Allspring

MARKETING COMMUNICATION

Emerging Markets 2.0: The Tipping Point Is Here

The past decade has been one of "exceptionalism" for U.S. equities as technological innovation has created a league of American superstar companies driving extraordinary equity gains.

By comparison, the same decade has been described as "lost" in emerging markets (EM), which have been driven downward by uncompetitive currencies, failure to perform, property crashes, and geopolitical conflicts.

But, are there now strong signals that the narrative is set to change? Here, we outline the reasons why we believe the time is right to invest in EM as we see green shoots in all regions—and, perhaps more importantly, why it's important to invest actively and with a different approach, tailored to the volatility of these markets, for greater success.

Why invest in EM now?

THREE POWERHOUSE COUNTRIES COULD PROPEL EM GROWTH WELL AHEAD OF DEVELOPED MARKETS.

The decade-long relative underperformance of EM is set to reverse. Following a traditional development trajectory, EM should grow faster than developed markets, but what is driving the current wide growth premium is the strength of the two largest markets—China and India. China has consistently outgrown; even in the depths of the COVID-19 crisis, China delivered 2.2% growth. In the current environment of trade uncertainty, the U.S. risks falling into recession, whereas we believe China could maintain economic growth at 3–4% by raising its fiscal deficit and focusing on new infrastructure, domestic consumption, and the recovery of the property market. With 40% of China's gross domestic product (GDP) coming from consumption in 2024, further recovery in consumer confidence combined with government stimulus should keep a recovery on track. Future growth will be fueled by the development of advanced technologies such as industrial automation, autonomous driving, and artificial intelligence (AI).

India, which now makes up almost 20% of the EM index, is likely to deliver even higher growth of 5–6% due to rising consumption from an upwardly mobile population, capital expenditure driven by tax cuts, an improvement in rural demand, and the proactive easing of rates. All of these conditions are supported by a skilled labor force, the strengthening of energy infrastructure, and a shift of private savings into real estate and local equity investments.

ALISON SHIMADA

+ Senior Portfolio Manager and Head of Total Emerging Markets Equity

ELAINE TSE

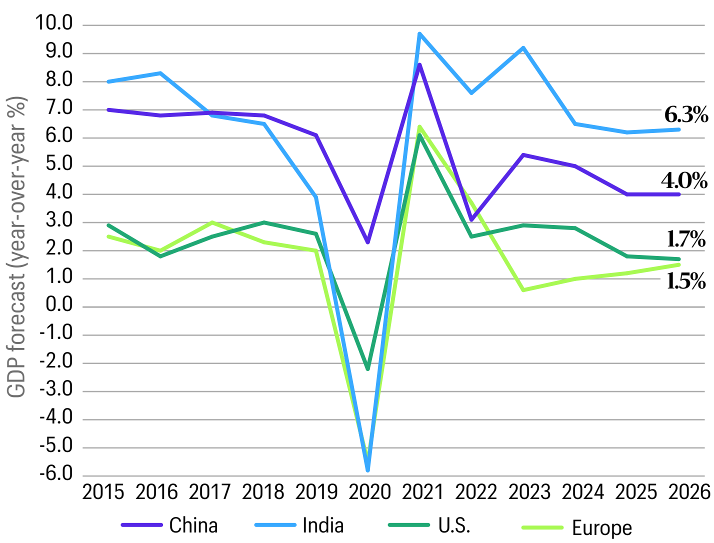
+ Senior Portfolio Manager for Total Emerging Markets Equity

JAMES GUDGER, CFA, CAIA

+ Senior Portfolio Specialist

Another leading economy poised for growth that does not attract as much attention as the two giants is Indonesia, where GDP could reach 4–5% over 2024–2026. With major companies in global agricultural commodities, mining and manufacturing, and tourism, this country of 285 million people—with an average age of 30—has domestic consumption and export potential. Faced with external uncertainty, many EM countries can shift their focus to domestic markets and the robust EM growth premium can be sustained by a large and growing middle class of consumers, governments with the leeway to provide fiscal stimulus, and central banks that can cut interest rates.

