

Emerging Markets 2.0: The Tipping Point Is Here

We see strong signals that the “lost decade” in emerging markets is over, and we believe it’s time to invest in these rapidly developing regions. The future is already being built in the powerhouse emerging countries poised for pursuing exceptional growth.

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? In this paper, we outline why we believe the time is right to invest in EM, highlighting emerging green shoots across regions and, perhaps more importantly, why success in these markets requires an active, differentiated approach deliberately tailored to the volatility of these markets.

Why invest in EM now?

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

Emerging markets are reversing a decade of relative underperformance. While EM have historically grown faster than DM, the current wide growth premium is being driven by a world-class artificial intelligence (AI) supply chain, abundant natural resources (copper, gold, silver, iron ore), and competitive manufacturing in goods and services.

China is expected to sustain 4–5% gross domestic product (GDP) growth over the next two to three years, supported by resilient exports, gradual consumption recovery, and a diminishing drag from the property sector as it moves toward stabilization. At the same time, rising investment in AI, advanced manufacturing, and renewable energy are strengthening China’s industrial ecosystem and export competitiveness, with “new economy” sectors playing a growing role in driving growth. The country maintains global leadership in electric vehicles and batteries, renewables, and robotics, supported by scale, vertically integrated supply chains, and improving technological capability, positioning it to expand global market share and move into higher-value-added industries.



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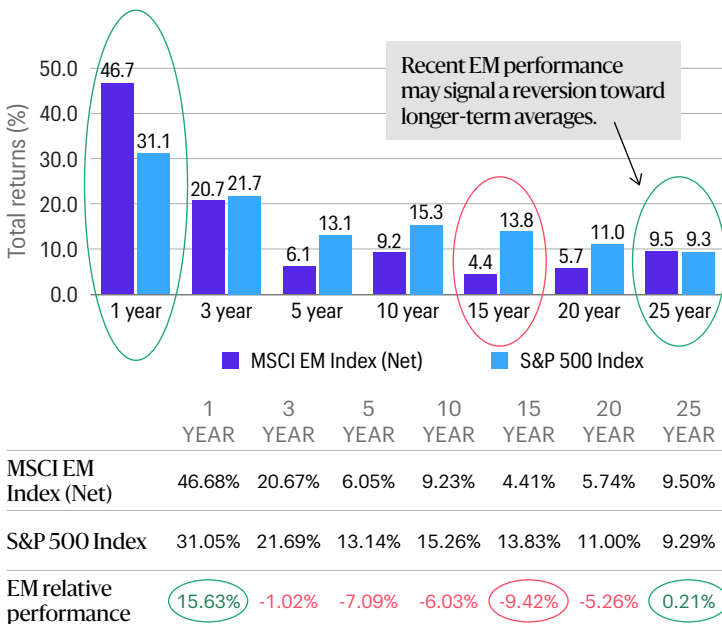


South Korea provides exposure to advanced technology, important industrial exports, and ongoing governance reform. It is central, not peripheral, to the argument in favor of a strong semiconductor cycle. It offers differentiated access to future-oriented industrial sectors, including semiconductors, defense, power equipment and batteries, shipbuilding, and structural consumer growth via food and K-culture. Across these sectors, Korean companies benefit from leading technology, strong cost competitiveness, and structurally shorter lead times versus DM peers. Despite very strong market performance, valuations remain low given continued upward earnings revisions. Estimated GDP growth of 3% masks the underlying strength of the country at less than 10 times price/earnings, well below EM peers. Strong earnings growth underpins market performance, supported by continued government-led shareholder reforms aimed at increasing dividend payouts, expanding buybacks, and improving corporate governance transparency.

Brazil is another country with substantial natural resources, a large population and a deepening financial market. It is renowned for its export capacity for agricultural and mining commodities and is among the four nations with the largest potential for oil production growth over the next five years—no straits attached! Brazil’s population of 203 million, with a median age of 35 and rising incomes, supports an increasingly attractive domestic market. Its abundant hydroelectric generation capacity ensures low-cost power for housing and manufacturing. The country’s central bank is starting a rate-cut cycle in 2026, and a tax reform should start yielding fruit in 2027. Valuations remain attractive and could find a new catalyst if upcoming election candidates articulate a credible commitment to fiscal responsibility.

