

Geopolitical realignment and emerging markets: political alignment can trump fundamentals



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Key takeaways:

- The 2026 emerging markets landscape is increasingly defined by political alignment with the Trump administration; divergent geopolitical positioning creates significant differentiation within the asset class and new sources of alpha generation.
- Latin America faces a critical inflection with major elections across Colombia, Peru and Brazil during 2026, while US-China competition for regional influence—particularly regarding ports, commodities, and energy infrastructure—shapes policy trajectories and capital flows.
- Portfolio positioning reflects this differentiated environment: tactically favoring select hard currency debt and carry opportunities where political risk is manageable, while managing exposure to jurisdictions facing fiscal headwinds before or during electoral cycles.
- Concentrated carry trades face structural vulnerability: High-yield positions in Turkey, Brazil, and Mexico depend on policy continuity and geopolitical stability, creating asymmetric downside risks in a shifting landscape that demands active management over passive EM beta exposure.

The investment thesis for emerging markets remains intact. For decades, emerging market analysis rested on a familiar foundation: fiscal sustainability, inflation dynamics, current account balances, and central bank credibility. These metrics are still critical, but important new factors now influence portfolio construction decisions in 2026. Indeed, a new variable has emerged, impacting asset valuations and capital flows: political alignment with the Trump administration.

This represents a significant evolution from the post-Cold War consensus. We have seen several instances where the rules-based international system that underpinned emerging market returns has given way to the US administration's transactional, regionally focused foreign policy framework. The consequences for institutional investors are profound. Geopolitical positioning can offset creditworthiness metrics. Diplomatic friction can disrupt years of policy credibility, and traditional correlation structures that anchored portfolio construction can be challenged.

The New Calculus: Alignment Over Metrics

Consider Argentina's experience. Despite impressive progress in eliminating its chronic fiscal deficit and taming inflation pressures, the government had still not regained international market access in late 2025. Midterm elections loomed; polling suggested the Milei administration was headed toward a repudiation at the ballot box. Market commentary centered on the viability of the reform program and whether political support could survive another electoral cycle.

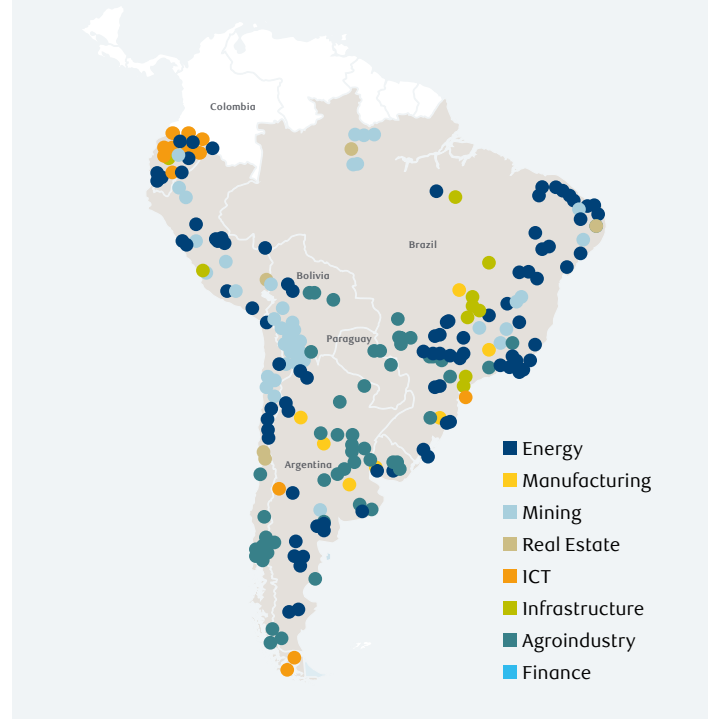
The US response, with strong statements of support from President Trump, bypassed this conventional analysis. Washington announced a \$20 billion swap line—not based on Argentina's macroeconomic metrics, but because Javier Milei had cultivated explicit alignment with the US administration. He attended CPAC conferences, championed aggressive fiscal adjustment, withdrew Argentina from global climate negotiations to mirror US policy, and voiced vocal support for Israel. The conditionality attached to this support was clear: maintain this alignment, and capital flows would follow.

The result was striking. Argentine assets stabilized. Milei's government performed better than expected in midterms. The markets had effectively repriced the country based not on economic fundamentals but on the windfall emerging from this geopolitical positioning.