FIGURE 1. THE GDP GROWTH DIFFERENTIAL BETWEEN EMERGING AND DEVELOPED MARKETS REMAINS ROBUST



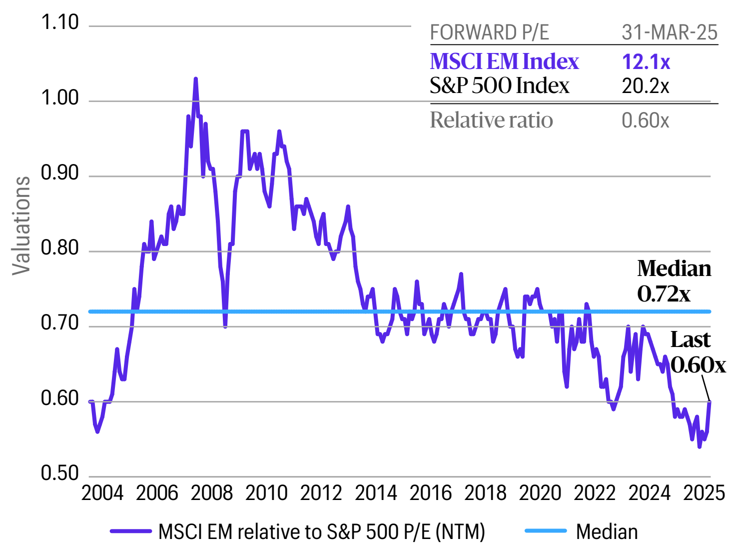
Source: FactSet, as of 31-Mar-25

INVESTING IN EM IS A WAY TO DIVERSIFY OUT OF THE CURRENT VOLATILITY IN THE U.S.

The policy moves by President Trump's administration on tariffs, immigration, and the Department of Government Efficiency pose a greater risk to the U.S. than to EM countries, in our opinion, due to the inflationary pressures and negative economic growth shock they are likely to bring. The U.S. "exceptionalism" narrative is fading, and with the weakening of the dollar, we expect EM to outperform the U.S. EM countries are currently significantly under-owned by global investors, and as the U.S. market sells off, investors are likely to benefit from diversification into EM, which have lower valuations than the U.S. market and are experiencing unique domestic growth catalysts and structural changes such as urbanization, youthful populations, and an expanding middle class—all relatively unaffected by global factors. We see signs of a global reallocation in a new world order.

On the matter of valuations, even following the pullback earlier this year, U.S. equity markets have been trading at high valuations of around 20 times earnings. Conversely, since the presidential election, EM equities have dropped to below 12 times earnings. Relative valuations versus the U.S. have been at historical lows—at discounts greater than 40%.

