



—
Investing for a
world of change

Reframing fixed income: the old rules are no longer fixed



Peter Kent
Co-Head of Emerging
Market Fixed Income

Bond markets are in a new regime – ‘safe havens’ are no longer acting as such, and investors can no longer expect asset classes to behave as they have done historically. As a result, asset allocation approaches need a reboot, and portfolio diversification has never been such a virtue.

The new market regime

One thing that’s clear from the recent market turmoil is that asset classes are not behaving as they should. Traditional ‘safe haven’ debt markets have entered a new (higher) volatility regime, while supposedly ‘risky’ areas of the market have shown surprising resilience. The once distinct line between developed market (DM) and emerging market (EM) assets appears to have blurred. This, together with other macroeconomic and geopolitical shifts, has profound implications for asset allocators.

Unexpected behaviour in bond markets – a blurring of lines

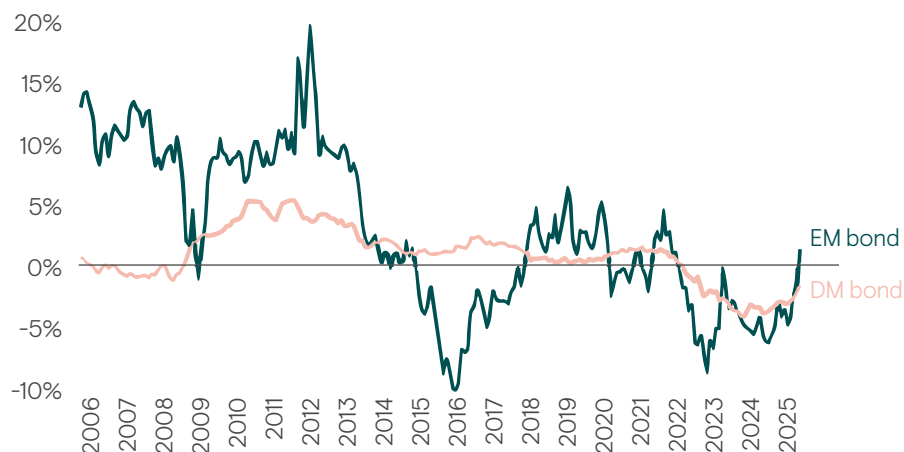
Back in 2022, we began alerting investors to an apparent regime shift in bond markets. Recent market events suggest this is more than a fleeting move – a fundamental shift appears well underway.

Reframing fixed income: the old rules are no longer fixed

In recent years, the volatility of asset classes traditionally viewed as risk-free, such as the UK Gilt, German Bund and US Treasury markets, has shifted gear. In fact, considering the behaviour of both the EM and DM asset classes from a risk and return perspective, there appears to have been a blurring of lines – a phenomenon we refer to as the ‘EM’ification of DM’.

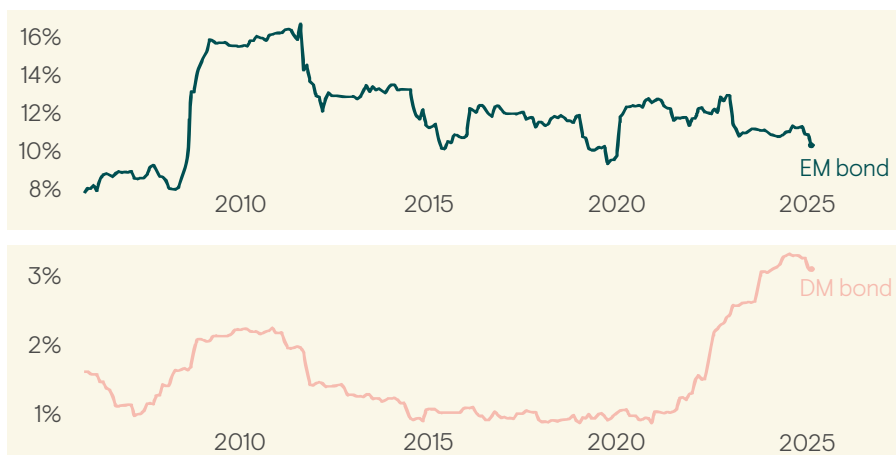
Since 2022, returns have been lacklustre in DM bond markets, while EM bonds have shown surprising resilience (Figure 1). Meanwhile, volatility in the EM bond market has remained within its historical ranges, but in DM it has risen sharply (Figure 2). Furthermore, there have been episodes of bear steepening in DM yield curves, which reflect concerns around policy credibility (as noted [here](#)) – an unenviable phenomenon traditionally reserved for EM bond markets.

