated emerging market fixed- and floating-rate debt instruments issued by sovereign and quasi-sovereign entities. Euro High Yield refers to the Bloomberg Pan-European High Yield (Euro) Index, which measures the market of euro-denominated, non-investment grade, fixed-rate corporate bonds. Euro Investment Grade, also labeled EU IG, refers to the Bloomberg Pan-European Aggregate: Corporate Index, which measures fixed-rate, investment grade corporate securities issued in European currencies. US Investment Grade refers to the Bloomberg US Corporate Bond Index, which measures the investment grade, fixed-rate, taxable corporate bond market. US High Yield refers to the Bloomberg US Corporate High Yield Bond Index, which measures the U.S. dollar-denominated, high yield, fixed-rate corporate bond market. EM IG refers to the investment grade segment of the U.S. dollar-denominated emerging market corporate bond universe within the J.P. Morgan CEMBI framework.

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