



Quality momentum in emerging market debt

EMD report Q2 2026

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Quantifying spread convergence and fundamental alignment with developed markets

Executive Summary

Emerging market debt (EMD) has evolved into a cornerstone asset class for institutional fixed income investors seeking income, diversification and alpha in the complex global environment. Powered by decades of policy reforms, enhanced macroeconomic stability, and improved market infrastructure, EMD now offers spreads that are converging with developed market credit, presenting a compelling opportunity for consultants and institutional allocators.

Importantly, EMD is not a monolithic asset class. As dispersion across countries, sectors and structures widens, thoughtful benchmark selection and disciplined portfolio construction have become critical drivers of outcomes.

At Federated Hermes, our active, research-driven approach to EMD leverages deep fundamental insights and rigorous risk governance. This paper outlines why spread convergence is reshaping the opportunity set in EMD and how institutional allocators can harness this dynamic using Federated Hermes’ distinctive investment philosophy and fixed income experience.



The EMD opportunity: Context and convergence

Historically, EMD offered a premium relative to developed markets to compensate for elevated risks including political volatility, inflation and liquidity constraints. Over the past decade, however, fundamental improvements — anchored by post-global financial crisis reforms — have fostered macroeconomic stability and enhanced policy credibility across a range of emerging market (EM) countries.

Data from Federated Hermes’ Q1 2026 research shows the Bloomberg Seasoned ex Agg/Eurodollar peaked at OAS+920 basis points (bps) in mid-2022, and spreads have since tightened to OAS+365bps as of Q1 2026, with an index duration of 4.8 years — comparable to US investment-grade (IG) credit but offering materially higher income per unit of duration. This spread convergence reflects a narrowing credit premium gap and signals maturation of the asset class.

Income and duration profile

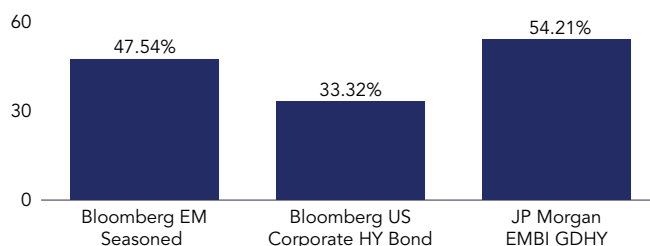
	Yield to Worst	OAS*	Duration	5 yr Sharpe
Bloomberg EM Seasoned ex Agg/Eurodollar Index	7.86	3.70	4.87	0.21
Bloomberg US Aggregate Index	4.57	0.30	5.88	-0.48
Bloomberg US High Yield - 2% Issuer Cap Index	7.40	3.17	3.02	0.12
Bloomberg US Leveraged Loan Index	8.73	n/a	-0.05	0.76

Sources: Bloomberg as of 31/3/2026. * Option adjusted spread.

Recent EM total returns are competitive versus US high yield

We see the return drivers of EM, particularly in the specific idiosyncratic sovereign markets, as distinct. The strong performance of the two referenced EM indexes below was driven by unique credit stories — Argentina, Ecuador, Egypt — that would have evolved regardless of the global backdrop. EM can add unique return potential in portfolios that is not dependent on broad market risk drivers. Strong, bottom-up selection, driven by multifactor models that we employ, can help to capture such opportunities.