Figure 1: Returns - rolling 3-year excess return over cash



Source: April 2025. EM bond = JPM GBI-EM unhedged. DM bond = equal weighting of USD hedged US, Japan, Germany, UK, Canada, New Zealand from Bloomberg Barclays Aggregate series. For further information on indices, please see the Important information section.

Figure 2: Risk - rolling 3-year volatility



Source: April 2025. EM bond = JPM GBI-EM unhedged; DM bond = equal weight of USD hedged 3-5yr US, Japan, Germany, UK, Canada, New Zealand from Bloomberg Barclays Aggregate series. For further information on indices, please see the Important information section

Driving forces behind a shift in asset class behaviour

Three broad developments – across EMs and DMs – help to explain a shift in DM bond market volatility and blurring of lines between DM and EM bond market behaviour:

1. Orthodox monetary policy in EMs
2. Fiscal restraint in EMs
3. Less certainty around policymaking in DMs

1 Orthodox monetary policy in EMs

Despite the headwind of relentless US dollar strength – plus the negative impact of Russia's local currency debt being written down to zero in 2022 – the EM debt asset class has shown resilience. This is largely thanks to orthodox monetary policy in many EM economies, with EM central banks wasting no time in embarking on interest rate-hiking cycles when inflation began to rise post-COVID 19. In contrast, some of the world's largest government bond markets have suffered from delayed action by DM central banks, which deemed higher inflation to be a 'transitory' phenomenon, meaning the eventual rate-hiking cycle was possibly faster and more pernicious than the path followed by EM central banks.

2 Fiscal restraint in EMs

In stark contrast to some of their DM peers – where fiscal discipline has eroded in recent years – fiscal fundamentals in many EM economies have strengthened over the past decade. Spurred on by the upheaval of the 2013 taper tantrum, which exposed underlying economic imbalances, many EM economies have undergone a significant rebalancing, strengthening their resilience. Even after the COVID-19 pandemic took hold, many EM policymakers remained fiscally prudent, resulting in primary fiscal balances returning to surplus within just a few years and debt-to-GDP stabilising at modest levels. Today, there are some great examples of sound economic stewardship across the EM investment universe, with Argentina now an unlikely poster child in this regard (fiscal discipline and reform are turning around the Argentine economy).

The fundamental improvements in EM economies are fuelling an improvement in rating dynamics. Combining the outlooks of S&P, Moody's and Fitch, ratings upgrades in 2024 outstripped downgrades across EM regions. Furthermore, this positive trend looks set to continue: at the time of writing, 44 EM countries are currently on positive outlook, compared with 32 on negative outlook.

While there are notable exceptions, credible policymaking and fiscal reform are unmistakable trends in EM economies, and this is reflected in increased resilience.

3

Less certainty around policymaking in DMs

'Political instability', 'rising populism' and 'unsustainable public finances' are terms traditionally associated with EM countries, but they have become increasingly common descriptions for some of the world's largest and most 'developed' economies in recent years.

While each country's political backstory is unique, the common theme is a pronounced deterioration of macroeconomic fundamentals. Today, glaring fiscal imbalances in some 'advanced' economies suggest the world order has been turned on its head, with little sign of this reversing materially. All of this speaks to a much less predictable policymaking backdrop in DM economies, equating to a more uncertain macroeconomic outlook, and necessitating increasing caution by – and risk premium for – investors.

The fundamental improvements in EM economies are fuelling an improvement in rating dynamics.

Has DM debt lost its defensive properties?