FIGURE 2. EM RELATIVE VALUATIONS ARE AT THE CHEAPEST LEVELS IN 20 YEARS



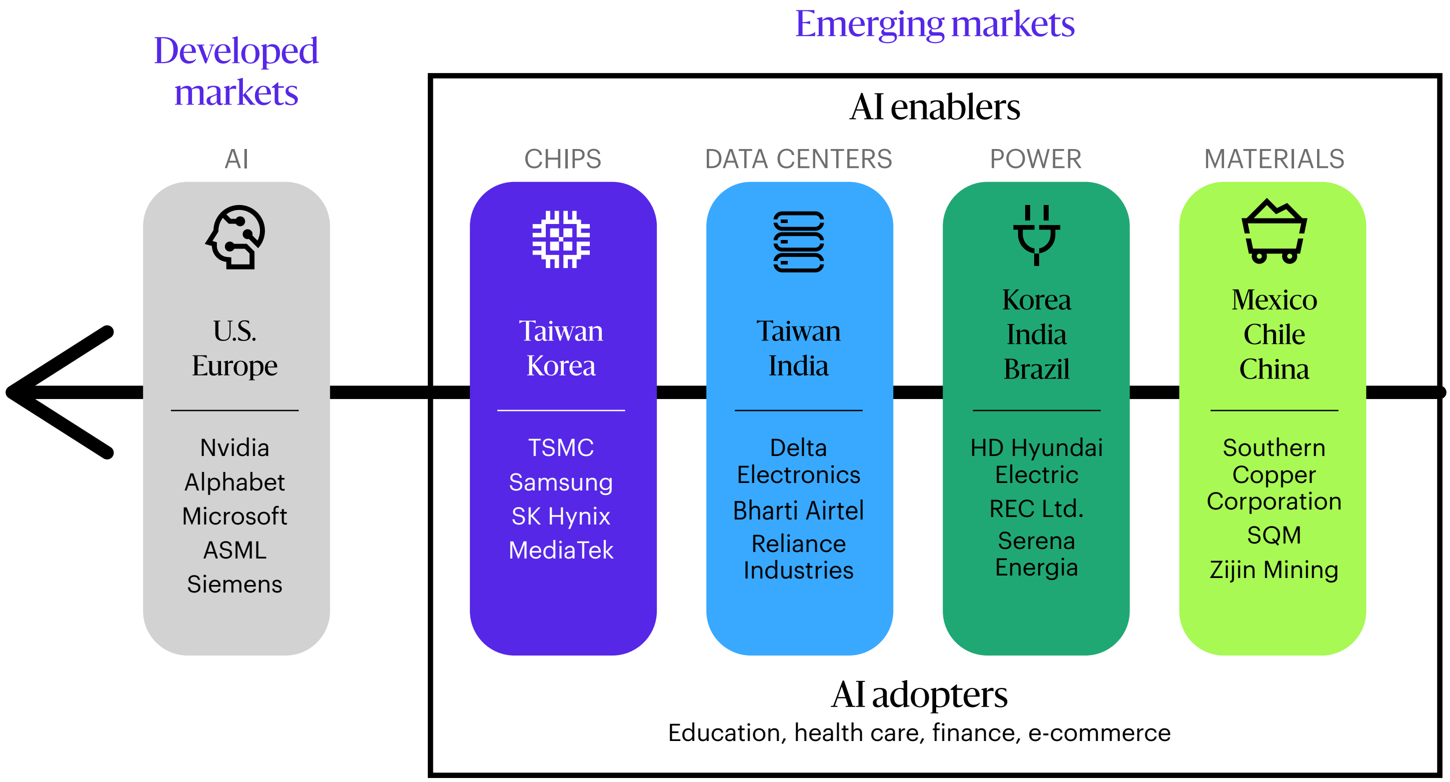
Source: FactSet, as of 31-Mar-25
Forward P/E: Next 12 months (NTM)
Past performance does not guarantee future results.

THE FUTURE IS BEING BUILT IN EM—WE EXPECT TO SEE A RAPID LEVELING UP.

Technological innovation, infrastructure development, and industrial upgrades are all at the heart of EM economies, and investing in these themes could bring multiyear gains. These are vibrant, rapidly growing economies with strong intellectual capital that don't need the U.S. or developed markets to create their own new products or technology—as was shown by the unveiling of China's DeepSeek AI technology earlier this year.

EM countries are arguably well prepared for the AI revolution: Taiwan and Korea are the world's leading chip manufacturers and Taiwan and India are home to major data centers, while the power and raw materials to fuel the AI revolution will come from countries such as Korea, India, Mexico, and China (see the following diagram). Fintech, health care, telecommunications, and medical equipment—these are all areas where rapid innovation and development are obvious within EM and all sectors where AI is likely to be rapidly integrated and boost growth opportunities. Consumer staples are also an important EM investment theme, as are commodities and materials such as gold, silver, copper, and oil.

FIGURE 3. THE GLOBAL AI VALUE CHAIN



EM ARE NOTORIOUSLY VOLATILE—SO WHAT'S THE BEST APPROACH?

There can be no doubt that investing in EM comes with heightened risk. Typical risks faced by investors include greater volatility and reaction to news and current events. EM currencies can depreciate more suddenly and more rapidly. EM countries can be more susceptible to political instability. There can be risks around regulatory uncertainty and the difficulties in enforcing contracts and reporting on environmental, social, and governance (ESG) concerns. We believe active and highly selective investment is the key to mitigating these risks.

