

Prospects for EM Assets Diverge After a Stellar Six Months

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

In the first half of 2025, emerging market (EM) assets delivered their best performance in decades, in both absolute terms and relative to developed market (DM) assets, including US equities. Many are calling for a rotation into EM assets in anticipation of a sustained period of outperformance ahead. This comes after a prolonged trend of consistent underperformance, albeit with several short swings in the opposite direction.

A key driver for the recent rally has been the sharp weakening of the US dollar, sparked by growing concerns over US fiscal deficits and a fading narrative of US exceptionalism. In credit markets, currency appreciation relative to US dollars accounted for nearly half of EM local currency debt's 11% year-to-date gains,¹ with the remainder coming from a combination of yield compression and carry. Overall, EM delivered the strongest returns across global credit markets, demonstrating resilience in the face of elevated macro and political uncertainties.

Among EM credit, Latin America stood out, with countries such as Brazil and Mexico benefiting from both local currency strength and a recovery in bond markets. While future foreign exchange (FX) appreciation may be limited, improving fundamentals are expected to support continued momentum. Despite ongoing fiscal concerns in countries like Brazil and Colombia, central banks in the region are now in a stronger position to ease monetary policy amid disinflation and the weak dollar, further reinforcing the market's perception of growth potential.

Turning to equities, the MSCI EM index has gained 17% this year, though this headline number has been mostly driven by dollar weakness. Excluding currency effects, returns are at a more modest 7%. EM GDP is accelerating, albeit moderately, and earnings revisions have only been in the range of 1%-2%, which is not a big premium to their long-term history. As such, valuations may appear stretched without a stronger pickup in earnings; earnings acceleration in turn requires macro growth acceleration.

So, is this yet another blip, or are there more sustained drivers at play that could result in a positive trend change for EM over the medium or even longer term?

It's critical to first identify the fundamental drivers of the sustained underperformance of EM assets for more than 20 years – a double whammy of headwinds for emerging markets and tailwinds for developed markets, particularly US assets. The main challenge for EM assets was the structural slowdown of the Chinese economy as it naturally matured and the fading of its demographic dividend. This had knock-on effects on emerging markets, particularly those feeding China's insatiable commodity demand. In the US, on the other hand, an innovative environment with breakthroughs across the technology complex, along with proactive monetary and fiscal policy and a supportive regulatory regime, all helped power US equities ahead of all others.

Most of these drivers remain intact, bringing into question the sustainability of EM assets' outperformance. Looking ahead, we believe a nuanced assessment of each asset class at the regional or country level is more likely to yield success than a broad-based rotation into "EM beta."

For EM equities to sustain their outperformance, and given current valuation levels, the heavy lifting needs to be done by improving earnings growth. Beyond short-term fluctuations, we are skeptical that this is on offer. Nothing we see suggests a structural

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About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

¹ Source: J.P. Morgan GBI-EM Global Diversified Index as of 31 July 2025.

shift to higher EM earnings growth. Meanwhile, we continue to view growth prospects in both the US and Europe as favorable, driven by technological innovation and reshoring in the US and by forceful fiscal policy in Germany. Only the softer US dollar remains as a positive contributor to EMs, via easier financial conditions.

For EM fixed income, on the other hand, the hurdle for growth is lower. The combination of high carry and the potential for a sustained monetary easing cycle provides a supportive backdrop for the asset class to add value to investment portfolios. A softer US dollar can also support local currency bond performance.

In terms of risks, we note that recent EM gains have also been supported by global inventory building in anticipation of new tariffs, which has particularly benefited export-heavy emerging markets with elevated tariff exposure, such as China. This front-loading effect is expected to fade in the second half of the year, potentially resulting in softer growth for these economies. In contrast, countries like Mexico and Brazil appear less affected by front-loading, and with ongoing policy easing and reform momentum, they are relatively better positioned to sustain growth.

Given these factors, can EM outperformance continue? In our view, the foundation of US economic strength remains intact – with ongoing fiscal support, regulatory relief, and structural themes such as AI, reshoring, and domestic manufacturing likely to power a productivity supercycle. Although EM currencies may still find support from the soft US dollar, performance will rely more heavily on effective monetary easing. In this context, EM equities face a high bar to compete with the US on growth and earnings fundamentals. EM fixed income has a better chance of delivering attractive risk-adjusted returns over the medium term.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Alfonso de la Torre
Sovereign Analyst,
Emerging Markets Fixed Income

CS 3.25 (unchanged)

US yields were higher through July as growth data surprised to the upside while inflation data remained in line with or below expectations. With tariff pass-through now becoming evident for core goods but partly offset by services disinflation, a rate cut remains in play for the September Fed meeting. This is consistent with June Federal Open Market Committee (FOMC) forecasts of two rate cuts this year amid expectations of higher inflation (3.1% core PCE) and higher unemployment (4.5%) by the end of the year. With tariff rates likely to shift further and recent data indicating a stronger starting point for the US economy, a soft landing remains the baseline expectation.