A further incentive for US support for Argentina was to chip away at China's influence, and we expect this to remain a theme for the whole region in 2026. The US is clearly sensitive to China's presence in infrastructure, but a couple of decades of aggressive investment means that there are plenty of other potential flashpoints, including in energy and mining (Chart 1).

Contrast this with Brazil and Colombia. Both countries attempted diplomatic pragmatism toward the Trump administration, yet both faced swift economic penalties. Brazil's independent judiciary prosecuted Jair Bolsonaro for his post-election coup plot; the US responded with 50% tariffs, seemingly indifferent to economic implications or its existing trade relationship with Brazil... Colombia's president tweeted criticism of US deportation policy in January 2025; within hours, 25% tariffs followed. The message was unambiguous: public refusal to get 'in line' with US policies can result in economic and political damage. Petro soon reversed his position, permitting US planes carrying Colombian deportees to land in Bogota and averting a trade war, although periodic spats have broken out ever since. In Brazil's case, private sector lobbying and diplomatic outreach softened the US stance – and Bolsonaro remains in jail.

Chart 1: Chinese FDI in Latin America



Source: ICLAC, as at November 2025.

Error and incident metrics, such as lost specimens and accidents, are tracked carefully, and over time, data has shown meaningful improvements. This can be compared to smaller hospital labs where there are more manual steps and room for error, as well as lower automation and staff who tend to be more generalist. At this lab it's the opposite: a high fixed cost but very low marginal cost per additional test, with lower error rates. This likely creates a real competitive advantage and is a big piece of the moat: lower error rates plus faster turnaround typically means better economics.

Venezuela offers the starkest illustration. On January 3, 2026, Nicolas Maduro was captured in Caracas and extradited to face drug trafficking charges. The operation represented a dramatic reassertion of US regional authority—what commentators have dubbed the "Donroe Doctrine." Beyond the symbolic show of force, the underlying calculus was geopolitical: Venezuela's oil flows to China represented a threat to US interests. The regime shift that followed (rather than full regime change) reflects calculated US intervention designed to reorient Venezuela's foreign policy away from China and Iran.

For institutional investors, the lesson is stark: for some countries, their position in today's geopolitical landscape can trigger outcomes that fall outside of the scenarios that traditional fundamental and credit analysis would have suggested.

Electoral Cycles as Political Inflection Points

This geopolitical realignment intersects a critical electoral calendar in 2026. Latin America faces elections in Colombia, Peru and Brazil—precisely the jurisdictions where US influence is greatest and where outcomes could reshape regional dynamics.

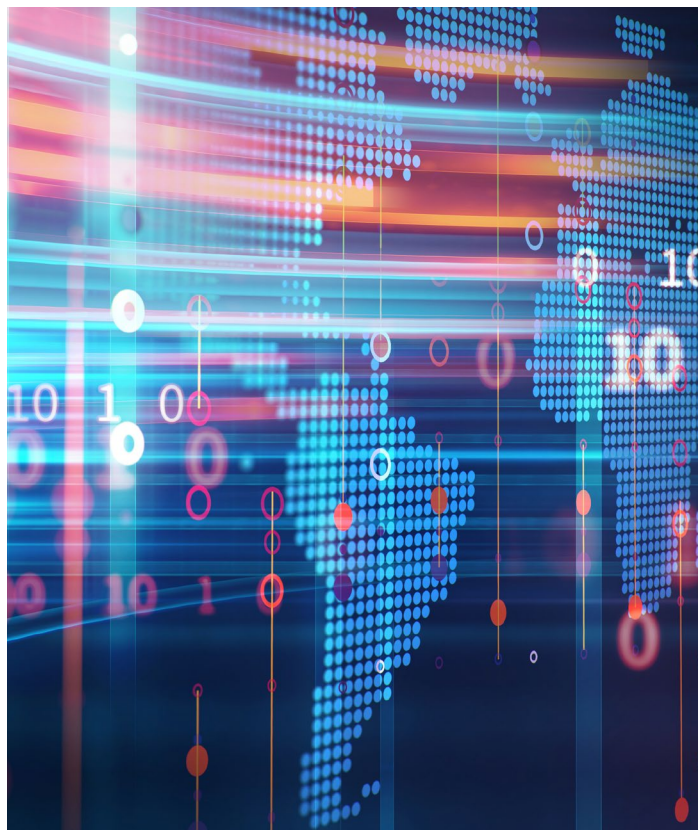
Colombia’s mid-year ballot appears most consequential. Current polling suggests a shift from Gustavo Petro’s left-leaning government toward centre-right governance. Such a shift would likely improve Colombia-US relations and restore policy coherence. For many portfolios, long positions in sovereign hard currency and local currency debt in anticipation of an improved policy mix and fiscal restraint could present an attractive risk-reward profile.

