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EMERGING MARKET DEBT

An opportunity for U.K. institutional investors

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The U.K. government's *Fit for the Future*[1] reform is reshaping the Local Government Pension Scheme (LGPS) landscape. Larger dedicated investment pools are retrenching governance, oversight and operational capacity to pursue increasingly sophisticated investment strategies to secure more ambitious outcomes. This is a pivotal moment for LGPS investors to reassess where genuine opportunities exist.

One area where increased allocations could merit serious consideration is Emerging Market Debt (EMD). Despite representing approximately 20% of the $145 trillion global fixed income universe[2], and spanning a rich spectrum of sub-asset classes across hard and local currency, sovereign and corporate debt, the average LGPS scheme allocates approximately 1% of scheme assets to the asset class, based on Nuveen's research[3]. That gap between opportunity and allocation is notable, particularly at a time when EMD's fundamental backdrop is improving materially.

Flows tell part of the story. After years of outflows, 2025 marked the first year of positive EM bond flows since 2021, with nearly $31 billion returning to the asset class. Despite heightened volatility and ongoing uncertainty from geopolitical conflicts (both Iran and Venezuela): year-to-date flows in 2026 have already reached $17.4 billion, as of March 2026[4]. The scale of the opportunity is equally compelling: emerging markets now account for around 60% of global GDP[5] and contribute roughly 65% of global growth[6], yet many institutional portfolios remain underweight.

For LGPS investors specifically, the case for EMD rests on several converging arguments. The asset class has compared favorably with major credit sectors on a risk-adjusted basis, while offering some of the highest yields available in liquid fixed income; an attractive proposition against an increasingly crowded developed credit market. Structural improvements in credit quality and central bank credibility have bolstered the resilience of the asset class. EMD has also historically performed well during periods of US dollar weakness and could offer meaningful diversification for sterling-based portfolios. With consolidation unlocking greater scale and investment resources, LGPS schemes are now better positioned than ever to access these opportunities selectively and efficiently.

This paper sets out the case for why EMD deserves a more prominent role in LGPS portfolios, and how investors might think about building that exposure.

Closing the gap: A case for revisiting EMD allocations

Based on public disclosures, U.K. LGPS allocations to EMD appear relatively modest, averaging around 1% of scheme assets.[2] Most pools appear to access EMD primarily through multi-asset credit (MAC) mandates, while a smaller number maintain dedicated EMD allocations with specialist managers.

Accessing EMD via MAC can be entirely appropriate, particularly where the objective is broad credit diversification. However, it can also mean EMD is treated as a secondary or opportunistic exposure rather than a deliberate strategic allocation. In practice, this may reduce an asset owner's ability to set (and maintain) a target exposure, express a clear preference between hard-currency, local-currency and corporate EMD, and manage portfolio risks, such as duration, currency-hedging approach, and country concentration in a transparent way. A standalone EMD allocation could therefore be helpful where schemes want clearer governance, sizing discipline, and accountability for outcomes within this specific opportunity set. It also creates the conditions for more deliberate RI implementation, whether that means applying a bespoke exclusions framework, setting explicit expectations around ESG assessment, or ensuring that climate-related risks are managed in a manner consistent with the scheme's broader sustainability commitments.

This mismatch is notable given EMD's long-term performance characteristics. Since the inception of EM indices in 1999, the asset class has delivered attractive risk-adjusted returns relative to other sectors typically found in multi-asset credit portfolios:

Figure 1: EMD has provided strong risk-adjusted returns relative to other credit sectors since inception of the EMBI Global Diversified Index

	Market size ($tn)	Return	Std dev	Yield	Sharpe ratio
Emerging market debt	$4.0	7.56%	8.70%	7.31%	0.65
U.S. high yield	$1.7	6.29%	8.81%	7.38%	0.50
U.S. senior loans	$1.5	4.97%	6.04%	8.70%	0.50
Euro high yield	$0.4	4.73%	10.74%	6.09%	0.19
U.S. commercial mortgage-backed securities	$0.7	4.85%	5.89%	5.58%	0.49
U.S. asset-backed securities	$0.7	3.53%	2.23%	5.62%	0.66

