

Beyond Developed Markets: The Case for Emerging Market Local Debt Today

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Executive Summary:

- ◆ **High real yields:** EM local debt offers high real income (inflation-adjusted) versus developed country bonds
- ◆ **Policy credibility:** Many EM central banks reacted early and decisively to anchor inflation expectations during the post-pandemic inflation shock
- ◆ **Attractive EM FX Valuations:** EM FX is relatively inexpensive versus the US dollar and external balances are improving
- ◆ **More resilient EM:** Stronger EM institutions and policy frameworks have improved durability versus past cycles
- ◆ **Multiple Sources of Returns:** EM local debt offers high carry, EM local bond duration, and EM currency exposure, offering an attractive risk/reward profile, especially for diversified active strategies.

Emerging market (EM) local currency debt has become an increasingly compelling investment opportunity in the global fixed income landscape that has changed dramatically over the last few years. While developed market central banks have raised interest rates sharply from their post-pandemic lows, the improvement in nominal yields has not always translated into attractive real income once inflation is considered. At the same time, many developed market economies are dealing with deteriorating fiscal positions, aging populations, and weaker long term growth prospects. Against this backdrop, EM local debt stands out as an area where investors can still find high real yields, improving fundamentals, and diversified sources of return.

Source: HSBC Asset Management. The views expressed above were held at the time of preparation and are subject to change without notice. Any forecast, projection or target where provided is indicative only and not guaranteed in any way.

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A New Era for EM Local Debt

A key shift in this cycle has been the behavior of EM central banks. Historically, they were often perceived as lagging their developed markets peers—slow to respond to inflation and quick to ease policy at the expense of currency and price stability. However, in the most recent cycle, many EM central banks reacted earlier and more aggressively than the Federal Reserve (Fed) or the European Central Bank (ECB) when inflation surged. Policy rates in several EM economies were raised decisively to anchor inflation expectations, in some cases into double digits. As a result, inflation in EM economies normalized more rapidly than in many developed market economies, creating a compelling opportunity in EM local bonds: high real income with potential for capital gains as yields decline alongside monetary policy easing in developed market economies.

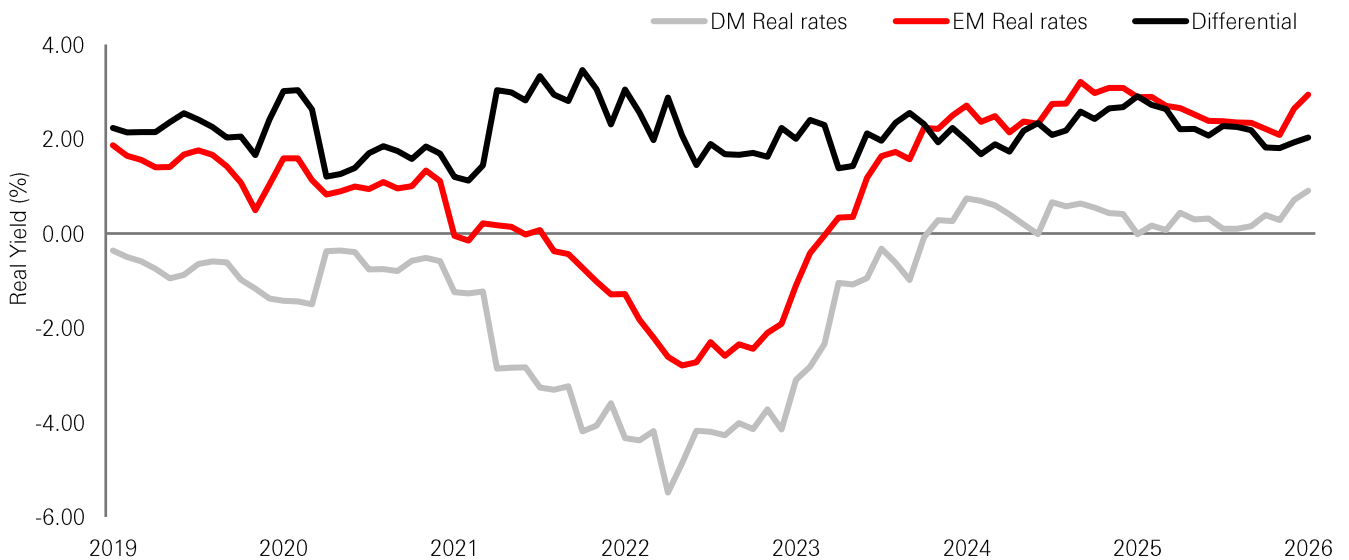
Why has the pattern changed? EM central banks can act more independently of the Fed and the ECB than in past cycles due to the following factors:

- Increased financial depth – larger pension pools serving as dedicated buyers of local debt, underpinning liquidity and volumes
- Greater financial sophistication – larger financial sectors, with banks and insurance companies acting as intermediaries that improve monetary policy transmission
- De-dollarization – a higher money supply relative to GDP and a shift in savings and wealth away from hard currencies and into local-currency assets

We believe this means we are not going back to the previous world, and EM currencies and interest rates will behave more idiosyncratically going forward.

Restrictive monetary policy in many developed market economies has caused global yields to remain elevated. In comparison, the carry of EM local bonds is attractive and can be a powerful driver of returns over time. High carry can provide a margin of safety, compensating investors for taking on credit, liquidity, and political risk, and offering a cushion against adverse shocks in global rates or risk sentiment.

EM Premium over DM

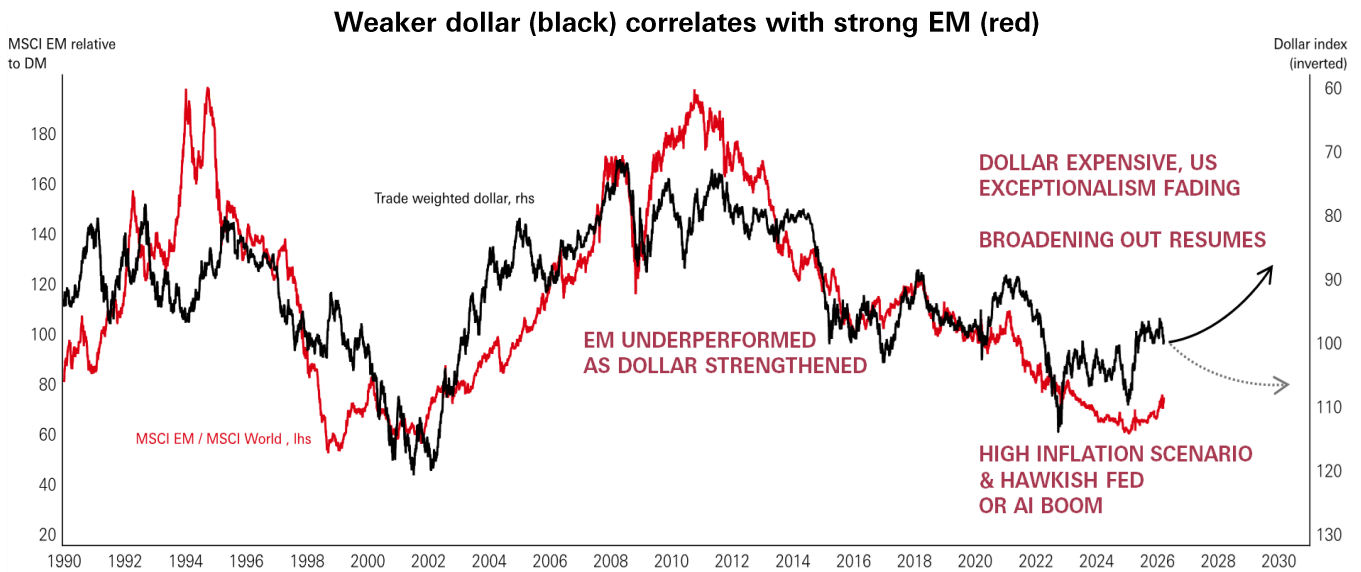


Sources: HSBC Asset Management, Bloomberg, JP Morgan, as of 31 March 2026.

