

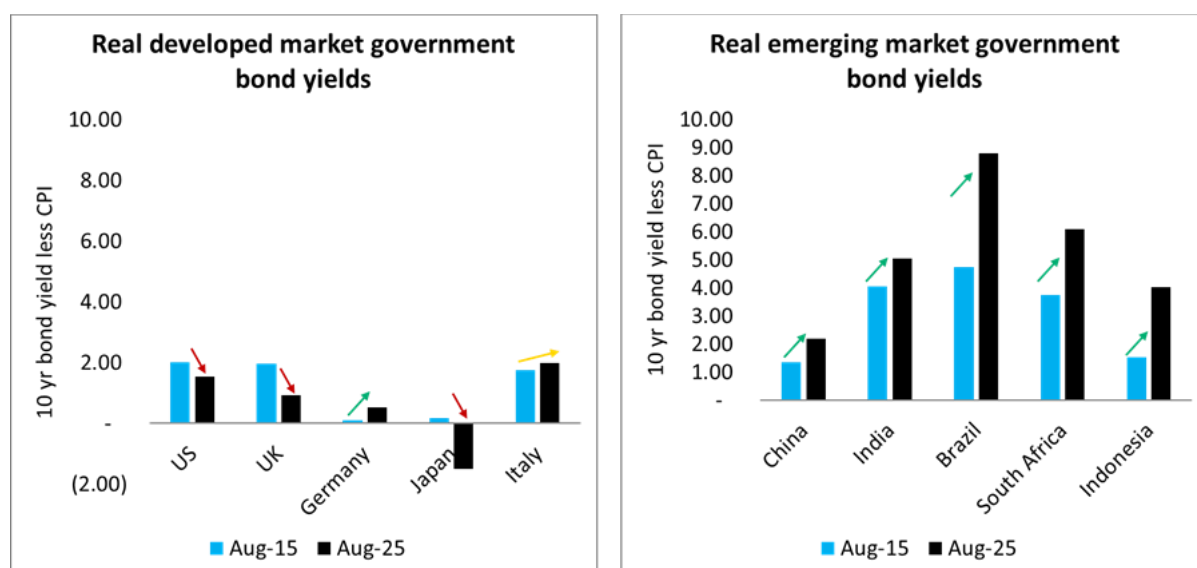
When safe havens aren't safe: Do EM investors have a home-field advantage?

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For decades, investors thought they knew the rules. Developed market (DM) bonds were 'safe havens': stable, predictable, and underpinned by powerful central banks that acted as buyers of last resort when times were tough. Emerging market (EM) bonds, meanwhile, were treated with suspicion—too much political risk, fears of inflation, and the potential for debt spirals (where more debt is required to finance existing debt and interest payments).

But the world has changed. The risk differential between EMs and DMs has steadily declined. Some DMs are beginning to look, in risk terms, a lot like EMs used to look, while many EMs have worked hard to strengthen their fundamentals. In some cases, the traditional roles have not just blurred – they've inverted. The result is a global fixed-income landscape that looks far less familiar, and far less predictable, than it did a decade ago.

At the same time, the payoff for investors has shifted. Real returns on EM sovereign bonds have risen, while real yields on those supposedly 'safe' DM assets have broadly declined (and the few increases in real DM yields have been marginal). The irony is hard to miss: what investors once feared has become familiar, and what was once relied on has become far less predictable.