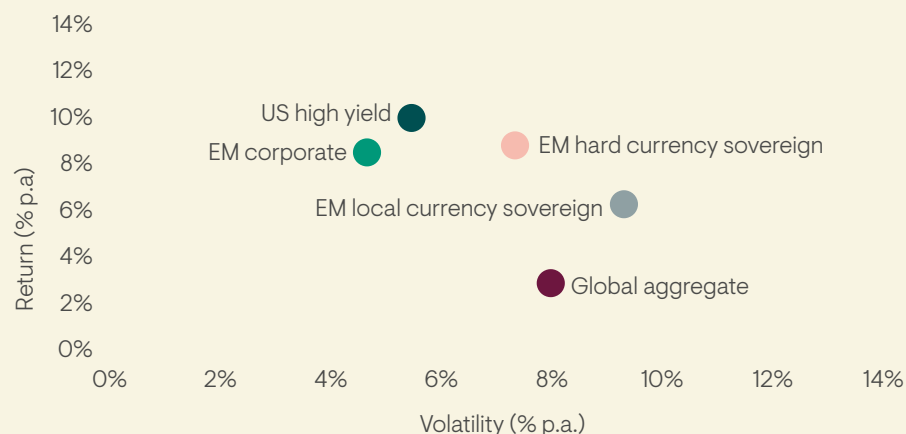
In addition to entering a new volatility regime, DM debt has also seen its role as a defensive portfolio allocation put to the test.

Over the past few decades, the economic community has generally become accustomed to dealing with ‘demand shocks’ – disruptions to aggregate demand, with the Global Financial Crisis a prime example. Analysing demand shocks, and policy responses to them, is relatively less complex than analysing supply shocks. Furthermore, the asset-class implications were predictable: when growth fell, lower inflation would follow, meaning fixed income behaved well as a defensive asset. But in the past 5-10 years, the nature of shocks hitting the global economy has changed. We have seen a series of ‘supply shocks’ – including Brexit, COVID-19, Russia’s invasion of Ukraine, and trade tariffs. These are exceptionally hard to quantify and have resulted in growth and inflation moving in opposite directions – i.e., lower growth and sticky inflation. That has led to higher correlations between defensive and cyclical assets; in this context, DM bonds have been less able to shield investors from equity market losses.

Put another way, the shift from demand to supply shocks has changed the nature of interest rate risk and its relationship with risk assets, meaning it’s not as helpful for managing a balanced portfolio as it used to be.

This shift has not gone unnoticed by policymakers; Fed Chair Powell recently noted: “We may be entering a period of more frequent, and potentially more persistent, supply shocks – a difficult challenge for the economy and for central banks”.

Figure 3: The new order of fixed income volatility: 2023 to March 2025 (in US dollars)



Source: Ninety One, Bloomberg, JP Morgan, as at 31 March 2025. EM corporate: JPM CEMBI. US high yield: Bloomberg US Corporate High Yield index. EM hard currency sovereign: JPM EMBI. Global aggregate: Bloomberg Global Aggregate. EM local currency sovereign: GBI-EM GD. For further information on indices, please see important information section.

Implications for asset allocators

Time to recalibrate asset-class perceptions

All of the shifts outlined above point to the need to view DM debt markets in a different light when considering portfolio allocations.

The same can be said for EM debt, where perceptions are often outdated. As we outlined [here](#), much has changed since so-called Brady bonds were first introduced in the late 1980s – when yields were sky high, liquidity was scarce, and most debt was dollar-denominated. Credible monetary policy in EM economies has underpinned the development and significant growth of the EM local currency debt market, and the volatility of the benchmark has fallen with the inclusion of more Asian markets, with somewhat lower yields today reflecting the higher quality of the asset class.

A major headwind to EMs is retreating

Taking a more forward-looking perspective, asset allocators need to question whether their experience over the past decade is likely to be repeated. The path of the US dollar is crucial, in this regard. The US dollar strength that has prevailed over the past decade, casting a shadow over EM asset-class returns, is arguably [fading](#). While the US economy has dominated global growth in recent years – resulting in US assets attracting the lion's share of inflows and the US dollar going from strength to strength – the investment and inflation outlook for the next decade is likely to mean a more even distribution of nominal growth across the globe.