Source: Bloomberg, Morningstar Direct, JPM as of 1st August 1999 – 31 March 2026. **Representative indexes: Emerging markets debt:** JPM EMBI Global Diversified TR USD Index; **U.S. high yield:** ICE BofA US High Yield TR USD Index; **U.S. senior loans:** Morningstar LSTA US LL TR USD Index; **Euro high yield:** ICE BofA Euro High Yield TR EUR Index; **U.S. commercial mortgage-backed securities:** ICE BofA US Fxd Rate CMBS TR USD Index; **U.S. asset-backed securities:** ICE BofA US Fxd Rate ABS TR USD Index. **Past performance is no guarantee of future returns. It is not possible to invest in an index.**

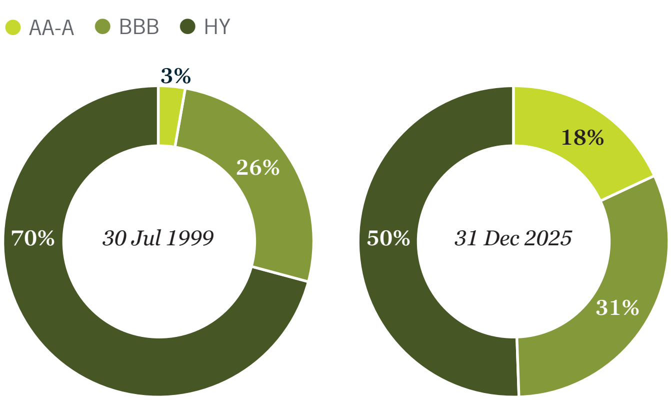
It is also worth noting that, at approximately $4 trillion, the EMD Hard Currency market is considerably larger than any other asset class in this comparison, more than twice the size of US High Yield and nearly ten times that of Euro High Yield. The distinction is not merely a matter of market size. EMD offers a meaningfully different credit profile to US High Yield, which on average carries lower credit quality and has historically experienced higher default rates than the crossover investment grade and high yield opportunity set available within EMD. EMD's Sharpe ratio of 0.65 is one of the highest in the group, combining strong returns with moderate volatility. With a current yield of around 7.3%, EMD offers one of the highest starting yields among the credit sectors shown, which may provide attractive income generation potential. Further, with hedging costs to convert dollar assets into sterling currently de minimis, EMD can offer a meaningful pickup over Gilts (264 bps) and other U.K. corporates (178 bps) on a currency-adjusted basis.[7]

Not your grandparents' EM: structural quality transformation

The evolution of emerging market debt over the past two decades represents a fundamental transformation. Structural improvements, both in terms of credit quality and central bank credibility, distinguish today's EM from its historical reputation.

Positive trends in Credit Quality have long been evident: EMD is often seen by asset owners as a volatile and risky asset class, compared more to high yield than to investment grade credit. Yet the long-term trend has been one of steadily improving credit quality on average. In 1999, emerging market indices were dominated by high-yield issuers, which comprised more than 70% of the market. Back then, only 3% of bonds were rated single-A, and there were no AA-rated issuers. Today, the AA-A rated segment represents 18.5% of the universe, while high yield has fallen to around 50%. U.K. institutional investors can now access a genuinely diverse, deep, and liquid opportunity set of higher-quality emerging market bonds. Even as some countries mature and graduate from the sovereign indices (Kuwait, Qatar, UAE), corporate opportunities remain designated as EM and offer good relative value for active investors. The boundaries of what constitutes an emerging market are less relevant these days as geopolitics overshadows some of the pricing dynamics for such assets. For active managers with the flexibility to navigate across this spectrum, the blurring of these boundaries represents an opportunity rather than a constraint.

