



## YEAR-END LETTER FOR 2025

*Emerging Country Debt Team*

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Dear Client,

On behalf of the GMO Emerging Country Debt team, thank you for your continued investment with us. In 2025, both our hard currency and local currency benchmarked strategies delivered exceptional results. Emerging Country Debt and Emerging Country Local Debt returned 21.8% and 23.7% net of fees, respectively, and outperformed their benchmarks by 747 and 442 basis points. Peer comparisons were similarly strong: as of 12/31/25, our hard currency strategy ranked in eVestment's 1st, 1st, 2nd, and 1st percentiles over 1-, 3-, 5-, and 10-year periods, while our local currency strategy ranked in the 9th, 2nd, 4th, and 5th percentiles over the same horizons.

With inflows now returning to the asset class, we have seen a broader pickup in interest across our strategies. In September, we introduced a blended currency benchmarked approach, and we are developing an absolute return-oriented strategy with a SOFR+3% objective for the year ahead—both intended simply to give clients additional ways to access our core, existing investment process. Given current valuations, interest in local currency debt has also strengthened meaningfully. J.P. Morgan's 2025 fund flow data show the first net inflow in four years, with \$17 billion and \$14 billion into hard and local currency, respectively. They expect that trend to continue, particularly in local currency, which they describe as a U.S. dollar “debasement” trade. Regardless of the terminology, local currency debt remains at generationally attractive valuations in our view. We also recently reintroduced a retail-friendly class of our flagship hard currency fund to support investors seeking access as interest develops.

Looking ahead, we continue to see higher return potential in the local currency debt benchmark relative to hard currency. Our [Quarterly Valuation Update](#) publication now details the asset allocation of our blended currency strategy, which launched in September with a 30/70 hard/local asset allocation, the maximum deviation from its 50/50 benchmark. Beneath the surface, it remains business as usual, and we expect instrument selection to regain relative prominence as the tailwind of distressed sovereigns (responsible for much of recent country selection alpha) wanes. Within instrument selection, the quasi-sovereign corporate team is again evaluating new issuers in both public and private markets. In local markets, we continue to see select so-called “frontier” local market opportunities.

The rest of this letter addresses investment performance in [Hard Currency](#), [Local Currency](#), [Asset Flows and New Strategies](#), [Research](#), and [Valuations & Outlook](#).

### ***Strategy Performance***

The team navigated the year's biggest market event—the Liberation Day tariff shock—very well, although the backtracking from the original tariff rates helped most markets. Our analysis indicated that a majority of emerging countries would be able to navigate higher tariffs reasonably well, owing in part to the nature and size of their exports to the United States in relation to their economies. We felt that credit spreads widened too much, and emerging currencies remained very cheap relative to the dollar.

#### **Hard Currency (EMBIG-D benchmarked)**

It was our best year in terms of gross and net alpha in more than 10 years. Our hard currency strategy is designed to deliver strong alpha in most market environments, but, frankly, the amount of alpha we generated in 2025 surprised even us. All of our alpha programs delivered for clients. We continued to benefit from our thoughtful approach to the distressed and semi-distressed end of the credit spectrum. Positions in deeply distressed (defaulted but pre-debt-restructuring) Venezuela and Lebanon were meaningful, as were post-debt-restructuring positions in countries like Argentina, Ecuador, Ghana, Suriname, and Sri Lanka, where we remained long and rode the improvement in economic policies and payment capacities. Our quasi-sovereign credit process was also important during the year, with positions in Mexico being particularly meaningful. Because of our high conviction on the cheapness of emerging currencies, we also deployed some off-benchmark, selective positions

in in local debt, which paid off in countries like Uruguay and South Africa, where we were not enthusiastic about the value in sovereign credit spreads.