With the US dollar unlikely to follow the same path as the past decade, and the US dollar shadow fading, EM debt deserves to move back onto asset allocators' radars.

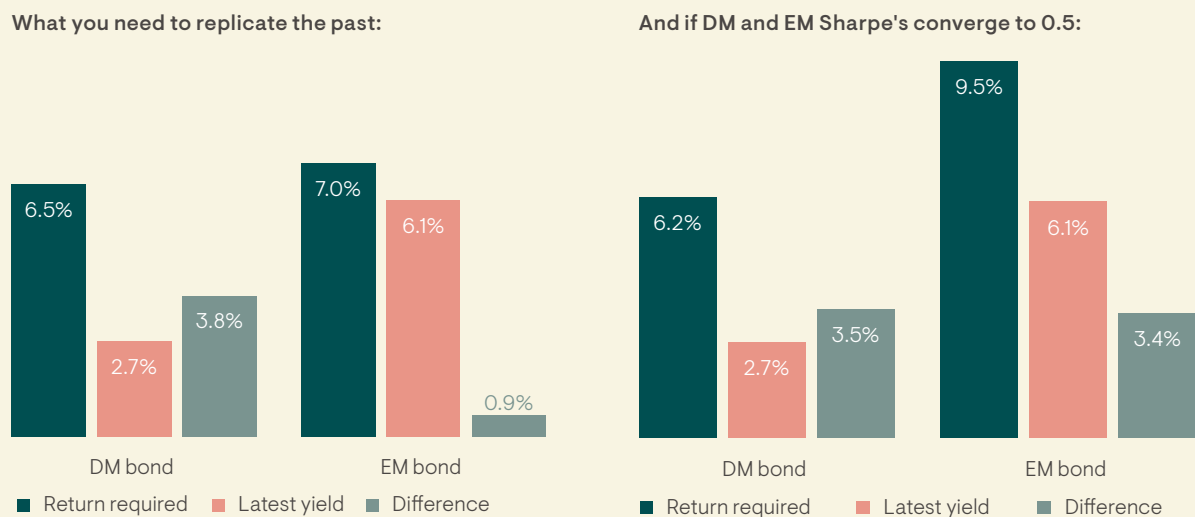
In addition to entering a new volatility regime, DM debt has also seen its role as a defensive portfolio allocation put to the test.

A different decade lies ahead

While asset allocators' experience will differ according to region and portfolio specifics, the framework below serves as a stylised example of what the new regime in DM bond market volatility means for asset allocators.

Heightened volatility in the DM bond market shifts the risk side of the risk/return equation. That means higher returns are now required to replicate past experience. Furthermore, if investors want to achieve the same Sharpe ratio from their DM and EM allocations as they have done historically, lower current yields point to a much higher capital gain requirement in DM; in contrast, yields in EM should provide the majority of what's needed (Figure 4).

Figure 4: The implication of the new volatility regime in markets



Source: Ninety One, Bloomberg, JP Morgan. Return required to replicate the past (left-hand chart): annualised return achieved January 2003 to May 2025. Latest yield: as at May 2025. EM bond = JPM GBI-EM unhedged. DM bond = equal weighting of USD hedged US, Japan, Germany, UK, Canada, New Zealand from Bloomberg Barclays Aggregate series. For further information on indices, please see the Important information section.

However, it seems reasonable to conclude that DM bonds will struggle to replicate historical outcomes. The next decade is likely to be more favourable for EMs as the rallying US dollar headwind begins to weaken and structural themes such as deglobalisation, the energy transition and demographics impact market behaviour.

Diversification has never been more important

Shifts in asset-class behaviour, coupled with the changing nature of economic shocks outlined above, mean the case for portfolio diversification has never been stronger. Crucially, a 'far and wide' approach may be needed when diversifying. And this is not just about picking winners; it's about avoiding losers, especially in today's geopolitical reality.

Importantly, asset allocators need to look at diversifying across new dimensions. In the past, diversification was thought of in terms of regions, currencies, asset type (sovereign/credit etc.) but the changing role of interest rate risk and duration in portfolios is a vital consideration. All of this points to a more diversified global fixed income portfolio, which includes EM debt and probably has somewhat shorter duration.