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Multiple drivers of return

EM currency exposure is another source of potential returns when investing in EM local debt. After a decade of US dollar strength, many EM currencies are relatively inexpensive. Although we saw the US dollar begin to weaken last year, it is still well off historical lows and continued weakening could be supportive for EM FX. Against this backdrop, external balances have improved in many EM countries, as can be seen with shrinking current account deficits and higher levels of foreign exchange reserves. EM FX may have room to appreciate over the medium term if EM fundamentals continue on this improving trend and the US dollar experiences further weakness.



Source: Refinitiv, MSCI, HSBC Asset Management, March 2026.

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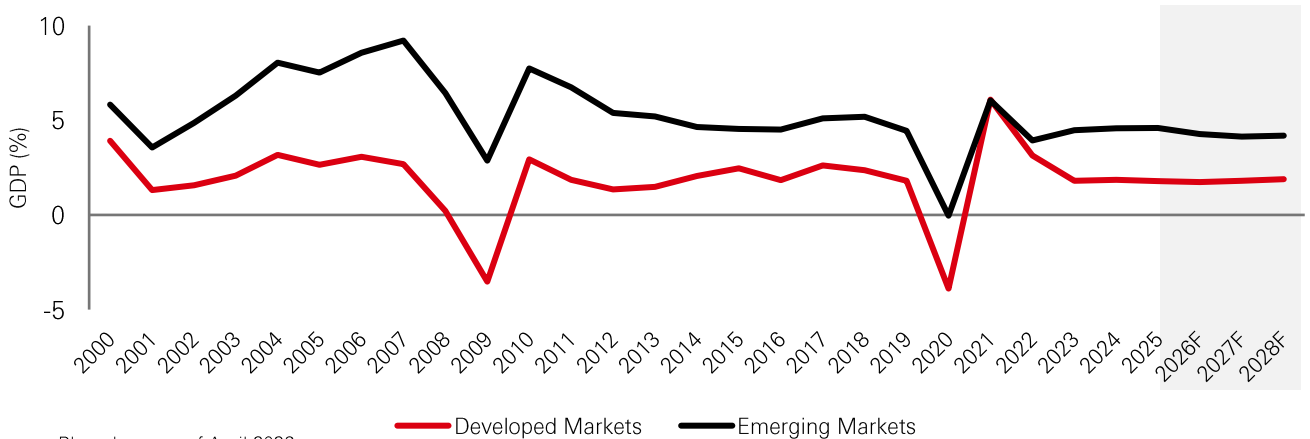
Policy Improvements and Growth Drivers

The structural backdrop in EM has also evolved meaningfully. Today's EM local debt is not the same asset class it was 20 years ago. Many EM countries have strengthened their institutional and policy frameworks, granting greater independence to central banks, adopting explicit inflation targeting regimes, and introducing more disciplined fiscal and debt management practices. These changes have helped anchor inflation expectations, reduced the incidence of extreme inflation episodes, and increased investor confidence in local bond markets and currencies. As a result, EM economies have become more resilient to periods of US dollar strength, higher global interest rates, and episodes of global risk aversion. While risks remain in specific countries, the overall quality and resilience of the asset class have improved.

Looking ahead, the macroeconomic case for EM local debt remains robust. Many EM economies continue to offer higher long term growth potential than their developed counterparts, supported by younger and growing populations in some regions, ongoing urbanization and industrialization, productivity catch up, and structural reforms. On average, EM economies have delivered around 3% higher GDP growth than Developed Markets. Higher trend growth can support better debt sustainability, healthier tax bases, and stronger domestic savings, which in turn deepen local capital markets. Over time, stronger growth and productivity can also support real currency appreciation, reinforcing the case for local currency exposure.

The post-pandemic global inflation shock of 2021-2022 served as a major test for EM central banks. Many passed that test by responding early and decisively with meaningful rate hikes. Credible monetary policy should give investors greater confidence that EM central banks will keep inflation expectations anchored and high real yields are not a precursor to renewed instability, but instead an attractive value proposition.