FIGURE 1. REVERSION TO THE MEAN IN THE NEXT REGIME: BEYOND U.S. EXCEPTIONALISM

MSCI Emerging Markets Index (Net) vs. S&P 500 Index



Source: FactSet. All periods greater than one year are annualized. As of 30-Apr-26.

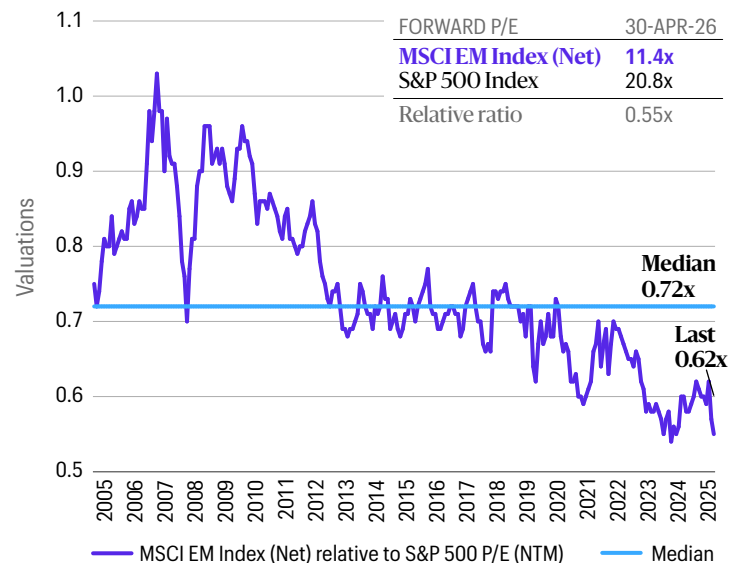
INVESTING IN EM IS A WAY TO DIVERSIFY OUT OF THE CURRENT VOLATILITY IN THE U.S.

In our view, tariff, immigration, and the Department of Government Efficiency policies under the Trump administration pose greater risks to the U.S. than to EM countries given their inflationary pressures and potential drag on economic growth. The Iran war has weakened the credibility of the U.S. as a world leader. 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. RELATIVE VALUATIONS FOR EM ARE AMONG CHEAPEST LEVELS IN 20 YEARS

MSCI Emerging Markets Index (Net) relative to S&P 500 Index P/E (forward)