Rates

Gunter Seeger
Portfolio Manager, Developed
Markets Investment Grade

CS 4.00 (unchanged)

Since March, when we changed our score to 4.0, the 10-year note is higher at 4.36%, while the long bond (30-year) rose by 33 basis points (bps) over the same period to more than 5%. As we said last month, this year has been incredibly volatile so far, and we see no reason for that trend to reverse. In fact, it may get far worse, as there are no signs of slowing in the wars in Europe and the Middle East, where peace talks have stalled.

Our forecast remains the same: The US 10-year note will soon join the 20-year and 30-year and will touch 5% before the end of the year. In the past 10 months, the European Central Bank has cut short-term rates eight times, to 2.15% from 4.25%, and the German 10-year note has a higher yield than it did last September, before the rate cuts started. Over the same period, the Federal Reserve has cut rates to 4.50% from 5.50%, and the US 10-year note has a higher yield than it did last September (before the rate cuts started).

Inflation is still problematic in the US, and slightly less so in Europe. However, longer-term rates are not appeased by rate cuts when the prospect of future inflation is not under control. This theme will remain as long as inflation stays above target.

Credit

Steven Oh, CFA
Global Head of Credit
and Fixed Income

CS 3.50 (unchanged)

Credit markets continue to shrug off any potential risks and remain steadfastly tight, with strong demand. But trade negotiation deadlines are approaching, and tensions could again rise. The positive impact of pull-forward demand in the first half of the year is likely to reverse to a decelerating trend in the months ahead. In fact, while the economy has shown resilience, we expect signs of deceleration to emerge and for the Fed to resume easing, albeit in a slow and cautious manner. Valuations have not budged and remain at tight levels that are below our current fair value range. While our base case outlook – which does not foresee any meaningful US recession – remains intact, we maintain our CS at an incrementally more defensive posture. While we do not believe this is a market environment to become hyper defensive, we are trimming the highest risk/beta positions within portfolios and adding back an element of dry powder.

Currency (USD Perspective)

Anders Faergemann
Senior Sovereign Portfolio
Manager, Emerging Markets
Fixed Income

CS 3.00 (unchanged)

Countervailing forces are keeping the US dollar in check after an eventful first half, which saw the US dollar (DXY) drop close to 10%. Surprisingly, foreign exchange (FX) volatility has declined in recent weeks despite all the headline noise and elevated uncertainty around geopolitics and the macroeconomic outlook, suggesting the US dollar could remain rangebound in the near term.

Outperformance of US assets in the second quarter mitigated concerns about an immediate reallocation away from US assets and may also have slowed the pace of otherwise rising FX hedging ratios. In contrast, the ballooning US twin deficits and a broader diversification theme still make the US dollar vulnerable to further losses over the medium term.

Positioning has left the market short the US dollar, and with the lack of new catalysts to drive it weaker, we have seen a small, tactical bounce in the DXY. Some of the US dollar reversal has been linked to political noise in the UK and the election outcome in Japan, which could prove temporary. Still, the euro/US dollar relationship is lining up to play in a range of 1.14-1.18 into year-end, making us more confident about hitting our 1.1500 forecast over the next 12 months.

The biggest near-term risk to the US dollar appears to be increased speculation that President Trump is considering dismissing Fed Chair Powell or appointing a shadow Fed leader to impose rate-cutting pressure on the FOMC. Notwithstanding the legal implications of firing Powell, appointing a dovish Fed chair and risking a significant dent in Fed independence would effectively defeat the purpose of lowering front-end interest rates by leading to further curve steepening, and would effectively mitigate the benefits of any rate cuts.

We have affirmed our “Soft Landing” scenario and expect a gradual weakening of US growth over the next three to six months as labor market conditions soften and the second quarter’s front-loading reverses. Well-anchored inflation expectations and higher real yields should allow the Fed to resume its easing stance by December and into 2026, providing firmer ground for the US economy to recover.

Emerging Markets Fixed Income

Alfonso de la Torre
Sovereign Analyst,
Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)
CS 2.75 (unchanged)

Local Markets (Sovereign)
CS 3.00 (unchanged)

US dollar-denominated EM sovereigns continue to benefit from a positive rating outlook, with upgrade candidates outweighing potential downgrades. Recent positive rating actions include Argentina, Oman, and Uzbekistan, in line with our positive credit trends. While the latest tariff escalation is negative, it remains a manageable shock, with most countries facing effective tariffs below the US average or having limited (<15%) US trade exposure.

For dollar-denominated EM corporates, first-quarter results have been broadly neutral but with a positive skew to beating expectations, especially in mining and metals, consumer goods, and technology, media, and telecommunications. There were misses in utilities and pulp and paper (P&P). For the second quarter, we expect more balanced results with a negative tilt, specifically credits in Turkey, P&P, and industrials.

Finally, the EM local market has benefited from ongoing disinflation and a weaker US dollar. Both factors have allowed central banks to take further steps toward monetary easing, with recent rate cuts in Indonesia, Mexico, and Thailand. In the absence of further US weakness, however, returns should moderate in the second half of the year.

Multi-Asset

Peter Hu, CFA
Portfolio Manager,
Global Multi-Asset

CS 3.00 (unchanged)

Geopolitical tensions in the Middle East have recently eased following a fragile ceasefire between Iran and Israel. The US strike on Iran is viewed as a strategic move to reassert deterrence, which has helped reduce the region's risk premium. As a result, the market focus is shifting back to the global economic outlook, which continues to show signs of a gradual slowdown.

