Rethinking emerging markets: diversification and growth opportunities in equities and fixed income

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Growing global uncertainty around company valuations, monetary policy and business cycles is prompting investors to rethink their asset-allocation strategies – and emerging markets (EM) are ideally placed to benefit. Across EM, a number of factors are combining to create compelling diversification opportunities in both equities and fixed income.

Allocations to EM equities have in the past tended to treat the asset class as a single, relatively undifferentiated entity. For many years, investing in emerging markets equities often meant investing in the China growth story. Today, that picture is far more nuanced. Across the EM universe, returns are being driven by a wide range of distinct themes, from artificial intelligence (AI) and advanced manufacturing to the energy transition, creating a richer and more diversified opportunity set for investors.

EM debt, meanwhile, has matured considerably and has transformed from the volatility of the 1990s into an asset class characterized by strong fundamentals, disciplined policy mixes and effective structural reforms. In both equities and fixed income, valuations are cheap relative to most developed markets – and investor allocations remain low.

So why do EM assets continue to be underrepresented in investor portfolios? In part, this is the result of historic attitudes towards EM stocks and bonds that were formed during the various crises of the 1990s and early 2000s. Many investors still believe that emerging markets are inherently unstable – but the reality is quite different. In recent years, EM assets have demonstrated high levels of resilience during periods of volatility.

At the same time, the countries that make up the EM universe are playing a more central role in driving global growth. Recent research from S&P Global suggests that emerging markets will be responsible for as much as two-thirds of world GDP by 2035.

In an increasingly uncertain investment landscape, assets that have traditionally been seen as safe havens – such as gold, US Treasuries and the US dollar – no longer appear to offer the same level of security. Diversification offers investors the chance to de-risk their portfolios, and this is where EM equities and debt have valuable roles to play.

EM equities: taking advantage of structural growth drivers

The EM investment universe features a large and growing number of companies which are global leaders and that not only boast stronger balance sheets than many of their peers in developed markets, but also have significantly higher levels of profitability. Meanwhile, EM equities continue to trade at a considerable discount to those in the US and Europe: earlier in 2026, EM stocks were trading at around 12 times earnings compared to approximately 20 times in developed markets.

It is important to understand that emerging markets are no longer driven by a small number of overarching themes, such as the China growth story in the early years of the 21st century. EM assets are not one homogenous group, and performance across both equities and debt is driven by a wide range of tailwinds and fundamentals.

In terms of EM equity performance, we have identified several key factors that have the potential to provide significant sources of alpha over the medium to long term:

Technology and AI

A number of Asian countries are at the heart of the global AI supply chain, most notably Korea and Taiwan. These markets are home to some of the world's most important semiconductor manufacturers, in particular the high-bandwidth memory chips required for the latest processors. As capital expenditure among hyperscalers such as Amazon, Microsoft and Alphabet continues to rise rapidly, these producers can be expected to record strong earnings growth.

Innovation in the Chinese economy

China's shift away from property and infrastructure investment towards innovation and advanced manufacturing – which also includes the development of competing AI models and semiconductor production – is another important structural change. The nation's focus on industries ranging from electric-vehicle production and renewable energy technology to automation and biotechnology is creating new global leaders.

India's multi-year expansion

India has been one of the fastest-growing economies in the world over the past decade, in particular in the post-pandemic period. The country is forecast to continue this pace of expansion over the next 10 years, with some models suggesting it will be behind only Vietnam in terms of average GDP growth between now and 2035 – by which time India is forecast to be the world's third-largest economy, behind only the US and China. India is expected to continue to benefit from the likes of the expansion of the manufacturer sector, rising domestic consumption and digitalization.

The energy transition and industrial transformation
EM economies are also well placed to take advantage of the global energy transition and the move towards net zero. Many EM countries are major producers of the materials needed for both decarbonization and the implementation of advanced technologies, such as copper – a vital component in electrification programs as well as computer hardware – as well as tin and lithium, which play crucial roles in energy-storage technology.