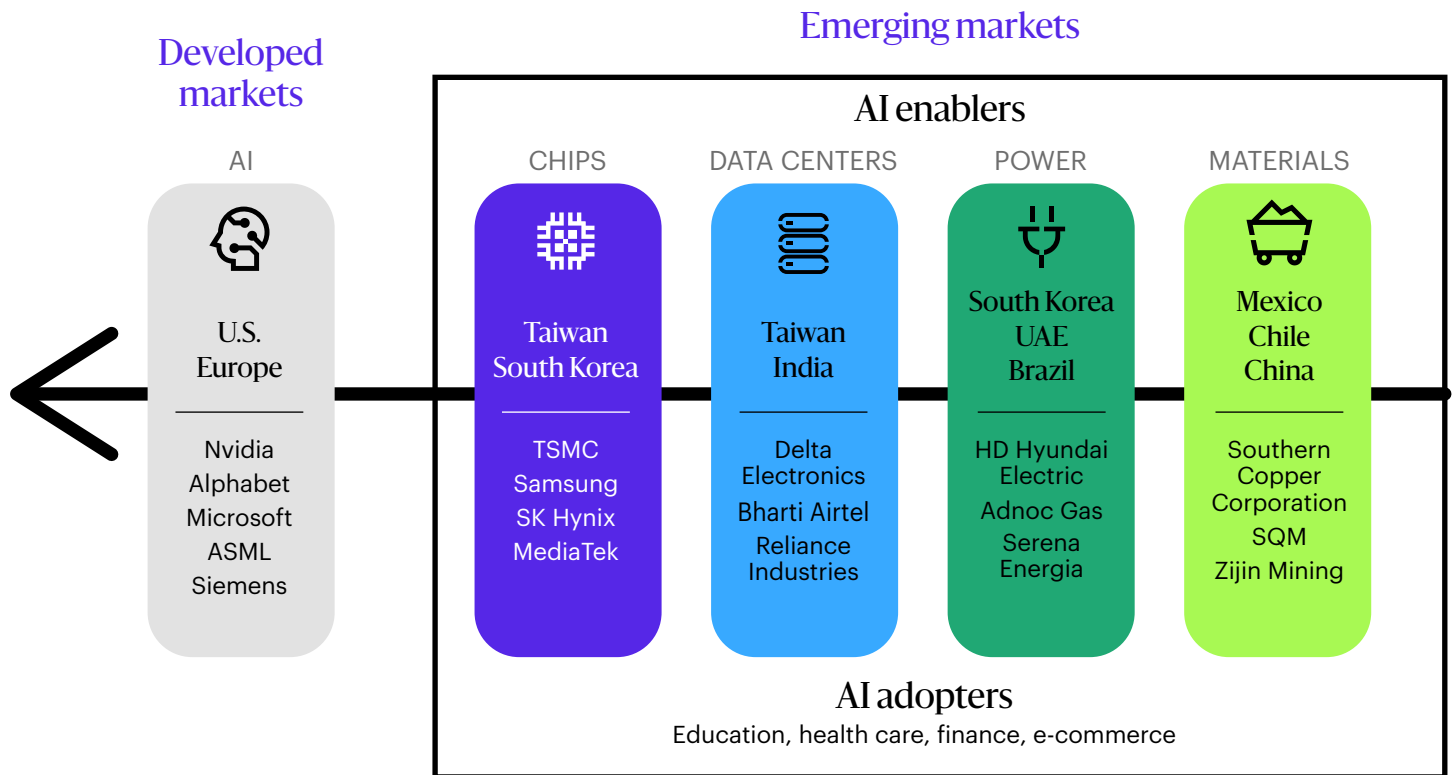


Source: FactSet, as of 30-Apr-26
Forward P/E: Next 12 months (NTM)

Past performance does not guarantee future results.



FIGURE 3. THE GLOBAL AI VALUE CHAIN



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 DM to create their own new products or technology—as was shown by the unveiling of China's DeepSeek AI technology last year.

EM countries are arguably well positioned for the AI revolution, starting with Taiwan and South Korea as the world's leading chip manufacturers. The energy and raw materials required to power AI data infrastructure will be largely sourced from Latin America and the Middle East. (see Figure 3 above). Within EM, fintech, health care, telecommunications, and medical equipment stand out as areas of rapid innovation where AI adoption is likely to be rapidly integrated and boost growth opportunities. Consumer staples are also an important EM investment theme, alongside commodities and materials such as gold, silver, copper, and oil.

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

Investing in EM undeniably entails heightened risk. Typical risks faced by investors include greater volatility and sensitivity to news and current events, more abrupt currency depreciation,

increased exposure to political instability, and regulatory uncertainty, including challenges related to contract enforcement and environmental, social, and governance (ESG) reporting. We believe an active and highly selective investment approach is key to mitigating these risks.

Drawing on our significant experience investing in this region—and supported by MSCI research (detailed in Figure 4)—we conclude that active investment with a risk-adjusted, total return approach is the most effective way to invest in EM over the long term. Balancing top-down risk assessment with bottom-up fundamental analysis, this approach aims to build resilient portfolios capable of generating alpha and outperforming 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.

