

2026 Emerging Markets Outlook

We believe there is room for rebalancing in emerging markets, which remain meaningfully under-owned and undervalued relative to their weight in the global economy.

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Key takeaways

- **EM outlook:** Stronger fundamentals and narrowing risk premiums position emerging markets for a constructive 2026, in our view.
- **China strategy:** Amid a shift from beta to policy-led alpha, we favor high-quality consumer franchises and tech- and manufacturing-aligned opportunities with China's 15th Five-Year Plan.
- **Growth drivers:** We believe AI investment becomes more selective; rising consumption growth in countries such as India and Indonesia remains a key long-term anchor.

Emerging markets: Constructive setup into 2026

We maintain a constructive view on emerging market (EM) equities heading into 2026. The risk premium between EM and developed markets continues to narrow, supported by stronger macro fundamentals and improved resilience across EM economies. Unlike the previous decade, when vulnerabilities such as large current account deficits defined the "Fragile Five," many of these economies have strengthened external balances and fiscal positions. This structural improvement reduces systemic risk and provides a foundation for a more broad-based equity rally. Importantly, performance is expected to be driven by multiple factors beyond artificial intelligence (AI), including domestic consumption growth, policy support, and sector diversification.

2026: Taking a selective barbell approach as market moves from beta to policy-led alpha

Despite ongoing geopolitical tensions between the U.S. and China and macro data pointing to a soft domestic economy, China has been an outperformer within EM year to date. While China delivered a beta-driven rally this year, we expect 2026 to be more selective. The market should continue generating positive returns as China embarks on its 15th Five-Year Plan. Historically, domestic equities have delivered positive returns in the year following the release of each plan, with sectors and sub-industries highlighted in the proposals often outperforming. Boosting consumption is a key priority in the 15th plan. In light of this, our preferred approach is a barbell strategy: pairing high-quality domestic consumer franchises trading at attractive valuations and yields with multiyear growth opportunities in technology and advanced manufacturing aligned with policy priorities. These segments may benefit from structural support and improving capital efficiency.

AI investing in EM: From "fund everything" to "funding what works"

AI remains a multiyear growth theme, but the market is transitioning from the early-stage "fund everything" phase to a more disciplined investment stage. In EM, AI-related performance has been influenced by U.S. tech partnerships that highlight collaboration among technology firms, capital markets, and government—particularly in infrastructure development, a layer where

China faces fewer constraints. We believe Chinese tech names offer a compelling counterbalance for investors seeking long-term AI exposure, especially as concerns grow over potential overbuild in U.S. AI infrastructure. For incremental capital flows into China's AI ecosystem, key catalysts include easing of chip and foundry restrictions and tangible progress in domestic semiconductor and advanced node development. These milestones will potentially determine China's ability to capture a meaningful share of global AI investment.

Consumption growth remains a key long-term anchor for EM growth

Beyond technology, EM growth remains anchored in rising consumption and disposable income. We see the most attractive opportunities in Indonesia and India, where favorable demographics and income trends underpin long-term demand. Near-term tariff-related headwinds have pressured valuations in consumer sectors, creating entry points into companies with strong free cash flow profiles. In Indonesia, while policy uncertainty persists, pro-growth fiscal measures and capital market reforms from the current administration could restore consumer confidence and accelerate domestic demand. For India, despite relative underperformance year to date, this comes off a high base. While geopolitical friction with the U.S. warrants monitoring, India's strategic role in Asia and its alignment with a potential bipolar global order reinforce its long-term investment case.

Bottom line: Quality and selectivity drive alpha

EM enter 2026 with improved fundamentals, narrowing risk premiums, and diversified growth drivers. While selectivity is key, we see compelling opportunities across consumption-led economies and technology-driven sectors. A quality-first, fundamentally driven approach anchored in structural themes and policy alignment positions EM equities for another constructive year.

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.

Beta is a measure of an investment's sensitivity to market movements. It indicates how much a security or portfolio is expected to move relative to a benchmark index. Beta is based on historical performance and does not represent future results.

Diversification does not ensure or guarantee better performance and cannot eliminate the risk of investment losses.

"Fragile Five" emerging market economies refer to a group of five emerging market economies that are identified as particularly vulnerable to capital outflows and currency depreciation during periods of global financial stress—especially when U.S. interest rates rise or liquidity tightens. They are composed of the following EM countries: Brazil, India, Indonesia, South Africa, and Turkey.

Free cash flow is a profitability metric that shows how well a company converts sales into cash and how efficiently it turns revenue into cash flow.

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