Three-year total index return as of 31/12/2025

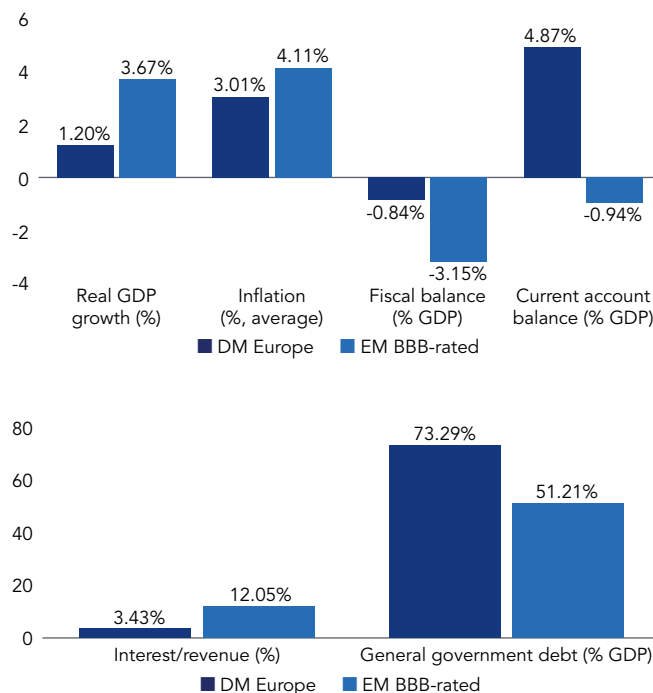


Source: Bloomberg as of 31/12/2025

EMD presents comparisons to DM Europe

On balance, EM IG sovereign credit metrics are in line (some better, some poorer) with DM Europe metrics.

DM Europe vs EM BBB-rated sovereigns (2023-25 average)



Sources: Bloomberg, Federated Hermes as of 14/10/2025

Key drivers of spread convergence and EMD strength

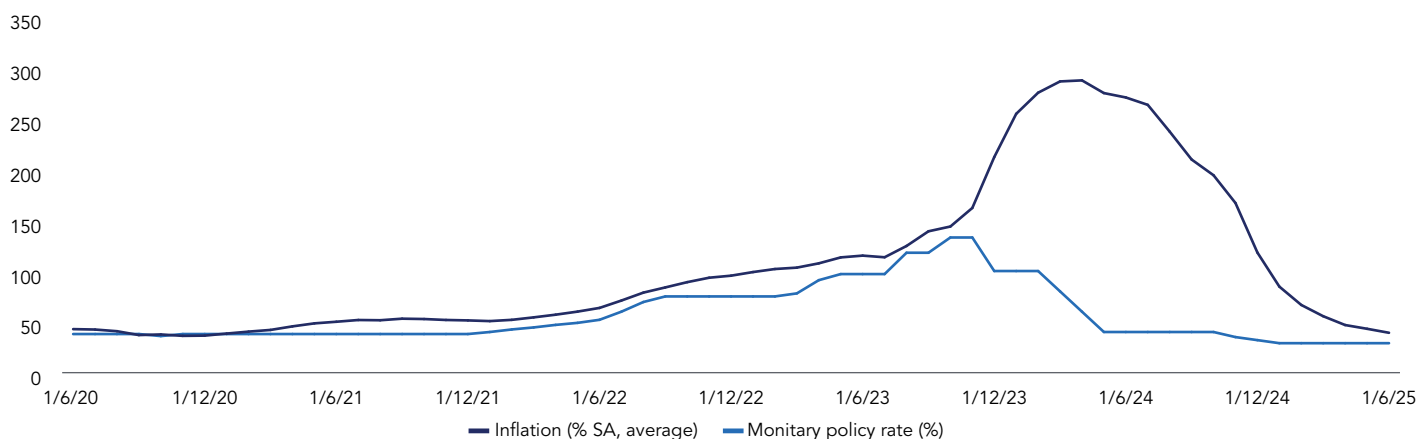
A key driver of spread convergence in EMD has been the increasing credibility of EM policymaking, particularly in monetary policy. In contrast to developed markets, many EM central banks (such as Brazil, Mexico, Chile, and Turkey) responded decisively to post-pandemic inflation pressures, often hiking rates earlier and more aggressively. This credible monetary policy approach has anchored inflation expectations, reduced risk premiums, and supported tighter sovereign spreads.

Many EM countries have transitioned from fiscal deficits and external imbalances to healthier positions, enabling more sustainable debt servicing capacity. For example, following President Milei's economic liberalisation and fiscal austerity, Argentina secured a US\$20bn IMF loan and relaxed capital controls. Inflation has fallen dramatically (from 292% to under 56% YoY), and GDP growth is projected at 5.7% in 2025.