With our significant experience investing in this region, we've concluded—and research by MSCI (detailed in Figure 4) backs us up—that active investment with a risk-adjusted, total-return approach is the most effective way to invest in EM over the long term. This approach considers top-down risks and the bottom-up fundamentals with the aim of creating a resilient portfolio able to generate alpha and outperform over the cycle.

We focus on assessing the macroeconomic and political risks in each country and evaluate each sector and industry. Then, for security selection, we look at shareholder yield (cash dividends, stock buybacks, spin-offs) as well as capital appreciation to identify quality companies, generate returns, and protect against downside risk.

Deep fundamental and ESG analysis is crucial, and we invest in companies we believe offer the best risk-adjusted upside. In our experience, if companies are quality and liquid, they are more likely to ride through any short-term turbulence, which is why proper and active stock selection is so important—it influences the countries, sectors, and companies that we choose to invest in.

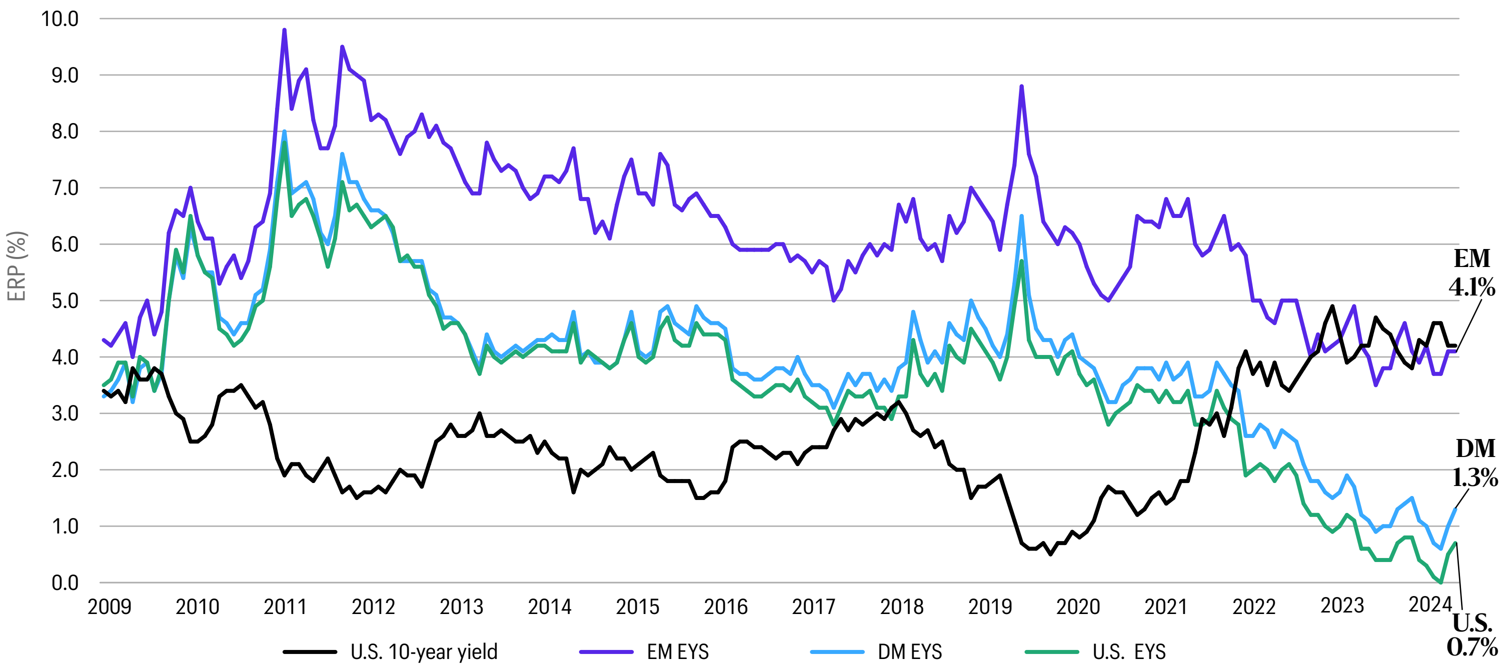
FIGURE 4. EM EQUITY RISK PREMIUM (ERP) VERSUS DEVELOPED MARKETS (DM) AND THE U.S.