### **Local Currency (GBI-EMGD benchmarked)**

Local debt was similar, as it was our second-best year ever in terms of alpha. Our models for currency relative value, local interest rate selection, frontier currency valuation, and bread-and-butter instrument selection all performed well. In currency selection, we generated alpha by being overweight currencies with higher nominal and real yields (COP, BRL) and currencies that benefitted from positive terms of trade (PEN). Opportunistic positions in frontier currencies with very high yields and improving fundamentals, like TRY, NGN, and EGP, were also important drivers of performance. With most central banks easing monetary policies during the year, we were able to add alpha in interest rate selection by being overweight EM duration most of the year, specifically in Brazil, South Africa, Mexico, and Chile. Finally, our usual process to derive alpha from security selection was at play once again this year with strong performance from instrument choices in on-benchmark countries like Romania, Chile, and South Africa, and off-benchmark countries like Venezuela, Israel, and Argentina.

## ***Asset Flows and New Strategies***

### **Flows**

Industry fund flows for the emerging debt asset class turned positive for the first year in four, with \$17 billion in inflows into hard currency funds and \$14 billion into local currency funds.<sup>1</sup> For GMO, inflows across our strategies totaled more than \$4 billion, with \$3.7 billion coming from our hard currency strategy, and \$370 million from our blended, local, and distressed strategies. Notably, there is renewed interest in our local-currency debt benchmarked strategy, given that our view on relative valuations has begun its expected multi-year outperformance.

### **New Hard Currency Fund Vehicle for U.S. Intermediary and Wealth Platforms Introduced**

An exciting development for us is the relaunch of a U.S. vehicle that gives intermediary and wealth platforms access to our hard currency benchmarked U.S. mutual fund. Although we'd hoped that the SEC's plan to enforce swing pricing for anti-dilution in U.S. mutual funds would materialize and align with European market practice, more recent guidance suggests that they may recommend liquidity fees instead. The challenge to making our mutual fund available on these platforms has been our anti-dilution liquidity fees, in place since the fund's inception in 1994. With this new vehicle, these liquidity fees are wrapped into the NAV, allowing the systems to process the vehicle.

### **New Blended Currency Benchmark Strategy Up and Running**

As previously mentioned, we launched a blended currency-benchmarked (50/50 hard local) strategy in September. We look forward to giving the full-year performance update next year, which will include contributions from the asset allocation tilt away from 50/50. Here's our chance to "put money where our mouths are," as the asset allocation tilt comes directly from the metrics we publish in our [Quarterly Valuation Update](#) publication.

### **New Absolute Return (SOFR+3% Objective) Strategy Launching in 2026**

Early in 2026, we will be launching an absolute-return-oriented strategy with returns in excess of SOFR+3% as the objective. The merits of this idea are:

- It offers an attractive combination of low duration and high yield—similar to private credit but accessed through liquid public markets while establishing a disciplined, return-focused hurdle.
- By requiring spreads that clear SOFR + 3%, the strategy naturally concentrates hard currency exposure in higher-yielding, lower-rated issuers and sets a meaningful threshold for unhedged local currency positions, often leading to compelling opportunities in frontier markets.
- Securities that meet this hurdle typically exhibit lower empirical interest rate duration, reducing the need for hedging and supporting our objective of delivering high return potential with limited sensitivity to U.S. rates.

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<sup>1</sup> Source: J.P. Morgan "EM Flows Weekly," December 30, 2025

While the resulting portfolio overlaps significantly with what many label “frontier,” the goal is not classification but the pursuit of differentiated, diversifying returns, reflecting a return to GMO’s roots before broad EM benchmarks were dominated by large, low-spread issuers.

Both the blended currency benchmarked strategy and the total return strategy will find themselves in the “blended” eVestment category. I often say that this category’s name is very poor, akin to the word “hedge fund.” All of our strategies are “blended” by opportunity set; the difference among them is their objectives. Our “hard currency” strategy has a hard currency benchmark (EMBIG-D), though it takes local currency exposures when attractive. Our “local currency” strategy has a local currency benchmark (GBI-EMGD), yet it takes hard currency (sovereign and quasi-sovereign corporate) exposures when attractive. The “blended currency benchmarked” strategy mixes the two and adds the timing alpha from [Quarterly Valuation Update](#) metric signals. The total return strategy focuses on the higher-yielding subset of the market, has low duration as an attribute, and employs more shorting of bonds in the absence of a bond benchmark.