Figure 2: AA-A, BBB and HY credits as a % of EMD indices



Source: JPM (Dec 2025)

Further evidence of the positive structural trends in EM is the greater monetary credibility shown by their central banks. Prior to the Global Financial Crisis, emerging market central banks operated under significant fiscal dominance; when governments increased spending, central banks accommodated monetary easing while inflation expectations rose. The period following the GFC witnessed fundamental transformation. Today, when faced with unexpected fiscal expansion, EM central banks respond by tightening monetary policy rather than accommodating government spending.

Figure 3: Responses of inflation expectations & policy rates to fiscal spending shocks

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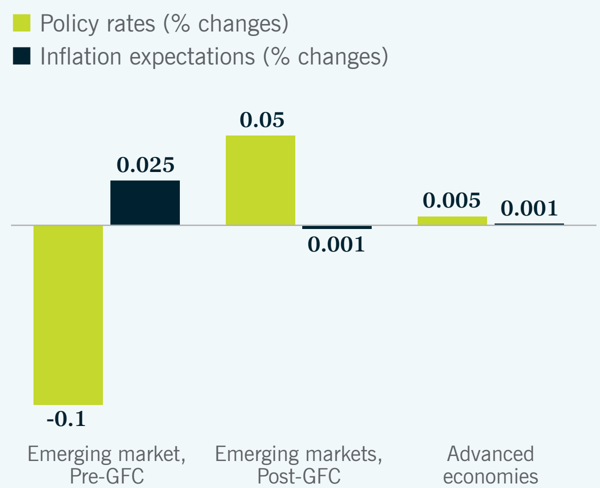


Source: IMF

IMF research in Figure 3 examines whether emerging market central banks remain subject to fiscal dominance by analyzing their response to unexpected military spending increases. Prior to the global financial crisis (1997 – 2009), emerging markets exhibited clear fiscal dominance: increases in spending triggered monetary easing (policy rate coefficient: -0.1) and rising inflation expectations (0.025). Since 2010, this pattern has been reversed entirely. Emerging market central banks no longer accommodate fiscal expansion, with policy rates now responding positively (0.05) to spending shocks while inflation expectations remain anchored near target (-0.002), mirroring the behavior of advanced economies.

The structural bull case: EMD is a major beneficiary of bearish US dollar markets

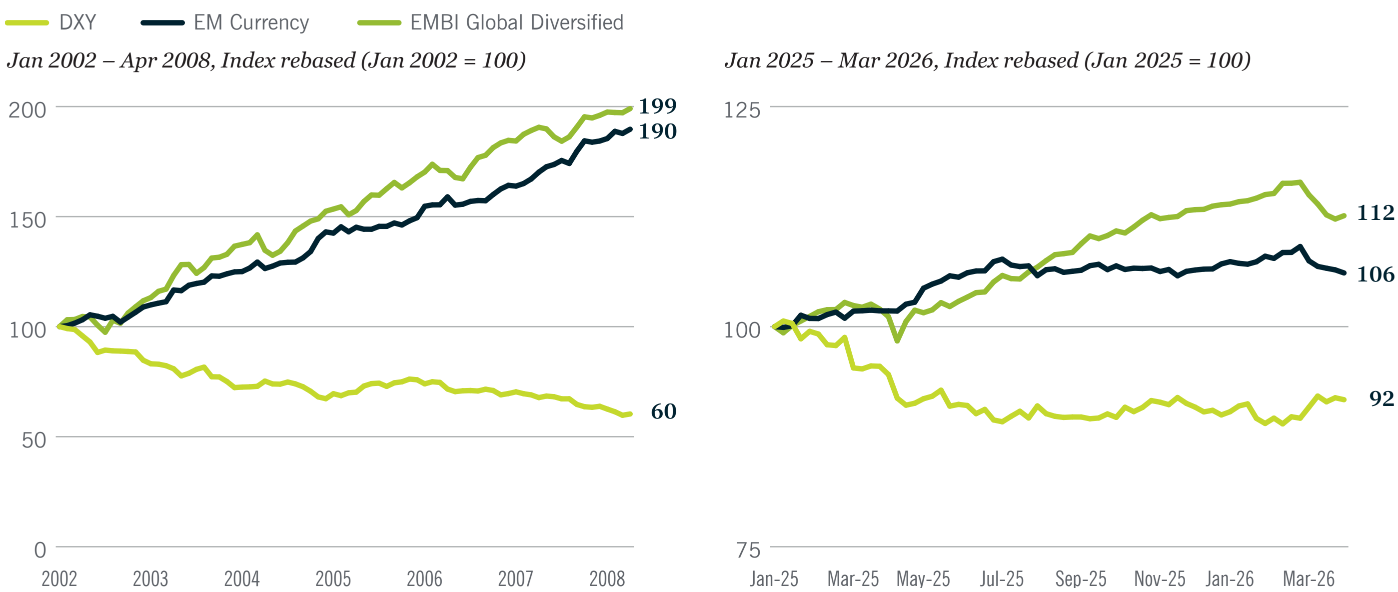
Emerging Market Debt has historically demonstrated strong performance during periods of US dollar weakness, making it an attractive allocation for periods when the dollar faces headwinds. The most recent evidence of this relationship comes from the post-9/11 period: from January 2002 through April 2008, as the US Dollar Index (DXY) declined by approximately 40% (from 120.21 to 72.51), the JPM EMBI Global Diversified Index delivered returns approaching 100%.