In this context, it is important to recognise the usefulness of EM debt as a portfolio diversifier, given the varied behaviour of individual asset classes across the cycle and the large dispersion across markets that sit within these. A key benefit to investing across all EM debt asset classes is that the performance of each sub-asset class is differentiated through the broader economic and monetary policy cycle.

EM debt – the great diversifier

The differentiated behaviour of local currency debt portfolios reflects the distinctive factors driving returns: differing interest rate regimes, divergent economic cycles and currency fluctuations.

All things being equal, the quality of the local currency debt opportunity set has improved in recent years through the addition of India and China, the removal of Russia from the index, and underlying improvements in the fundamentals of other countries, as noted earlier. Further, it is clear from analysing the behaviour within this opportunity set that not all countries sing to the same tune. In broad terms, there are three cohorts: high-quality Asia, Central and Eastern Europe, and then the more cyclical markets. The upshot is that in addition to its low correlation to other asset classes, there are significant diversifying forces within this asset class.

The hard currency debt market today is also highly diverse, spanning oil exporters and importers, regional manufacturing hubs and services-driven economies across the globe. The increased importance of frontier markets offers the opportunity for investors to take meaningful – and diversified – exposure to a broad range of underlying return drivers. Over time, the opportunity set has become more geographically diverse, and experienced an increase in longer-duration issuance from investment-grade issuers.

Reframing fixed income: the old rules are no longer fixed

The different interplay of each of these EM debt asset classes also offers a diversification benefit that is not widely recognised.

Figure 5: Correlation between EM and DM assets (Jan 2003 - Dec 2024)

		EM hard currency sovereign	EM local currency sovereign	Global aggregate USD	US Treasuries	USD Investment-grade corporate
USD perspective	EMHC Sov	1.00	0.80	0.69	0.35	0.83
	EMLC Sov		1.00	0.70	0.21	0.61
	Global Agg USD			1.00	0.68	0.78
	US Treasuries				1.00	0.63
	US IGC					1.00
		EM hard currency sovereign	EM local currency sovereign	Global aggregate CAD	CAD bonds	CAD Investment-grade corporate
CAD perspective	EMHC Sov	1.00	0.68	0.65	0.55	0.56
	EMLC Sov		1.00	0.46	0.39	0.45
	Global Agg CAD			1.00	0.65	0.34
	CAD bonds				1.00	0.73
	CAD IGC					1.00

Source: Ninety One, Bloomberg, JP Morgan, ICE BofA, as at 31 December 2024. EM hard currency sovereign: JP Morgan EMBI. EM local currency sovereign: JP Morgan GBI-EM GD. Global aggregate: Bloomberg Global Aggregate. US Treasuries: JP Morgan GBI-US. US investment-grade corporate: ICE BofA US Corporate Index. CAD bonds = JPMorgan GBI Canada index. CAD investment-grade corporate: Bloomberg Canada Aggregate Corporate Total Return Index Value Unhedged CAD. For further information on indices, please see important information section.

In summary

Bond markets are in a new regime – one where old distinctions between EM and DM debt no longer hold and investors can no longer expect asset classes to behave as they have done historically. In short, we have seen the ‘EMification of DM’.

Asset allocation approaches need a reboot in a world where portfolio diversification has never been such a virtue, but the means to achieve this have changed. In this context, and supported by an enduring, positive shift in fundamentals, EM debt deserves a place at the global investor table.

General risks. The value of investments, and any income generated from them, can fall as well as rise. Costs and charges will reduce the current and future value of investments. Past performance does not predict future returns. Investment objectives may not necessarily be achieved; losses may be made. Target returns are hypothetical returns and do not represent actual performance. Actual returns may differ significantly. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

Specific risks. Emerging market (inc. China): These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems.

Important information

The content of this communication is intended for readers with existing knowledge of financial markets.