	31-MAR-25
EM earnings yield (NTM)	8.3%
U.S. 10-year yield	4.2%
EM equity risk premium	4.1%

	31-MAR-25
DM earnings yield (NTM)	5.5%
U.S. 10-year yield	4.2%
DM equity risk premium	1.3%

	31-MAR-25
S&P earnings yield (NTM)	5.0%
U.S. 10-year yield	4.2%
U.S. equity risk premium	0.7%

GLOBAL EARNINGS YIELD SPREADS (EYS)



Source: FactSet, as of 31-Mar-25
EM – MSCI Emerging Markets Index
DM – MSCI World Index
U.S. – S&P 500 Index
Earnings yield calculation = 100/NTM P/E

DOES THIS MORE BALANCED APPROACH COMPROMISE RETURNS?

Recent research from MSCI has validated our long-standing approach. According to the paper **Long-Term Investing in the Emerging Markets**[1], a company's profitability; investment quality; and, above all, dividend yield are all more important to long-term compounding stocks than the company's growth trajectory. Quality, yield, and profitability are all factors that we are constantly and actively looking for. EM can provide growth and income.

The low coverage of regions by analysts means that there are opportunities for managers who focus on key fundamentals and capital return policies and who take a systematic approach across companies of quality. Historically, these have all been investment approaches that have contributed to outpacing broader EM benchmarks.

In short, the defensive and risk-adjusted way in which we invest in EM has been a successful approach overall for us in these regions.

We believe that there is currently an opportunity for investors to diversify into EM when the first signs of an exceptional decade are beginning to appear. We expect to see money moving in a significant way from developed to emerging investments in the period ahead. We might even go so far as to say that this is the decade in which many of the so-called EM countries will fully emerge.

1. MSCI Long-Term Investing in the Emerging Markets—Identifying Drivers of Total Shareholder Return in EM Equities

For further information

We're committed to thoughtful investing, purposeful planning, and the desire to deliver outcomes that expand above and beyond financial gains.

Click or scan the QR code to check out Allspring's insights:

Distribution in Hong Kong: This document is distributed in Hong Kong by Allspring Global Investments (Hong Kong) Ltd., which is a Hong Kong–incorporated company licensed and regulated by the Securities and Futures Commission to carry on Types 1 and 4 regulated activities, as defined in the Securities and Futures Ordinance (Cap. 571 The Laws of Hong Kong; the SFO), subject to the following conditions: It shall not hold client assets and it shall provide services only to professional investors (the terms "hold," "client assets," and "professional investors" are as defined in the SFO and its subsidiary legislation). There may be information relating to funds that are not authorized for retail distribution and are available only to qualified professional investors. This document is not intended for, and should not be relied on by, any person other than professional investors (as defined in the SFO or the Securities and Futures (Professional Investor) Rules (Cap. 571D of The Laws of Hong Kong)). Neither the issue of this document nor the information contained in it has been approved or reviewed by any regulatory authority in Hong Kong.

Distribution in South Korea: This document is distributed in the Republic of Korea by Allspring Global Investments, LLC, which is registered with the Financial Services Commission pursuant to the Financial Investment Services and Capital Markets Act (the Act) to conduct investment advisory and discretionary investment business with qualified professional investors (as defined in the Act). This document is not intended for, and should not be relied on by, any person other than qualified professional investors.