## **Research**

It was a fairly light year for published research, although hardly a light year for investment research. As interest in the asset class ticked up, the team published “[EM Debt Resiliency Deserves More Credit](#),” which reviewed recent defaults and recoveries and what they mean for apparently low hard currency asset class spreads. In a similar vein, with local currency debt returns leaping higher, Victoria re-examined the “[Once in a Generation](#)” investment thesis. Perhaps tellingly about EM’s relative outlook, Tina addressed “[Fiscal Dominance in USA: Investment Lessons from the Emerging Markets](#),” at GMO’s 2025 Conference. Interestingly, the topic was requested by more than one of our clients—and apparently was topical enough to prompt Jason Halliwell of our Systematic Global Macro team to address it from his perspective in “[From Safe Haven to Risk Asset? Rethinking Treasuries in the Age of Deficits](#).”

In investment research, a non-exhaustive list includes four new sovereign issuers, of which one (Kyrgyzstan) ended up in the hard currency benchmark. There were no new sovereign defaults in 2025, aside from a restructuring of Ukraine’s GDP warrants, which we consider a follow-on to Ukraine’s bond default/restructuring as a result of Russia’s invasion in 2022. The corporate team was especially busy last year, as the market was further opened to new issuers and structured finance. The team reviewed about 150 new corporate names, assessing that about 75 met our sovereign support criteria while offering a spread over the relevant sovereign. Of these, we added about 15 new positions, several of which were structured similarly to private credit. In the frontier local bond space, we added four countries to our already extensive coverage list, most of them being in sub-Saharan Africa, where several small countries are trying to develop their local debt funding markets.

## **Valuations & Outlook**

The first few years of the 2020s were extremely challenging for emerging countries (COVID, Russia/Ukraine, steep rate hikes), and while some countries defaulted, many muddled through, using exchange rate depreciation as a shock absorber. As a result, upon exiting the shock period, exchange rates were largely undervalued relative to the dollar.

We believe the relative attractiveness of EM currencies (especially vs. the U.S. dollar) supports the case for overweight positions of local currency debt in blended EM debt portfolios, and for outright long EM local debt strategies.

Below, we share our usual one-year-ahead scenarios for the benchmarks for hard currency (left) and local currency (right) as of December 31, 2025. We start with the duration-weighted yields in the center, then vary the main inputs to these yields, namely hard currency spreads and U.S. dollar interest rates, as well as local currency yields and currency spot levels. As discussed in our [4Q25 Quarterly Valuation Update](#), we view hard currency as rich and local currency as very cheap. Thus, our blended strategy is tilted max local versus hard currency (70/30). Within the tables below, we’ve highlighted in orange the scenarios we consider likely based on valuations. Recall that these tables are only for the benchmarks; we continue to target 150 bps of net alpha in addition.

OUTLOOK: 1-YEAR TOTAL RETURN SCENARIOS

HARD CURRENCY								LOCAL CURRENCY DEBT									
EMBIG-D Spread* (22 bp Increments)	2.6%	8.3%	6.3%	4.2%	2.2%	0.2%	-1.9%	-3.9%	GBI-EMGD FX (1.1%) Higher = Depreciation	1.52	4.7%	3.9%	3.2%	2.4%	1.7%	1.0%	0.2%
	2.4%	9.7%	7.7%	5.6%	3.6%	1.6%	-0.5%	-2.5%		1.51	5.8%	5.1%	4.3%	3.6%	2.9%	2.1%	1.4%
	2.2%	11.1%	9.1%	7.0%	5.0%	3.0%	0.9%	-1.1%		1.49	6.9%	6.2%	5.5%	4.7%	4.0%	3.3%	2.5%
	2.0%	12.5%	10.5%	8.4%	6.4%	4.4%	2.3%	0.3%		1.47	8.1%	7.3%	6.6%	5.9%	5.1%	4.4%	3.7%
	1.8%	13.9%	11.9%	9.8%	7.8%	5.8%	3.7%	1.7%		1.46	9.2%	8.5%	7.7%	7.0%	6.3%	5.5%	4.8%
	1.5%	15.3%	13.3%	11.2%	9.2%	7.2%	5.1%	3.1%		1.44	10.4%	9.6%	8.9%	8.2%	7.4%	6.7%	5.9%
	1.3%	16.7%	14.7%	12.6%	10.6%	8.6%	6.5%	4.5%		1.42	11.5%	10.8%	10.0%	9.3%	8.6%	7.8%	7.1%
		3.5%	3.8%	4.1%	4.4%	4.7%	5.0%	5.4%			5.5%	5.6%	5.7%	5.9%	6.0%	6.1%	6.3%
	USD Yield Associated With EMBIG-D (31 bp Increments)								GBI-EMGD Yield (14 bp Increments)								