This inverse relationship stems from fundamental dynamics: a weaker dollar reduces the debt servicing burden for emerging market issuers (whose external debt is predominantly dollar-denominated), improves their terms of trade, and typically coincides with stronger commodity prices, all factors that enhance EM creditworthiness and bond valuations.

The current environment presents similar conditions. Under the "America First" agenda and tariff implementation starting in early 2025, the dollar has come under pressure, declining from 108.95 in January 2025 to just above 100 by March 2026. During this period, EMD has delivered strong returns, with the EMBI advancing over 12%, demonstrating once again the asset class's ability to capitalize on dollar weakness.

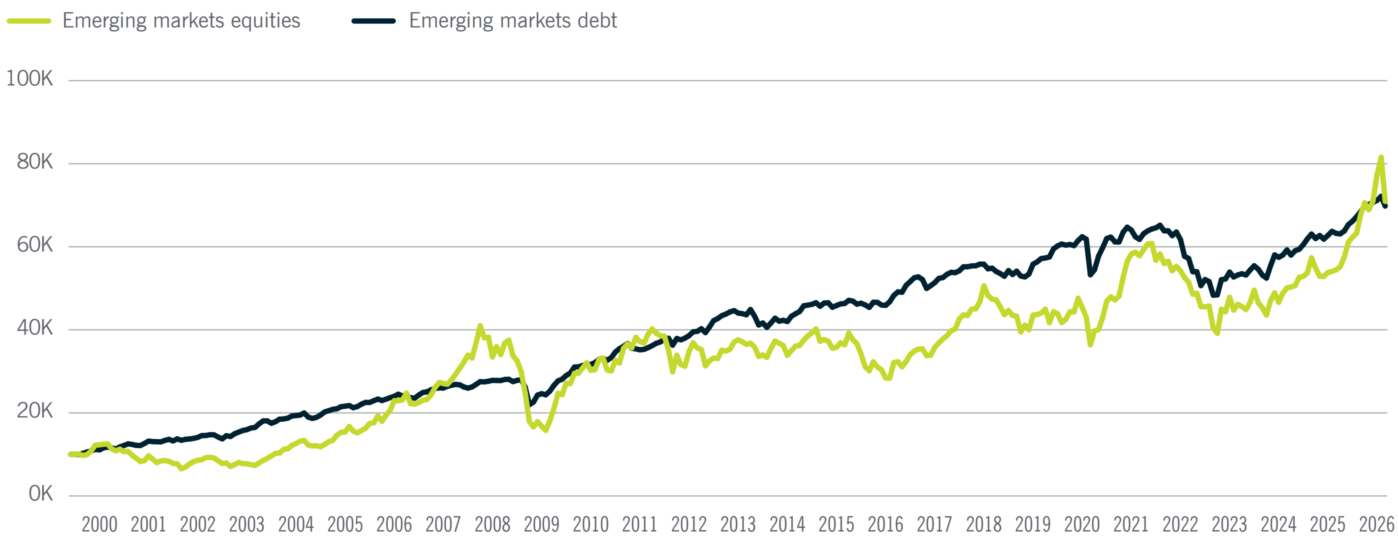
With continued US fiscal pressures, de-dollarization trends in emerging markets, and potential shifts in global capital flows, EMD is well-positioned to benefit from structural headwinds facing the US dollar over the medium term.