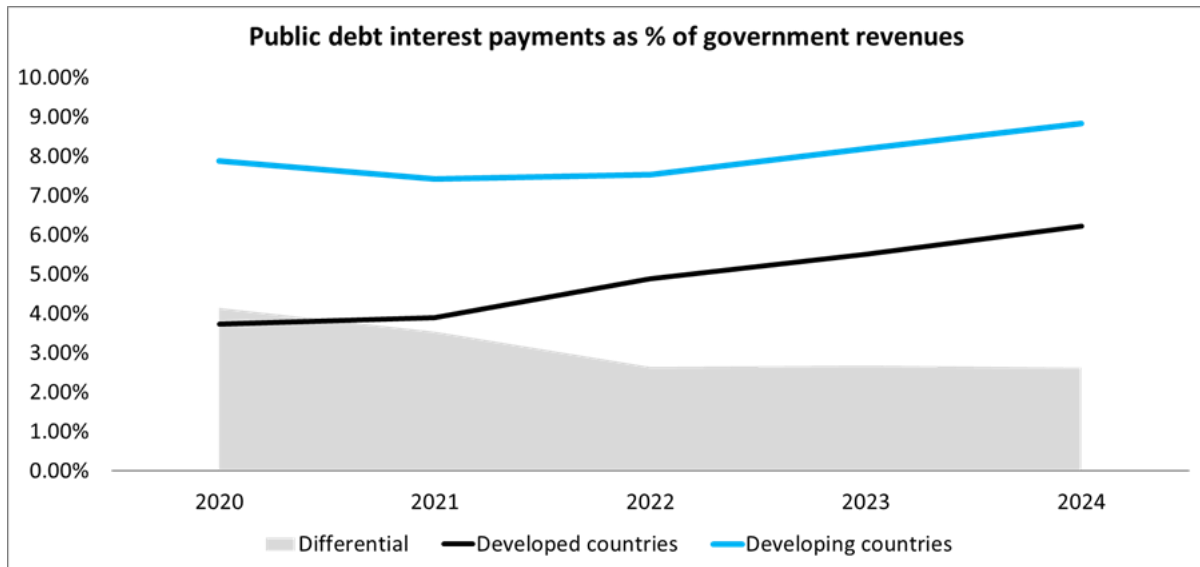
Source: Bloomberg

DMs are importing EM-style risks

For years, the standard argument in favour of DMs was simple: they could afford to carry more debt, because the cost of servicing that debt was much lower. EM governments, by contrast, risked a vicious cycle. High borrowing costs meant that too much of their revenue was swallowed by interest payments, crowding out other priorities and often forcing them back into the market for yet more expensive debt. The dreaded 'debt spiral' loomed large.

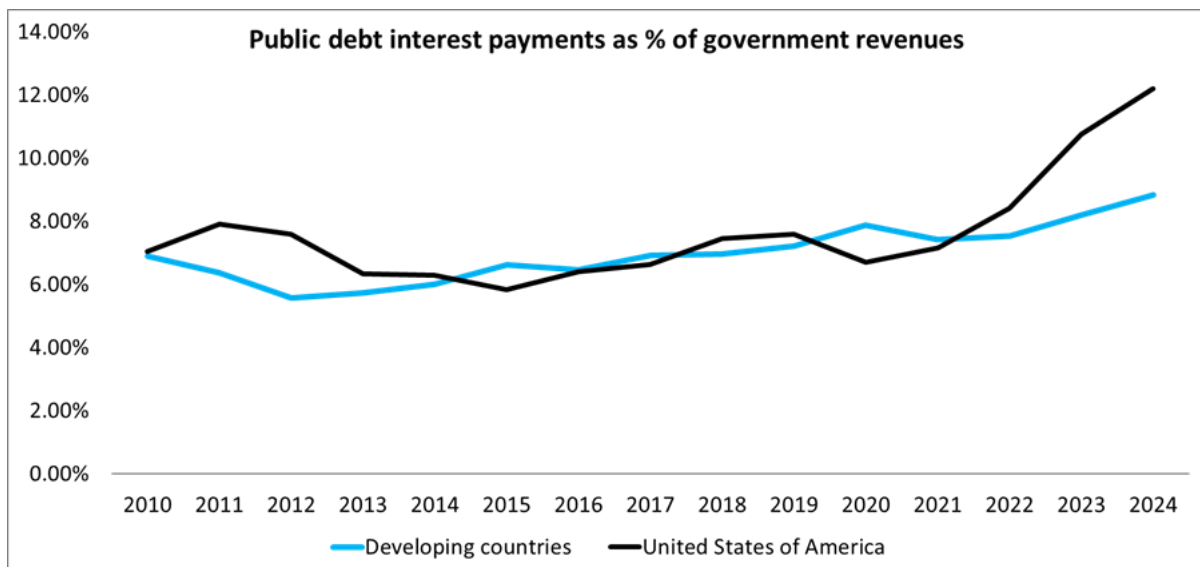
Fast forward to today, and that script looks outdated. Debt servicing costs have increased across the globe. However, the gap between what DMs and EMs spend on

interest payments has narrowed sharply since the 2020 pandemic stimulus binge in DMs, compared to relatively more prudent debt management in EMs.



