GENERALI INVESTMENTS

Emerging and frontier market debt in 10 key questions

March 2026

GlobalEvolution

Witold Bahrke
Senior Macro and Allocation Strategist at Global Evolution, part of Generali Investments

How is emerging market debt (EMD) reacting to the US-Israel-Iran conflict? What are the range of potential outcomes for emerging market (EM) countries? And why is frontier market debt a bright spot, even during times of volatility? Witold Bahrke answers the key questions EM investors need to consider.

1. WHAT IS YOUR BASE CASE SCENARIO FOR THE ESCALATION OF THE US-ISRAEL-IRAN CONFLICT?

Our base case is still that we are going to see a deescalation of the conflict after weeks rather than days or months. The range of outcomes has widened and the tails have become fatter, but we have not fundamentally changed our scenario.

The key variable is oil. While the oil price has jumped over the $100 per barrel mark, our central expectation is that prices do not settle sustainably above this for weeks or months. If that remains the case, the shock should be manageable for the global economy.

So our baseline is a period of elevated uncertainty and higher near-term oil prices, but not a structural change to the global macro cycle.

2. WHAT IS YOUR UPSIDE AND DOWNSIDE CASE?

The downside case is a conflict that drags on for months and pushes oil prices sustainably above $100. Initially that would look stagflationary – higher inflation combined with weaker growth – and if prolonged it could evolve into a recessionary dynamic. That would likely mean wider credit spreads, weaker Emerging Market currencies and a tougher environment for risk assets more broadly.

The upside case is simply that the conflict remains contained and de-escalates sooner than feared. A rapid geopolitical reset is difficult to rely on at this stage, so the more realistic upside is that the conflict proves shorter and more contained than markets currently expect.

3. HOW HAVE EM INVESTORS REACTED SO FAR AND WHY?

The clearest reaction has been in local-currency debt, which has sold off more than hard-currency debt. That is fairly typical in a risk-off environment. FX markets are liquid, and when investors rush to cut risk that is where the 'queue at the exit' tends to form first.

Large local markets are particularly exposed because they have deeper liquidity and meaningful foreign participation. On top, positioning was quite stretched as we went into 2026, which in and of itself makes the segment vulnerable to shocks.

Hard-currency debt has held up somewhat better. Overall, markets have moved in the direction you would expect, but the magnitude of the move so far has still been relatively moderate, testament to EMD's improving resilience.

4. HOW ARE YOU ASSESSING THE RISKS TO OIL PRICES, AND THEREFORE TO INFLATION AND GROWTH?

The duration of the conflict is critical. If the shock lasts weeks, the global economy can absorb somewhat higher oil prices without major disruption. If it lasts months, the picture changes.

In our central scenario, oil prices may spike but are unlikely to remain elevated long enough to trigger sustained demand destruction.

That means inflation risks rise in the short term, but not necessarily in a way that fundamentally derails growth.

There will be clear winners and losers, however. Oil importers are more vulnerable, while exporters outside the immediate conflict zone could benefit.

5. WHAT ARE THE IMPLICATIONS FOR CENTRAL BANKS?

Higher oil prices and rising inflation expectations make it harder for central banks, especially the Fed, to ease policy quickly.

We have already seen inflation expectations move higher, not just in the near term but further out the curve as well. That matters because central banks pay close attention to longer-term expectations when assessing credibility.

The implication is less easing and later easing, which reinforces our view that monetary tailwinds have already peaked and that duration will remain vulnerable in the near term. Last but not least, fading monetary tailwinds point towards a more tactical market environment as compared to last year, highlighting the importance of an active investment style.

6. WHAT ARE THE RISKS TO EM AND FRONTIER CURRENCIES AND CREDIT SPREADS?

The main risks are weaker EM FX and wider credit spreads, particularly because markets were already starting the year with fairly optimistic positioning and sentiment.

When valuations are stretched and optimism is high, it lowers the bar for disappointment. A geopolitical shock can therefore trigger a more pronounced adjustment. This is weighing on local currency EM sovereign debt, in particular.

That said, the widening in spreads so far has been relatively moderate. Markets have reacted as expected, but not in a disorderly fashion.

7. HOW ARE YOU THINKING ABOUT DURATION IN EMD AND FRONTIER MARKETS?

We remain cautious on duration. If oil prices feed through into higher inflation expectations and delay central-bank easing, that is not a supportive backdrop for long-duration assets.

Frontier markets stand out here because they tend to have significantly lower duration than mainstream hard-currency EM debt. In our frontier strategy, duration is around three years compared with roughly six and a half years for broader EM sovereign debt.

That structural difference is one reason frontier markets tend to show lower beta to global rate shocks.

8. HOW HAVE YOU ADJUSTED REGIONAL EXPOSURE IN YOUR EMD STRATEGY?

Our adjustments have focused on two dimensions: geopolitical proximity and energy vulnerability.

We have reduced exposure to the Middle East and cut positions in areas that are particularly exposed to higher energy prices, such as parts of Eastern Europe. South Africa has also been trimmed given its high-beta characteristics in a stronger-dollar environment.

On the other hand, Latin America looks relatively attractive, as several countries benefit from higher oil prices while being geographically removed from the conflict itself.

9. HOW HAVE YOU ADJUSTED REGIONAL EXPOSURE IN YOUR FRONTIER MARKETS STRATEGY?

Frontier markets are somewhat different because relatively few frontier issuers are located directly in the affected region. That is helpful in itself.

The strategy is also diversified across a broad range of countries, many of them in sub-Saharan Africa. Several of these economies benefit from commodity exposure as oil exporters, which provides resilience in the current environment.

10. ARE EM AND FRONTIER MARKETS STILL ATTRACTIVE IN THE CURRENT CLIMATE?

Despite near-term volatility, the longer-term case remains compelling: Robust growth and policy discipline provides a fertile ground for the asset class.

But even in the near-term environment, frontier markets in particular should prove to be more resilient than other carry asset classes as they have historically shown more limited drawdowns and faster recoveries during periods of risk aversion.

One reason is structural. In many frontier local markets, foreign ownership is relatively low, which means the queue at the exit is much shorter during stress episodes. That reduces forced selling and can dampen volatility.

So while caution is warranted in the short term, higher volatility can also create opportunities. In that sense, it may be a time to keep some powder dry, but not to lose sight of the strategic appeal of the asset class.

GLOBAL EVOLUTION FUNDS FRONTIER MARKETS [factsheet]

Strategy assets	$ 5.7 bn (Feb 2026)
AUM	$ 2.9 bn (Feb 2026)
ISIN (class I EUR-H)	LU0501220262
Inception date	15.12.2010
Investment currencies	Hard and local currency
Domicile	Luxembourg
Management company	Global Evolution Asset Management A/S
SFDR	Article 8