Although these growth drivers are spread across sectors and countries, the most interesting and compelling opportunities are unevenly distributed. Within individual countries, while some companies are demonstrating the ability to compound earnings and gain global market share, others remain tied to industries that face significant structural challenges.

This higher level of dispersion has created a particularly attractive environment for those skilled active equity portfolio managers who are able to call on deep research capabilities and local expertise. For investors who are looking for value in EM equities, the investment case is no longer predicated on macroeconomic conditions alone; rather, it is about identifying the companies best positioned to benefit from the powerful structural growth trends that are set to transform the global economy.

EM debt: resilience from strong fundamentals and structural reforms
Fixed-income assets in emerging markets have perhaps found it more difficult to shake off a reputation for volatility following the sovereign debt crises experienced around the turn of the century. EM hard-currency debt has consistently outperformed similarly rated US debt since 2023, and EM corporates have among the best Sharpe ratios – a measure of reward versus risk – in the global fixed-income market over the same period. Moreover, during recent bouts of market turbulence, such as those in the wake of President Trump's 'Liberation Day' introduction of tariffs in April 2025 and the start of the US-Iran conflict less than 12 months later, EM hard-currency debt outperformed.

Meanwhile, valuations in hard-currency debt for both sovereigns and corporates remain attractive versus other comparable rated sectors in fixed income, and yields are trading at the top end versus historical ranges.

EM debt is benefitting from the fact that a large number of emerging-market countries have, over the course of the past decade, committed to implementing structural reforms, strengthening key financial institutions and adhering to strict and credible monetary policy pathways. In the post-Covid period, EM central banks were able to quickly hike interest rates to bring inflation under control – in contrast to their developed-market counterparts, which were much slower to act and which have faced much more challenging fiscal conditions as a result.

The resilience of EM debt has been supported by positive fundamentals: as well as better growth rates, many EM economies have lower debt levels than developed markets. Similarly, net leverage for EM corporates is significantly lower than among comparably rated companies in the US. This resilience is perhaps best demonstrated by the fact that there have been no EM sovereign defaults since late 2023.

Over the same period, EM corporate defaults have declined and ratings upgrades have outnumbered downgrades, especially for sovereign credits. In terms of technical characteristics, the net supply of EM hard-currency bonds has been limited or negative over recent years – and net inflows have been positive, thanks in no small part to policy uncertainty in the US. In 2025, EM debt saw around $31 billion of inflows, a figure that was almost matched in the first eight months of 2026 alone. However, despite these recent inflows, investors are still underweight the asset class due to the significant outflows seen between 2022 and 2024.

As is the case in EM equity markets, expert, active portfolio management can lay the foundations for success. At UBS Asset Management, stress testing is one of the most important elements of our investment approach. This is a core risk management and alpha generation framework that is designed to identify downside risks early, assess resilience under adverse scenarios and ensure capital is deployed only where risks are adequately compensated.

In the weeks leading up to Liberation Day in April 2025, for example, we examined the potential impact of a global trade war on our portfolios, while we have been modelling volatility in oil prices recently. These exercises have been invaluable in identifying the countries and corporates that are best placed to withstand periods of market turbulence.

Our technical analysis is complemented by the information gleaned from our global network of country and sector specialists: these help us to gain fresh and often unique insights on investment decisions. For example, we engaged in dialogue with advisors to the key candidates in Argentina's recent presidential election to help us understand the most likely course of monetary and fiscal policy based on a variety of potential outcomes.

EM assets: a positive outlook
In both EM equity and debt markets, inflows are starting to gather pace, but portfolio allocations are still well below historic levels. EM macro fundamentals are stronger than many investors appreciate: inflation has broadly moderated, debt burdens remain relatively contained and credit trends continue to improve, creating a more resilient backdrop than in previous rate cycles. As investors continue to seek further diversification away from the US market and its technology sector in particular, we expect the 'perception gap' between outdated views of emerging markets and the current reality to narrow. In turn, this is likely to result in the valuations of EM assets moving in line with those in developed markets.