Source: United Nations Trade and Development (UNCTAD)

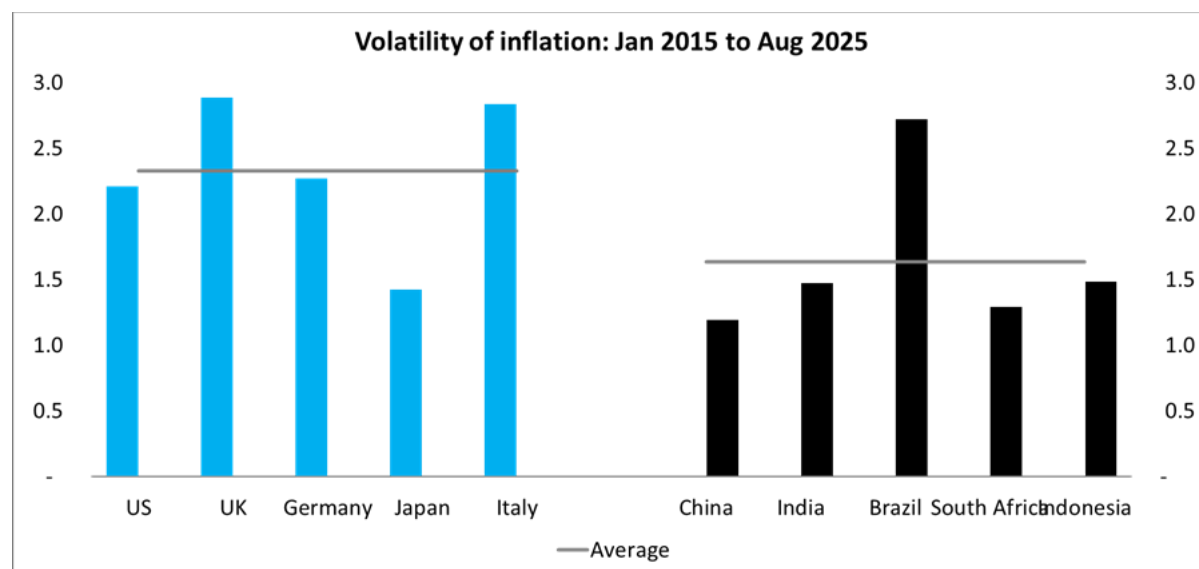
The US offers perhaps the most striking example. The average federal funds rate from after the Global Financial Crisis (GFC) and until the Covid-19 pandemic, was just 0.79%. Today, it's 4.25%. Even if debt levels had remained constant, this increase would have driven a massive increase in servicing costs. But US debt has risen too: from 108.2% of GDP in 2019 to 120.8% in 2024, with the International Monetary Fund (IMF) projecting 128.2% Gross Debt-to-GDP by 2030. As a result, the cost of servicing US debt now exceeds the average cost across emerging and frontier markets. While the US example is the most acute, the same phenomenon is evident in other DMs, such as the UK. This convergence highlights how quickly assumptions about debt sustainability can unravel when interest rate regimes shift.



Source: United Nations Trade and Development (UNCTAD)

The volatility shift

Another hallmark of EMs has always been volatility: in prices, currencies and inflation. Yet here too, the tables have turned. Inflation volatility has increased in DMs, with upside risks to absolute inflation levels now becoming more of a concern. In fact, the most liquid DM markets are today showing higher inflation volatility than their liquid EM counterparts.