Annual GDP: Developed vs. Emerging Markets

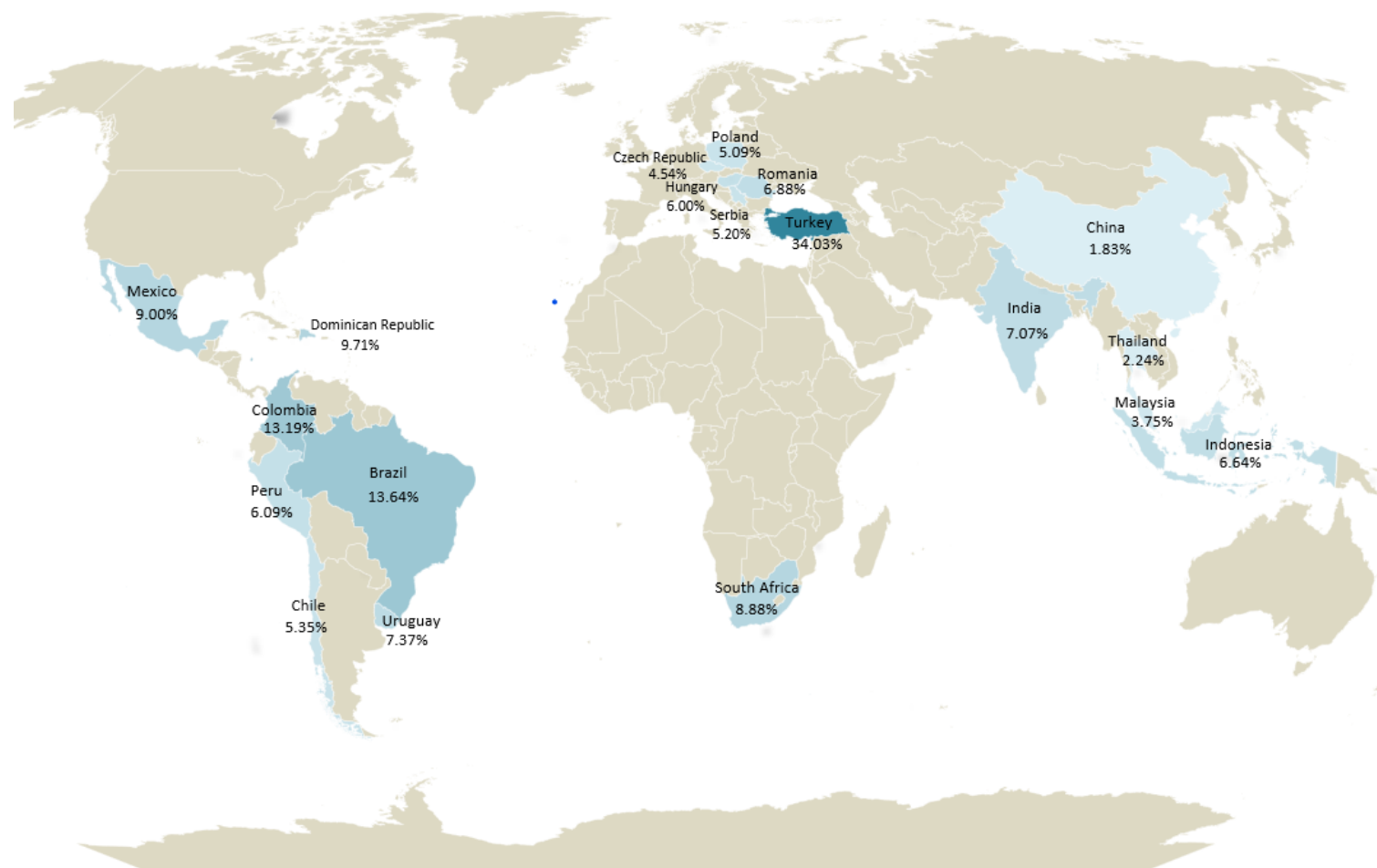


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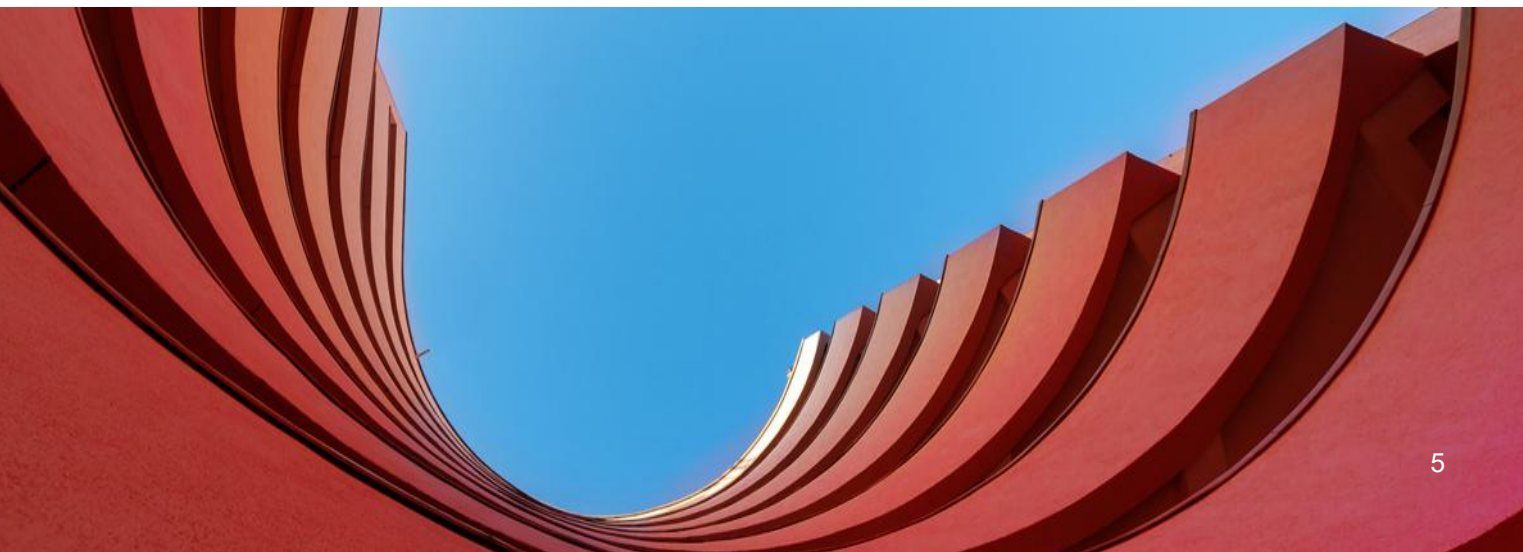
Average Yield to Maturity of countries in our EM local debt portfolio

Avg YTM
1.83% 34.03%



Sources: HSBC Asset Management, Bloomberg, as of 24 April 2026

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Conclusion

EM local currency debt stands out in today's markets by offering high real yields and attractive carry, delivering meaningful income and a margin of safety for investors. Improved policy and institutional frameworks have strengthened resilience, while exposure to a range of relatively inexpensive currencies adds diversification. Structural fundamentals are notably stronger than in previous cycles, further supporting the asset class.

Risks remain and should not be understated, but current valuations provide ample compensation—especially when accessed through diversified, actively managed portfolios. For investors willing to look beyond traditional developed market bonds, EM local debt presents a compelling opportunity to enhance income, diversify risk, and participate in the long-term growth and convergence of emerging economies.

To learn more about HSBC's offerings on Emerging Market Local Debt, please contact your local HSBC representative.