Brazil’s October election remains more fluid. Polling currently favors continuity under President Lula, but the contest is likely to create volatility through the election cycle. The critical variable for many portfolios is the interaction between the central bank’s rate-cutting cycle and electoral positioning. Local real rates appear attractive at 10-12%, and the high-carry currency benefits from strong seasonal agri-export flows. But this positioning could perform even better if opposition candidates narrow their polling deficit.

Argentina’s near-term trajectory appears more settled following midterm gains, but viability through to the 2027 general elections hinges on sustained US support. The conditionality attached to that support—improved governability and continued reform implementation—creates medium-term political risk. Any wavering in reform commitment or deterioration in US-Argentina relations could destabilize the reform narrative that has sustained the recent recovery.

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Hungary’s April election introduces a different flashpoint, with EU alignment impacting potential scenarios. Current polling suggests a 12-point lead for opposition TISZA party candidate Peter Magyar over Prime Minister Viktor Orbán. Yet historical polling patterns in Hungary systematically underestimate Orbán’s support in regional areas. An unexpectedly close result could invite contested election dynamics and social unrest, while also creating a potential EU-US positioning conflict. A TISZA victory would likely unlock substantial EU funding and could drive significant asset outperformance; an Orbán victory would necessitate fiscal contraction.



The Carry Trade Paradox

Beneath these electoral dynamics sits a structural vulnerability: concentrated positioning in high-carry assets within a low-volatility environment.

Turkey exemplifies this risk. Nominal yields of 35% appear attractive; combined with managed currency depreciation of approximately 15% annually, they offer the potential for returns of 15-20%. Yet this carry positioning is contingent on policy continuity from orthodox policymakers like Finance Minister İmrek and central bank governors. If Erdogan perceives a political opening—particularly given his constitutional inability to run beyond 2028—snap elections become plausible. A snap election scenario raises material downside risk to Turkish positioning, as Erdogan might sideline orthodox policymakers in pursuit of electoral advantage.

Brazil presents a similar dynamic at smaller scale. Real rates of 10-12% and robust carry components attract capital precisely because volatility remains low. Mexico’s carry opportunities remain attractive on currency and rates components, but they are fundamentally contingent on USMCA preservation. The trade agreement’s mid-2026 renegotiation represents a binary risk event. Success preserves the framework and supports sustained capital flows; failure would cascade across Mexican and broader EM confidence.

Active Management is Needed for the Road Ahead

These dynamics suggest that broad-based emerging market beta exposure is insufficient—indeed, potentially dangerous—in 2026. The asset class no longer trades as a single bloc and differentiation is key. Countries with clear geopolitical alignment and electoral clarity command premium valuations; jurisdictions facing electoral uncertainty or geopolitical headwinds risk losing sponsorship.

“Investors who adapt their analytical frameworks accordingly will likely find significant opportunities.”

This environment demands rigorous active management. Portfolio construction must incorporate geopolitical analysis: Is this country aligned with US interests? Are those interests stable or shifting? What is the electoral trajectory? What is the probability of policy reversal?

Mapping these geopolitical variables is a complement to traditional EM metrics.

The 2026 emerging markets opportunity set could reward investors who can accurately map geopolitical realignment, forecast electoral outcomes with precision, and position ahead of regime shifts. For institutional investors accustomed to analyzing EM solely through the lens of macroeconomic fundamentals, this represents a significant analytical shift.

The alpha in 2026 lies not in broad EM exposure, but in differentiation. Active management—grounded in deep geopolitical analysis, electoral forecasting, and understanding of bilateral US relationships—has moved from luxury to necessity. In a world where political alignment increasingly determines policy outcomes, and policy outcomes drive asset valuations, traditional fundamental analysis provides incomplete guidance.

Investors who adapt their analytical frameworks accordingly will likely find significant opportunities. Those who cling to traditional EM metrics risk substantial portfolio damage.



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