Robust primary issuance in 2025 (exceeding US\$286bn in the EM-17¹ cohort) and growing domestic ownership of local currency bonds have enhanced market liquidity and resilience. Barclays reports that 2025 EM sovereign hard currency (HC), corporate and quasi issuance were all above 10-year averages. This reduces reliance on volatile foreign capital flows and stabilises yields during market stress, a dynamic we monitor closely in our risk governance framework.

- Post-Global Financial Crisis reforms and early hiking cycles support macro resilience; rating momentum is positive.
- Public EMD hard currency HC markets, particularly sovereigns, exhibit strong depth and liquidity.
- Local currency returns are increasingly driven by credible policy and real yield dynamics, not just FX movements.

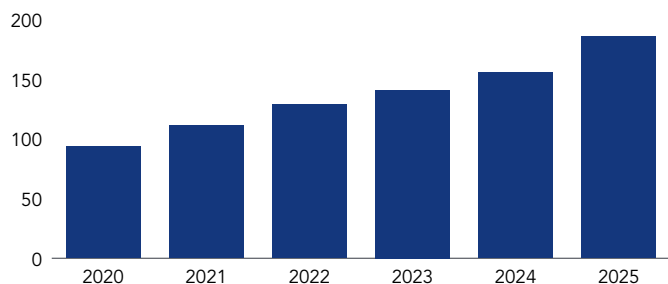
Argentina: Inflation and monetary policy



Sources: Instituto Nacional de Estadística y Censos/Haver Analytics as of 2/26, Banco Central de la Republica Argentina as of 6/25.

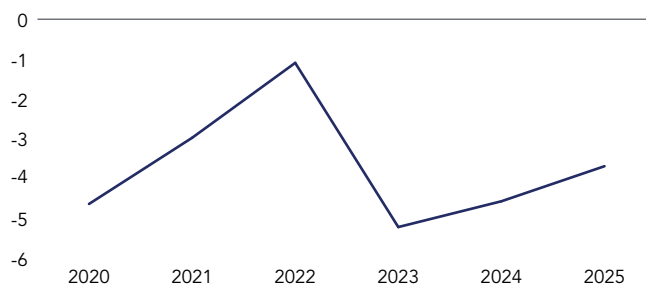
Turkey's orthodox policy shift in late 2023 has driven fiscal consolidation and disinflation (inflation reduced from 80% to 33.5% in mid-2025). FX reserves have rebounded, and the Central Bank's high real rates support Turkish local bonds and select hard currency corporates. Federated Hermes actively monitors Turkey's evolving landscape for tactical opportunities.

Turkey foreign exchange reserves (US\$ m)



Source: International Monetary Fund as of 14/3/25 and 14/10/25.

Turkey fiscal balance (% GDP)



The inclusion of corporates in the country buckets provides better spread and performance opportunities.

Additionally, the Bloomberg EM Seasoned Index shows superior volatility metrics compared to the standard market quoted EMBIG Diversified Index.

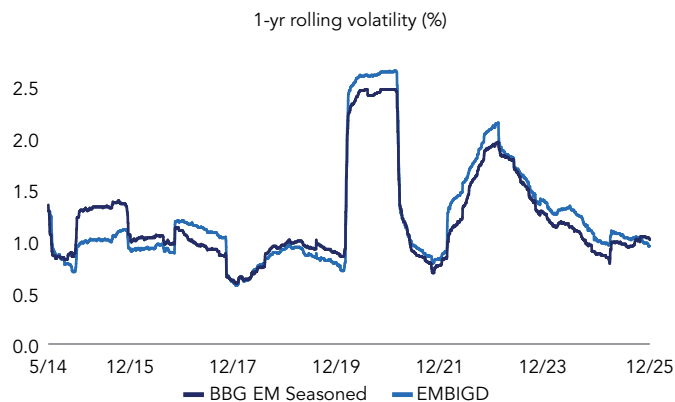
¹ The EM-17 group includes Argentina, Brazil, Chile, Colombia, Egypt, India, Indonesia, Malaysia, Mexico, Nigeria, Peru, the Philippines, Saudi Arabia, Thailand, Turkey, and Vietnam.