This communication is provided for general information only. Nothing herein should be construed as an offer to enter into any contract, investment advice, a recommendation of any kind, a solicitation of clients, or an offer to invest in any particular strategy, security, derivative or investment product. The information may discuss general market activity or industry trends and is not intended to be relied upon as a forecast, research, or investment advice. The economic and market views presented herein reflect Ninety One's judgment as at the date shown and are subject to change without notice. Views and opinions presented herein will be affected by changes in interest rates, general market conditions and other political, social and economic developments. There is no guarantee that views and opinions expressed will be correct and may not reflect those of Ninety One as a whole, different views may be expressed based on different investment objectives. Although we believe any information obtained from external sources to be reliable, we have not independently verified it, and we cannot guarantee its accuracy or completeness. Ninety One's internal data may not be audited. Ninety One does not provide legal or tax advice. Reliance upon information in this material is at the sole discretion of the reader. Investors should consult their own legal, tax and financial advisor prior to any investments. Past performance should not be taken as a guide to the future. Investment involves risks; losses may be made.

Except as otherwise authorised, this information may not be shown, copied, transmitted, or otherwise given to any third party without Ninety One's prior written consent. © 2025 Ninety One. All rights reserved. Issued by Ninety One, May 2025. In South Africa, Ninety One SA Proprietary is an authorised financial services provider.

Indices

Indices are shown for illustrative purposes only, are unmanaged and do not take into account market conditions or the costs associated with investing. Further, the manager's strategy may deploy investment techniques and instruments not used to generate Index performance. For this reason, the performance of the manager and the Indices are not directly comparable.

If applicable MSCI data is sourced from MSCI Inc. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

If applicable FTSE data is sourced from FTSE International Limited ('FTSE') © FTSE 2025. Please note a disclaimer applies to FTSE data and can be found at www.ftse.com/products/downloads/FTSE_Wholly_Owned_Non-Partner.pdf

Australia

Level 28 Suite 3, Chifley Tower
2 Chifley Square
Sydney, NSW 2000
Telephone: +61 2 9160 8400
australia@ninetyone.com

Botswana

Plot 64289, First floor
Tlokweng Road, Fairgrounds
Gaborone
PO Box 49
Botswana
Telephone: +267 318 0112
botswanaclientservice@ninetyone.com

Channel Islands

PO Box 250, St Peter Port
Guernsey, GY1 3QH
Telephone: +44 (0)1481 710 404
enquiries@ninetyone.com

Germany

Bockenheimer Landstraße 23
60325 Frankfurt am Main
Telephone: +49 (0)69 7158 5900
deutschland@ninetyone.com

Hong Kong

Suites 1201-1206, 12/F
One Pacific Place
88 Queensway, Admiralty
Telephone: +852 2861 6888
hongkong@ninetyone.com

Luxembourg

2-4, Avenue Marie-Thérèse
L-2132 Luxembourg
Telephone: +352 28 12 77 20
enquiries@ninetyone.com

Namibia

Am Weinberg Estate
Winterhoek Building
1st Floor, West Office
13 Jan Jonker Avenue
Windhoek
Telephone: +264 (61) 389 500
namibia@ninetyone.com

Netherlands

Johan de Wittlaan 7
2517 JR Den Haag
Netherlands
Telephone: +31 70 701 3652
enquiries@ninetyone.com

Singapore

138 Market Street
CapitaGreen #27-02
Singapore 048946
Telephone: +65 6653 5550
singapore@ninetyone.com

—

www.ninetyone.com

Telephone calls may be recorded for training, monitoring and regulatory purposes and to confirm investors' instructions.

For more details please visit www.ninetyone.com/contactus

South Africa

36 Hans Strijdom Avenue
Foreshore, Cape Town 8001
Telephone: +27 (0)21 901 1000
enquiries@ninetyone.com

Sweden

Västra Trädgårdsgatan 15,
111 53 Stockholm
Telephone: +46 8 502 438 20
enquiries@ninetyone.com

Switzerland

Dufourstrasse 49
8008 Zurich
Telephone: +41 44 262 00 44
enquiries@ninetyone.com

United Kingdom

55 Gresham Street
London, EC2V 7EL
Telephone: +44 (0)20 3938 1900
enquiries@ninetyone.com

United States

Park Avenue Tower, 65 East 55th Street
New York, 10022
US Toll Free: +1 800 434 5623
usa@ninetyone.com