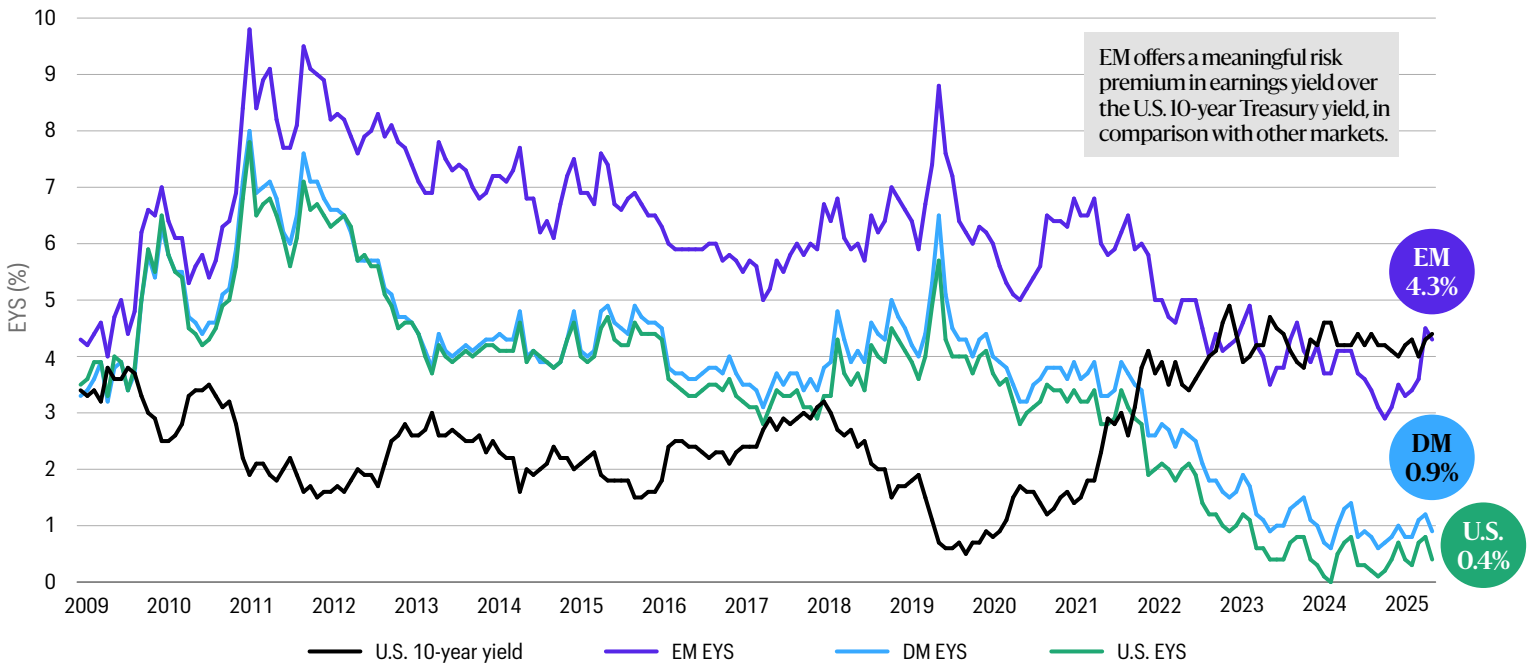
Deep fundamental and ESG analysis is crucial, and we invest in companies we believe offer the best risk-adjusted upside. In our experience, high-quality, liquid businesses are better positioned to withstand short-term market turbulence. This is why disciplined, active stock selection is so important—it influences the countries, sectors, and companies we choose to invest in.



FIGURE 4. EM EQUITY RISK PREMIUM VERSUS DM AND THE U.S.

	30-APR-26		30-APR-26		30-APR-26
EM earnings yield (NTM)	8.7%	DM earnings yield (NTM)	5.3%	S&P earnings yield (NTM)	4.8%
U.S. 10-year Treasury yield	4.4%	U.S. 10-year Treasury yield	4.4%	U.S. 10-year Treasury yield	4.4%
EM earnings yield spread	4.3%	DM earnings yield spread	0.9%	U.S. earnings yield spread	0.4%

GLOBAL EARNINGS YIELD SPREADS (EYS)



Source: FactSet as of 30-Apr-26
 EM = MSCI Emerging Markets Index (Net)
 DM = MSCI World Index (Net)
 U.S. = S&P 500 Index
 EYS 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 Markets¹**, a company’s profitability; investment quality; and, above all, dividend yield are all more important drivers of long-term compounding than a company’s growth trajectory alone. Quality, yield, and profitability are therefore central to our investment process, and EM offer a compelling combination of both 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 there is currently an opportunity for investors to diversify into EM as early signs of a potentially exceptional decade begin 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 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

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Alpha measures the excess return of an investment vehicle, such as a mutual fund, relative to the return of its benchmark given its level of risk (as measured by beta). Alpha is based on historical performance and does not represent future results.

Forward P/E ratio is a forward-looking perspective on a stock's valuation. A lower ratio suggests the stock is undervalued relative to its projected earnings while a higher ratio suggests it is overvalued based on projected growth.

MSCI Emerging Markets Index (Net)

The Morgan Stanley Capital International (MSCI) Emerging Markets (EM) Index (Net) is a free-float-adjusted market-capitalization-weighted index that is designed to measure equity market performance of emerging markets. You cannot invest directly in an index.

MSCI World Index (Net)

The Morgan Stanley Capital International (MSCI) World Index (Net) is a free-float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index (Net) consists of the following 23 developed markets country indexes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States. You cannot invest directly in an index.

Standard & Poor's 500 Index (S&P 500 Index)

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value-weighted index with each stock's weight in the index proportionate to its market value. You cannot invest directly in an index.

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