Source: Bloomberg

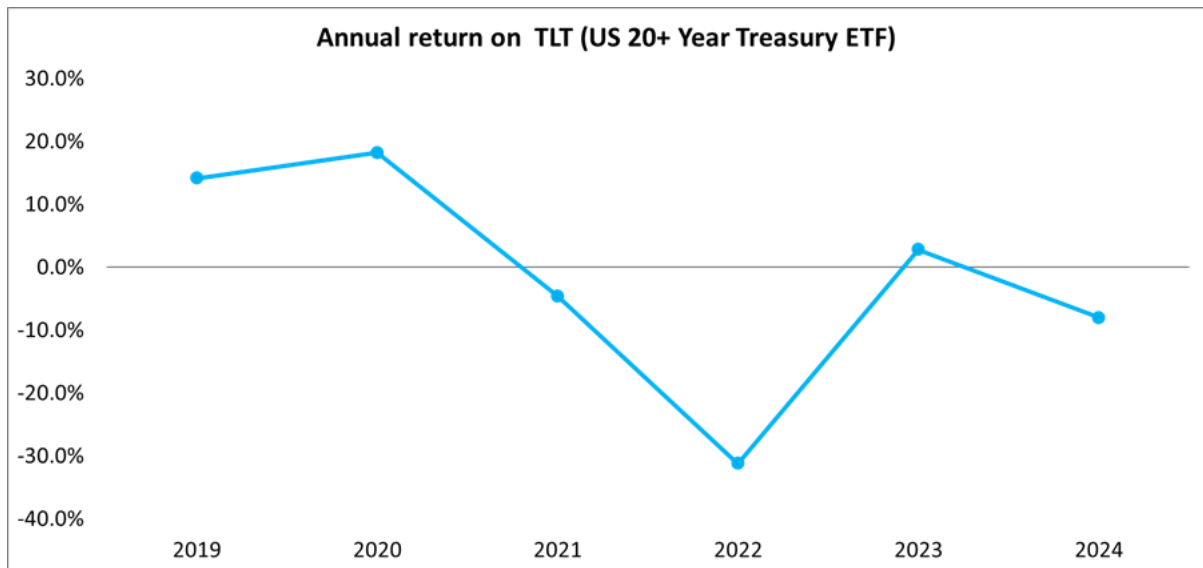
Investors once put up with EM volatility for the lure of higher yields. Now, the markets that were previously 'safe' have developed a taste for drama, while EM markets continue to offer high real yields with greater levels of certainty. Given these shifting dynamics, the R58.5 billion in net purchases by foreigners of SA government bonds, begins to make sense.

What does this mean for investors?

It doesn't mean rushing to sell all DM bonds or going all-in on EM debt. Instead, it means questioning long-held assumptions about what's truly safe and what's not, and ensuring portfolios are constructed taking new market dynamics into account. It also means ensuring you are being appropriately rewarded when investing, either in DM or EM bonds, for the risks you are taking on.

Fund managers who have been navigating EM markets for years suddenly find themselves with a home-field advantage. They know how to operate in an environment characterised by volatility, shifting fundamentals, and debt servicing pressure. They're used to seeing risk as dynamic rather than static, and they've developed the tools to find opportunity in those conditions. In many ways, the EM playbook – resilience, flexibility, and a readiness to adapt – is becoming the global playbook.

By contrast, some DM-focused managers have been caught off guard. Holding long-duration DM bonds in late 2020 would have been seen by many investors as prudent risk management. The spike in inflation and soaring bond yields in the ensuing years turned the 'normal' playbook on its head.



Source: Bloomberg

Rather than avoiding volatility, the more important question is: who knows how to use it?

Markets are messy, and risk isn't what it used to be. The once-clear distinction between EM 'risk' and DM 'safety' has blurred, and in some cases inverted entirely.

That creates both challenges and opportunities. Volatility is not the enemy. It's the terrain. And the managers who've been navigating EM landscapes for decades may now be best positioned to act as the guides in constructing global fixed income portfolios.