On the economic front, US personal income has declined, primarily due to reduced Social Security transfer payments. This decline is beginning to weigh on consumer spending, with many consumers shifting toward saving and discount-oriented purchases. Labor market data also show rising unemployment claims, suggesting a more persistent slowdown in job creation. Companies remain cautious, neither hiring nor laying off aggressively, which is making it harder for job seekers to find employment.

Inflation data from mid-June showed softer-than-expected readings, with both the Consumer Price Index (CPI) and Producer Price Index (PPI) surprising to the downside. Services, especially shelter, continued to show disinflationary trends, and even goods like automobiles experienced favorable price movements. Despite these trends, the Fed's outlook remains stagflationary. Markets are currently focused on supporting economic growth and are not overly concerned about short-term increases in goods prices, as long as services inflation continues to moderate. However, the recent strength in risk assets may fade or stall as stagflationary pressures build throughout the remainder of 2025.

We see cautious optimism looking ahead to 2026. Advances in artificial intelligence are expected to drive faster economic growth, reduce inflationary pressures, and improve productivity. This could shift market attention back toward a US-centric growth narrative. For now, however, uncertainties remain, and the outlook is clouded by unresolved issues related to tariffs and stagflation. As a result, we remain neutral on risk.

Global Equity

John Song
Research Analyst, Equities

CS 3.00 (unchanged)

Developed equity markets have recovered to all-time highs despite ongoing US high tariff/trade uncertainty. So far consumers and businesses appear to be weathering the tariff cost increases relatively well, although it is still early. As we head into the second-quarter earnings season, investors are expecting upside surprises in most cyclical industries, as company guidance was given three months ago during the "Liberation Day" aftershocks.

Markets also appear to be looking through to 2026 and a period of lower interest rates, less policy uncertainty, and a more business-friendly environment of lower taxes and deregulation. The passage of the OBBB Act has helped feed this narrative, although we think companies' second-half guidance will likely still lean conservative.

Earnings growth has broadened beyond the tech sector to industrials, financials, and healthcare. Consumer spending remains supported. We are still focused on neutralizing factor risk and are finding bottom-up fundamental ideas at attractive prices.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager,
Global Equities

CS 3.00 (unchanged)

The quarterly earnings reporting season has begun, with our portfolio companies thus far reporting decent results with one small miss. However, management guidance has been positive. Sectorally, AI-driven demand is being debated again, with an emphasis on high bandwidth memory (HBM) chips. Tariffs and the war in Ukraine remain key sources of top-down uncertainty.

In China, we see a tentative de-escalation of trade tensions with the US, as China is again allowing imports of several types of Nvidia chips. E-commerce competition is intensifying, this time by Alibaba. The broader economy remains slow, although tourism data are encouraging. In India, bank net interest margins will be under pressure for the next two to three quarters but should start to increase toward year-end. Management commentary for the fast-moving consumer goods universe has been centered on demand recovery in the second half, helped by the tax reduction, monetary policy easing, and expectations of a better monsoon. In Taiwan, TSMC kicked off the earnings season with an earnings beat and good guidance.

In Latin America, Brazil's narrative was shaken by President Trump's 50% tariff on the country's exports to the US, likely driven somewhat by personal animus between the two presidents. This caused some FX and equity market weakness. The earnings season thus far has been lukewarm, with two earnings misses, although one of them was favorable to us and the other was offset by positive guidance. Concerns about economic growth in Mexico and Brazil drive earnings uncertainty among investors with consumer stocks under pressure.

In EMEA, the peace process has been largely derailed, but some renewal of US support and additional EU sanctions raise pressure on Russia. The earnings season in EMEA has not begun yet.

Overall, this month was a continuation of the prior month's themes, where geopolitics again overtook bottom-up developments as the main stock driver. We continue to favor companies that are relatively isolated from top-down shocks and focus on the long-term outlook, which is admittedly a challenge in this environment.

Quantitative Research

Yang Qian
Fixed Income
Quantitative Strategist

We have seen tighter credit spreads (by eight basis points) versus last month and no change in the curve slope.

Our global credit forecasts remain negative, but less so. In developed market industries, our model favors technology, banking, capital goods, natural gas, and communications. It dislikes utilities, basic industry, finance companies, consumer cyclicals, and transportation. Among emerging market industries, the model likes pulp and paper, financials, technology, media, and telecommunications, and utilities. It dislikes EM real estate and diversified industries.

Our global rates model forecasts lower yield for Oceania, the UK, and the US and higher yields for Japan and the euro area. For slopes, the model forecasts a flatter curve globally, but the UK, Australia, and the US are on the steeper side.

The rates view expressed in our G10 Model portfolio is overweight global duration, being overweight the UK, France, Italy, New Zealand, Canada, and Spain while underweight the US, Germany, and Japan. Along the curve, it is overweight the six-month, 10-year, and 20-year and underweight the two-year, five-year, Japanese seven-year, and 30-year.

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