Statistical comparison of the Bloomberg EM Seasoned Index — a blend of sovereigns and corporates — shows superiority to a sovereign-only index (EMBI GD).

	Bloomberg EM Seasoned	EMBI Global Diversified
Ratings	BB-/B	BB
Duration	4.97	6.55
Yield to worst	7.05	6.8
Returns		
Average 20 yr	6.67%	5.61%
Average 15 yr	5.87%	4.71%
Average 10 yr	5.83%	4.39%
Average 5 yr	4.71%	1.78%
Average 3 yr	13.82%	10.58%
Average 1 yr	13.30%	13.72%
Sovereign	80%	100%
Corporates	20%	0%

Sources: Bloomberg, Factset, Federated Hermes as of 31/12/25.

Volatility of daily returns over one-year rolling periods for each of the past ten years.



Source: Bloomberg as of 31/12/25.

In the earlier days of these indexes, back to the year 2000, the EMBIGD showed superior metrics. However, we believe the past decade is far more relevant for today's allocators, as it captures the current EM regime defined by improved policy credibility, deeper markets, and structural convergence with developed credit. The fact that the past ten years is similar between the two indexes further illustrates our convergence theme. The lower-rated assets in emerging markets are "converging"/behaving more like investment-grade emerging markets instruments on the volatility side. Most impressively, the core plus index has seen its volatility fall to similar levels as the EMBIGD. Although the volatility is the same, the BBG EM Seasoned Index is a far greater yielding index, with more room for appreciation in price, and it has significantly outperformed the EMBIGD over the past ten years. We believe the BBG index offers greater opportunities for portfolio manager/security selection value add.

EMBIG is often viewed as lower risk due to its sovereign-only, higher-quality country exposure, while the BBG EM Index incorporates corporate credit (particularly in markets like Turkey, Brazil, and Argentina) highlighting how benchmark choice, rather than pure risk level, drives differences in exposure and opportunity.

Top Ten Country Weights

BBG EM Seasoned	Weight	Spread	EMBIG	Weight	Spread
Turkey	13.30%	232	Mexico	5.18%	222
Brazil	11.60%	303	Saudi Arabia	5.14%	178
Argentina	11.23%	537	Turkey	4.30%	546
Mexico	6.42%	363	Indonesia	4.17%	72
Colombia	5.91%	310	UAE	4.01%	58
Bahrain	3.63%	206	China	3.36%	41
UAE	3.41%	152	Brazil	3.15%	196
Dominican Rep	3.34%	166	Chile	3.11%	89
China	3.29%	232	Philippines	3.01%	59
South Africa	3.14%	209	Oman	2.94%	97
Weighted Average Spread of Top Ten	-	307	-	-	168

Sources: FactSet, Bloomberg, as of 31/12/25.

This perception of higher risk in certain EM markets warrants a closer look at issuer-level fundamentals rather than country labels alone. Generally, with EM issuers, we have found country ceilings providing downward pressure on ratings. We are noticing comparable volatility rates and lower debt to GDP, lower interest to revenue levels and higher real GDP growth rates for EM names both in the high yield (HY) and IG space, implying better credit metrics/credit health.

Higher spreads can mean more return potential

2022-2025	Brazil	Peru	Chile	Argentina	Egypt	Turkey
Returns	25%	20%	19%	243%	82%	40%
Spread move tighter	62	59	51	1631	460	208

Sources: Bloomberg, J.P. Morgan.

Greater opportunities for outperformance are often found in the higher Z-spread names, as there is far more room for compression and carry, and it is also easier to identify the unique HY stories, as opposed to guessing a mid-beta name is going to converge from tight to tighter.