Figure 4: DXY vs EM credit and currencies



Source: Bloomberg, January 2002-April 2008, January 2025- March 2026. **Past performance is no guarantee of future returns. It is not possible to invest in an index.**

Figure 5: Growth of $10,000: EMD has generated similar returns to EM equities over the long term, with a smoother ride



Source: Morningstar Direct, 1st August 1999 – 31st March 2026. **Representative indexes: Emerging markets debt:** JPM EMBI Global Diversified TR USD Index; **Emerging markets equities:** MSCI EM GR USD Index. **Past performance is no guarantee of future returns. It is not possible to invest in an index.**

Complementary exposure to EM equities

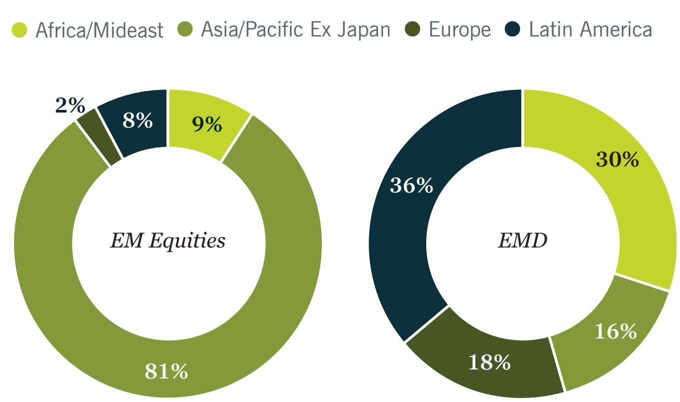
Since inception of EM indices, EMD has returned 7.56% annualized versus 7.62% for EM equities, similar outcomes achieved with 8.70% volatility compared to equities' 20.71%.

More importantly, EMD provides materially different exposure to Emerging Markets that are highly complementary to those offered by EM equities. The MSCI EM Equity Index, a proxy for global emerging market stocks is heavily concentrated in Asia, with China, Taiwan, South Korea, and India representing approximately 77% of the index, and Information Technology alone comprising roughly 30% of sector exposure. In contrast, EMD offers more diversified geographic exposure. Latin America represents approximately 36% of the index, and the Middle East and Africa represent approximately 30% of EMD, both regions with minimal equity market representation. Rather than mirroring the technology and manufacturing orientation of Asian equity markets, EMD offers exposure to commodity exporters, and economies with growing middle-class populations and expanding domestic consumer bases, as well as a wider range of development stages spanning frontier markets to more established emerging economies.

This complementarity extends to the issuer universe itself. Quasi-sovereign entities, such as state-owned enterprises and government-backed institutions, represent a significant and distinctive component of EMD that is often underrepresented or structurally disadvantaged in equity markets. While government ownership can make these entities appear less commercially driven and therefore less attractive to equity investors, in debt markets they frequently benefit from implicit or explicit sovereign support, which tends to enhance their creditworthiness, liquidity, and resilience during periods of market stress.

For U.K. Local Government pension schemes with existing EM equity allocations, EMD serves as a complement that could help to reduce geographic concentration risk, provides exposure to regions absent from typical equity portfolios, and delivers similar returns with lower volatility.

Figure 6: Regional breakdowns of EMD and EM equities



Source: MSCI, JPM as of 28th Feb 2026

A diversifier for U.K.-based portfolios

Over the long term, EMD has demonstrated notably lower correlation to U.K. fixed income assets.