As of 12/31/2025 | Source: GMO calculations based on data from J.P. Morgan  
\*EMBIG-D Spread (Spread Duration Weighted). We show duration-adjusted EMBIG-D yield.

In this quarter's [Quarterly Valuation Update](#), we introduced hedged metrics for our EUR-, GBP-, CHF-, JPY-, AUD-, and CAD-based investors.

Thank you for the trust you put in us to manage your investments. We look forward to seeing you and/or speaking with you in 2026.

Sincerely,

Tina Vandersteel and the GMO Emerging Country Debt Team



**Back row, left to right:** Sergey Sobolev, Mustafa Ulukan, Eamon Aghdasi, Carl Ross

**Front row, left to right:** Garrett Sullivan, Tina Vandersteel, Victoria Courmes

<i>Annualized Returns as of 12/31/2025 (Net, USD)</i>	<i>Inception</i>	<i>1-Year</i>	<i>3-Year</i>	<i>5-Year</i>	<i>10-Year</i>	<i>ITD</i>
<b>GMO Emerging Country Debt Composite<sup>1</sup></b>	04/30/1994	21.77%	17.09%	5.74%	6.77%	11.97%
<b>J.P. Morgan EMBI Global Diversified +</b>		14.30%	10.59%	1.78%	4.26%	8.38%
<i>Annualized Returns as of 12/31/2025 (Net, USD)</i>	<i>Inception</i>	<i>1-Year</i>	<i>3-Year</i>	<i>5-Year</i>	<i>10-Year</i>	<i>ITD</i>
<b>GMO Emerging Country Local Debt Composite<sup>2</sup></b>	2/29/2008	23.68%	14.56%	4.64%	5.85%	2.81%
<b>J.P. Morgan GBI-EM Global Diversified +</b>		19.26%	9.47%	1.12%	3.88%	2.59%
<i>Annualized Returns as of 12/31/2025 (Net, USD)</i>	<i>Inception</i>	<i>1-Year</i>	<i>3-Year</i>	<i>5-Year</i>	<i>10-Year</i>	<i>ITD</i>
<b>Emerging Markets Blended Debt Composite</b>	09/30/2025	1.96%	N/A	N/A	N/A	1.96%
<b>50% J.P. Morgan EMBI Global Diversified/ 50% J.P. Morgan GBI-EM Global Diversified</b>		3.32%	N/A	N/A	N/A	3.32%

Returns shown for periods greater than one year are on an annualized basis.

**Performance data quoted represents past performance and is not predictive of future performance.**

Net returns are presented after the deduction of a model advisory fee and incentive fee if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. Fees paid by accounts within the composite may be higher or lower than the model fees used. **GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®). A Global Investment Performance Standards (GIPS®) Composite Report is available on GMO.com by clicking the GIPS® Composite Report link in the documents section of the strategy page. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy's Composite Report.**

<sup>1</sup>Returns for one of the accounts in the composite are based on estimated market values for the period from and including October 2008 through February 2009.

<sup>2</sup>Returns for the composite are based on estimated market values for the period from and including October 2008 through February 2009.

**Disclaimer**

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