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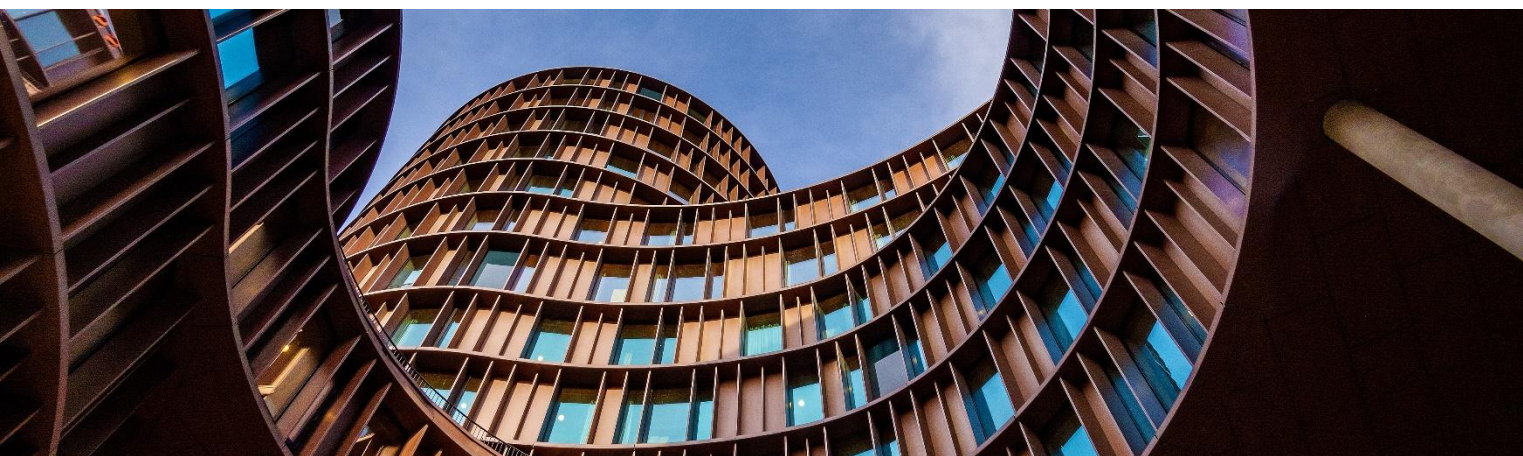




Key Risks

Risk Considerations. There is no assurance that a portfolio will achieve its investment objective or will work under all market conditions. The value of investments may go down as well as up and you may not get back the amount originally invested. Portfolios may be subject to certain additional risks, which should be considered carefully along with their investment objectives and fees.

- ◆ **ESG Investing Risk.** The use of ESG criteria in the strategy's investment process may cause the strategy to forgo investment opportunities available to other strategies that do not use these criteria, or to increase or decrease its exposure to certain sectors or types of issuers, which may negatively impact the strategy's relative performance as compared to non-ESG strategies. Investing on the basis of ESG criteria is qualitative and subjective by nature and there can be no assurances that the process utilized by the Adviser will enable the strategy to meet its investment objectives.
- ◆ **Exchange Rate Risk** Changes in currency exchange rates could reduce or increase investment gains or investment losses, in some cases significantly.
- ◆ **Counterparty Risk** The possibility that the counterparty to a transaction may be unwilling or unable to meet its obligations.
- ◆ **Liquidity Risk** is the risk that a Fund may encounter difficulties meeting its obligations in respect of financial liabilities that are settled by delivering cash or other financial assets, thereby compromising existing or remaining investors.
- ◆ **Operational Risk** may subject the Fund to errors affecting transactions, valuation, accounting, and financial reporting, among other things.
- ◆ **Derivatives Risk** Derivatives can behave unexpectedly. The pricing and volatility of many derivatives may diverge from strictly reflecting the pricing or volatility of their underlying reference(s), instrument or asset.
- ◆ **Emerging Markets Risk** Emerging markets are less established, and often more volatile, than developed markets and involve higher risks, particularly market, liquidity and currency risks.
- ◆ **Interest Rate Risk** When interest rates rise, bond values generally fall. This risk is generally greater the longer the maturity of a bond investment and the higher its credit quality.
- ◆ **Default Risk** The issuers of certain bonds could become unwilling or unable to make payments on their bonds.
- ◆ **Credit Risk** A bond or money market security could lose value if the issuer's financial health deteriorates.
- ◆ **CoCo Bond Risk** Contingent convertible securities (CoCo bonds) are comparatively untested, their income payments may be cancelled or suspended, and they are more vulnerable to losses than equities and can be highly volatile.
- ◆ **Sustainability risk** means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment.





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