Example: Oil exploration & production

- Our team maintains heightened attention to both the opportunities and challenges encountered by the global oil industry. Specifically, oil credits are highly exposed to changes in the price of Brent, thus resulting in periods of induced commodity price volatility. Such a characteristic, however, results in different market treatments between small-to-medium-scale E&P's and that of larger operators within the sector.
- In periods of high oil price environments, small-to-medium producers typically provide an avenue of significant opportunity to acquire attractive yield while providing the ability to capture positive real rates of return. Due to their smaller scale, these oil producers typically have lower operating netbacks and breakevens, therefore, leading to greater downside risks in times of weaker oil prices. As such, debt from such smaller operators typically trades at a considerable discount to that of major oil companies. In the haste of falling oil prices, many times the market will treat debt from such smaller issuers as largely equal vis-à-vis one another and unfairly disregard the differences in quality and creditworthiness. As a result, this provides an attractive investable window once oil stabilises and the market disruptions clear.
- In contrast, major oil producers benefit from their large-scale and vertically integrated operations. These companies enjoy greater production volumes, a dilution of costs, reduced breakevens and strong access to capital markets. Such underlying traits typically result in higher credit ratings. As a result, debt from these issuers typically trade at much lower yields and are not subject to swings as violent in sentiment as their smaller peers. Specifically, the major oil producers are positioned to survive instances of deep economic dislocation.

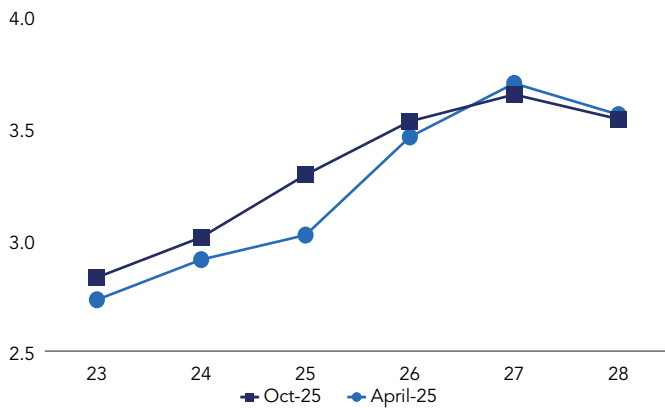
Positioning depending on macro views:

Operational competitiveness (for corporate issuers)	Higher yielding/lower rated name benefits in oil bull market	Higher rated/less yielding but still attractive, low-cost producer that can survive industry downturns
Competitive feedstock access	No	Yes
Production quartile	3	1
Feed stock source	Domestic fields in Colombia and Ecuador	Pre-salt fields have low extraction cost
Plant conversion efficiency	Medium	Refining conversion weak but pre-salt technology industry leading
Key products	Oil and natural gas	Oil, gas, refined
Product complexity (basic, medium, specialised)	Basic to medium	Basic to medium
Degree of competition	Heavy	Highly competitive across products
Import protection due to logistics	No	Some protection upon refining side
Tariff protection	No	None noted
Competition sources	Domestic and international	Domestic and external
Scale and infrastructure	Small	Large in upstream amid refining; \$46 including government share
Break even costs	Around US\$50 per barrel of oil	US\$46 including government share
1p reserve life	8.0 years as of the end of 2025	12.2 years
Previous workout or restructurer	No	No
Company credible	Yes	Yes
Credibility trending better	Yes	Yes

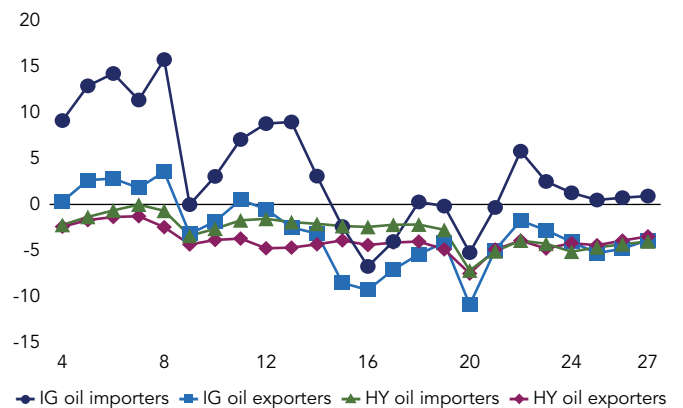
Federated Hermes' analysis of EMBI-weighted fiscal balances and current accounts demonstrates this improvement across both investment-grade and high-yield oil importers/exporters.