Distribution in Japan: This information is a marketing communication, unless stated otherwise, for "qualified institutional investors," as defined in Article 10 of the Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act of Japan. Not for retail use. This material and the information contained herein do not constitute and are not intended to constitute investment advice or an offer of securities and accordingly should not be construed as such. Any products or services referenced in this material may not be licensed or registered in all jurisdictions, and, unless otherwise indicated, no regulator or government authority has reviewed this material or the merits of the products and services referenced herein. This material and the information contained herein have been made available in accordance with the restrictions and/or limitations implemented by any applicable laws and regulations. This material is directed at and intended for "qualified institutional investors," as defined in Article 10 of the Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act of Japan. This material is provided on a confidential basis for informational purposes only and may not be reproduced in any form. Allspring does not provide tax, legal, or accounting advice, and this material does not take an investor's personal investment objectives or financial situation into account. Before acting on any information in this material, prospective investors should inform themselves of and observe all applicable laws, rules, and regulations of any relevant jurisdictions and obtain independent advice if required. This material is for the use of the named addressee only and should not be given, forwarded, or shown to any other person (other than employees, agents, or consultants in connection with the addressee's consideration thereof).

Distribution in China: This material may not be provided, sold, distributed, or delivered to any person for forwarding or resale or redelivery, in any such case directly or indirectly, in the People's Republic of China (the PRC, excluding Hong Kong, Macau, and Taiwan) in contravention of any applicable laws. This material does not constitute an offer to sell or the solicitation of an offer to buy anything referred to in the material, expressly or implied, in the PRC (excluding Hong Kong, Macau, and Taiwan) to any person to whom it is unlawful to make the offer or solicitation in the PRC.

Distribution in Taiwan: Any investment management and advisory services will be provided by Allspring, which does not hold the required licenses under the Taiwan law. The provision of any investment management and advisory services has not been and will not be approved by the Financial Supervisory Commission of Taiwan. Any transaction will be consummated outside of Taiwan. The clients within the territory of Taiwan may be required to comply with certain qualification requirements and restrictions as set forth in the relevant laws and regulations of the jurisdiction where Allspring is registered.

Distribution in Indonesia: Investment management and advisory services will be provided to Indonesian clients from an Allspring office located outside the territory of Indonesia. No services are provided in the territory of Indonesia. Allspring is not licensed under Indonesian laws or supervised by the Otoritas Jasa Keuangan.

Distribution in Thailand: This material, when distributed in Thailand, is intended only for institutional investors, as defined in the Notification of the Office of the Securities and Exchange Commission No. Kor-Nor. 43/2549 Re: Investment management not considered as private fund management dated 27 December 2006 (as may be amended). It is solely for the use of such investors and shall not be distributed, forwarded, passed on, or disseminated to any other person.

Distribution in Canada: Allspring Global Investments, LLC (Allspring Investments), is not registered as an investment advisor in any of the Canadian provinces, is only authorized to provide investment advisory services in Canada pursuant to an exemption available to foreign investment advisors under Canada's National Instrument 31- 103 (NI 31-103), and can provide such services only to permitted clients as defined under NI 31-103. Allspring Investments is registered as an investment advisor with the United States Securities and Exchange Commission. Its head office is located at 1415 Vantage Park Drive, 3rd Floor, Charlotte, NC 28203, and, thus, substantially all of its assets are situated outside of Canada. As a result, there may be difficulty enforcing legal rights against Allspring because of the above, and investors are directed to Blakes Vancouver Services, Inc., Allspring Investments' agent for service of process, in the event of any disputes at the following address, phone number, and email address: Blakes Vancouver Services, Inc., 595 Burrard Street, Suite 2600, Three Bentall Centre, Vancouver, BC V7X 1L3; tel: +604-631-3300; e-mail lisa.marchese@blakes.com.

Distribution in the Bahamas: The information provided herein is intended solely for the designated recipient thereof. It is not an offer to the public. The information contained herein is for general informational purposes and is not deemed an offer to the public. Advice of local counsel in connection with information contained herein is recommended.

Distribution in the Cayman Islands: Allspring is not regulated in the Cayman Islands and is not licensed or otherwise authorized to carry on business, including securities investment business, in or from the Cayman Islands.

Distribution in Chile: Allspring may not offer or provide any of the products or services in Chile. Allspring is not regulated by the Chilean authorities and participation in any product or service is an offshore investment activity that is not subject to any Chilean supervision and is not guaranteed by any regulatory or governmental agency in Chile.

Distribution in Peru: Allspring and the services offered are subject to the laws and jurisdiction of the United States and are not regulated or supervised by any Peruvian entity or government authority.