These lower correlations can provide valuable diversification for LGPS portfolios and complement U.K. exposures, positioning EMD as a diversifier with the ability to capture the long-term structural growth of Emerging Markets.

Conclusion

U.K. LGPS allocations to EMD remain relatively modest compared with the size of the opportunity set and the role the asset class can play in diversified fixed income. Since inception, EMD has delivered attractive risk adjusted returns relative to other credit sectors, alongside evidence of structural improvement in both credit quality and central bank credibility. With one of the higher starting yields available in liquid fixed income, and with currency hedging costs currently negligible, EMD can provide an attractive income profile for sterling-based investors. A weaker US dollar can also be a supportive backdrop for returns. Finally, EMD can strengthen overall portfolio diversification given its relatively low correlation with U.K. domestic assets.

Figure 7: 20-year correlations of EM sovereign, EM corporate and EM local indices vs U.K. assets

	EM sovereigns	EM corporates	EM local	U.K. gilts	Sterling corporates
EM sovereigns	1.00				
EM corporates	0.91	1.00			
EM local	0.76	0.69	1.00		
U.K. gilts	0.41	0.30	0.41	1.00	
Sterling corporates	0.41	0.33	0.52	0.69	1.00

Source: Morningstar Direct as of 28th Mar 2026. **Representative indexes: Emerging markets sovereigns:** JPM EMBI Global Diversified TR USD Index; **Emerging markets corporates:** JPM CEMBI Diversified TR USD Index; **Emerging markets local:** JPM GBI-EM Global Diversified TR LCL Index; **U.K. gilts:** ICE BofA U.K. Gilt TR GBP Index; **Sterling corporates:** ICE BofA Sterling Corp TR GBP Index. **Diversification does not assure a profit or protect against loss.**

Harnessing alpha opportunities in EMD through active management – the Nuveen approach

Research shows that EM country-level dynamics have a significant influence on sector and security level performance. A rigorous country risk assessment should therefore form the basis of a sound investment approach focused on uncovering value in the asset class.

We believe emerging markets are inherently inefficient, and an investment approach that strategically combines EM sovereigns and corporates in a hard currency portfolio can deliver superior risk-adjusted returns over market cycles more efficiently compared to siloed or purely beta-driven approaches. By expanding the investable universe to include hard currency corporate and non-benchmark quasi sovereign opportunities, investors can earn incremental yield and total return over comparable benchmark-eligible exposures often without introducing additional tracking error. This stems from 1) the high correlation of corporates and sovereigns (>90% over the long-term), 2) relatively high credit quality of corporate bonds, 3) shorter duration of EM corporates relative to their sovereign counterparts.

Central to our investment process is a proprietary country cohort classification framework that groups emerging markets into five categories (Steady, Reformer, Laggard, Frontier, and Crisis-laden), informing both top-down country allocation and bottom-up security selection.

Corporate allocations are predominantly within the steady and reformer cohorts, which offer a robust opportunity set to capture incremental value in markets where sovereign bonds trade tight given strong underlying fundamentals. Underpinning this is a rigorous approach to credit research and risk management; a discipline deeply rooted in our heritage as an insurance company.

For more information, please visit nuveen.com.

Endnotes

1 Source: U.K. Government, LGPS: Fit for the Future consultation, https://www.gov.uk/government/consultations/local-government-pension-scheme-england-and-wales-fit-for-the-future/outcome/local-government-pension-scheme-england-and-wales-fit-for-the-future-government-response

2 Source: Bloomberg, JPM as of 31st December 2025

3 Source: Nuveen based on compiled data from LGPS annual reports

4 Source: JPM, as of 27th March 2026

5 Source: IMF, World Economic Outlook, October 2025

6 Source: LSEG Datastream, December 2025

7 Source: Bloomberg, JPM as of 30th March 2026. Currency adjusted calculations include an 18bps pickup from hedging EM USD to sterling, based on 3-month hedging costs.

Sources

Important information on risk

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