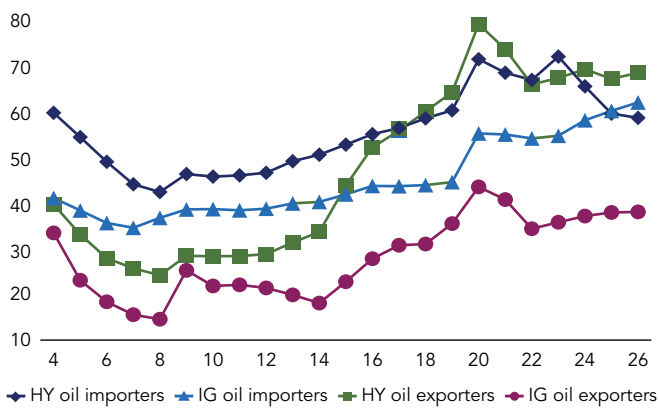
EMBI-weighted real growth



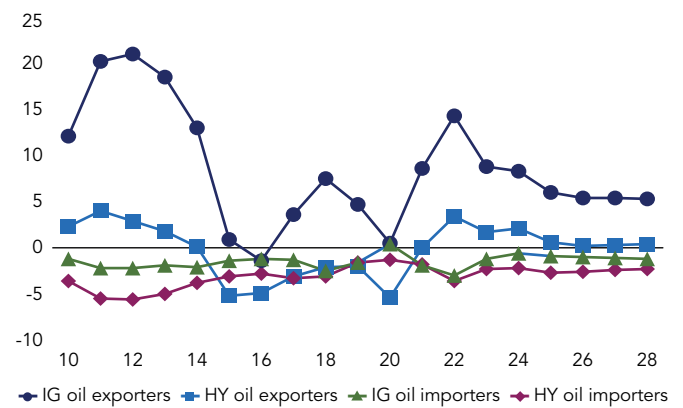
EMBI-weighted fiscal balances (% GDP)



EMBI debt projections (% GDP)



EMBI-weighted current accounts (% GDP)



Source: The International Monetary Fund (IMF) as of October 2025 including projections.

Case study: Brazil and Turkey

Sovereign credit analysis example — a mosaic of granular quantitative data and qualitative adjustments

On the sovereign side, we initiate our credit analysis by reviewing a sovereign’s scorecard, which tracks a wide variety of credit metrics. The granularity of data allows for the standardisation and easy comparison of individual sovereigns’ key credit drivers. Furthermore, it also permits us to compare different sovereigns across regions.

Besides a set of quantitative inputs, we incorporate qualitative analysis to determine a sovereign’s overall creditworthiness. The depth of variables we track and this quantitative mosaic approach allow us to see the broad picture and determine if a set of indicators outweighs less-than-stellar credit developments.

We provide examples of the quantitative data for Brazil and Turkey on page 7. Both countries demonstrate strong credit metrics, but the scorecard highlights different areas of credit strength. Furthermore, we revised Brazil’s overall score higher relative to the quantitative roll up due to a difference in institutional strength. In fact, our qualitative analysis revealed stronger independence and credibility of the Brazilian central bank.

Overall, Brazil carries a higher debt burden, more expensive debt and lower per capita wealth. That said, Brazil has higher institutional strength and very robust external reserves with nine months of import coverage. Brazil is also a heavy commodity producer, which is beneficial given demands from China and global trends towards AI development.

In the case of Turkey, low government debt, strong growth dynamics and relatively higher wealth levels are positive credit drivers. In the past, there were concerns regarding the sovereign’s institutional strength, primarily its unorthodox monetary policy. In recent years, however, Turkey’s monetary policy has become more prudent, with policy rates lingering higher to offset inflationary pressures.

Federated Hermes EMD proprietary scorecard example:

					Brazil		Turkey	
OVERALL SCORE					5.4		5.1	
Quantitative score					5.4		5.1	
Qualitative adjustments					0.0		0.0	
Factor weight	Factor	Sub-factor	Indicator	Indicator weight	Indicator	Score	Indicator	Score
17%	F1 - Economic strength				6.7		7.7	
	Growth dynamics			33%				
			Average real GDP growth 5Y (% , T-3 to T+2)		2.6	4	3.5	6
	Size of the economy							
			Nominal GDP (USD bn, T-1)	33%	2,171	10	1,323	9
	Wealth level							
			GDP per capita (PPP, USD, T-1)	33%	10,214	6	15,463	8
17%	F2 - Institutional strength - Quality of institutions				5.0		4.5	
	Quality of institutions							
			Quality of legislative and executive institutions (WGI 2024)	50%	-0.1	6	-0.2	5
			Strength of civil society and judiciary (WGI 2024)	50%	-0.1	6	-0.6	4
17%	F3 - Institutional strength - Monetary policy effectiveness				4.0		1.5	
	Monetary policy effectiveness							
			Average inflation 3Y (% , T-3 to T-1)	50%	5.1	5	57.8	1
			Nominal exchange rate volatility 5Y (T-1 #SDs)	50%	1.5	3	1.3	2
17%	F4 - Fiscal strength - Government finances							
	Government finances							
			Govt fiscal balance (% GDP, T-1)	25%	-6.6	2	-5.2	4
			Govt primary balance (% GDP, T-1)	25%	-0.3	6	-3.1	2
			Govt revenue (% GDP, T-1)	25%	38.8	9	28.7	8
			Govt expenditure (% GDP, T-1)	25%	45.5	1	33.9	3
17%	F5 - Fiscal strength - Government debt				6.0		7.3	
	Debt burden							
			Govt debt level: Govt debt (% GDP, T-1)	25%	76.5	3	26.0	9
			Govt debt trend: Govt debt (T-5/T-1 change)	25%	-0.1	7	-0.3	9
	Debt affordability							
			Govt interest payments (% govt revenue, T-1)	25%	16.2	4	7.4	6
	External govt debt							
			External govt debt (% total govt debt, T-1)	25%	3.9	10	56.1	5
17%	F6 - External resiliency				6.0		5.7	
	External resiliency							
			FX reserves trend 3Y (T-3/T-1)	17%	-	3	0.2	8
			FX reserves import coverage (T-1)	17%	9.4	9	5.1	5
			Current account balance 5Y (% GDP, average T-3 to T+2)	17%	-2.1	4	-1.6	5
			ST external debt/FX reserves (% , T-1)	17%	28.5	8	112.0	4
			External debt service ratio (T-1)	17%	32.4	5	19.7	6
			External debt/FX reserves (T-1)	17%	203.6	7	333.4	6



Conclusion: Positioning EMD as a core fixed income allocation

Emerging market debt has matured into a resilient, genuinely diversifying asset class with income-generating potential. Spread convergence — driven by more credible policymaking, stronger fundamentals and improved market infrastructure — has narrowed the gap between EM and developed market credit, while dispersion within EM has increased. In this environment, benchmark orientation and portfolio construction matter more than ever. EMD is no longer a peripheral allocation; when implemented thoughtfully, it can serve as a core building block within institutional fixed-income portfolios.

Federated Hermes' differentiated EMD approach is designed for this new regime. By pairing deep fundamental sovereign and corporate research with active, flexible allocation across hard-currency and local-currency opportunities, and underpinned by robust risk governance and liquidity discipline, our experienced investment team seeks to capture convergence-driven returns while managing downside risk. For institutional investors, an active, research-led EMD strategy offers a compelling way to enhance income, improve diversification, and unlock durable alpha in today's evolving global credit landscape.

The value of investments and income from them may go down as well as up, and you may not get back the original amount invested. Past performance is not a reliable indicator of future results.

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