

The Global Landscape is Reshaping Emerging Markets' Prospects

The global landscape is shifting, and structural tailwinds are lifting emerging market (EM) equities. Investors capitalizing on these trends could benefit from transformative growth opportunities for years to come.

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Date

8/12/2025

Topic

Equities

Key takeaways

- EM equities started out strong in the first half of 2025. Countries we're watching for the remainder of 2025 include India, Indonesia, Saudi Arabia, Brazil, and China.
- China is central to global growth themes such as artificial intelligence, automation, and electrification, but a selective investment approach remains essential.
- If assets continue to flow from U.S. equities, we see three structural tailwinds benefiting EM equities: demographics, foreign direct investment, and digital leapfrogging.

Investors who reduced their exposure to China and emerging market (EM) equities broadly should now think again—they could miss out on a once-in-a-generation opportunity.

As the global landscape shifts—with new trade agreements and a weakening U.S. dollar amid structural tailwinds like demographic trends and digital transformation—we see a much stronger investment case for the role EM equities can play in a diversified portfolio.

Midyear check-in

Recording net returns of 15.3% for the first half of 2025,¹ EM equities started the year on a strong footing, outpacing the returns of developed markets and notably the S&P 500 Index, which returned just 6.2%.² For the second half of 2025, we'll be watching two key factors: tariffs and the dollar. A trade deal between the U.S. and China could help China emerge from its deflationary slump and, crucially, encourage consumer spending. That would improve prospects for China's consumer discretionary companies where current valuations are pricing in significant pessimism. China's technology sector is also well positioned to benefit from the advancement of artificial intelligence (AI); here we continue to find compelling opportunities in this fast-paced part of the market.

If the U.S. dollar continues to weaken, we expect dollar-sensitive countries like Brazil, South Africa, and Korea to perform well, building on solid returns from the first half of 2025.

Global investors are likely to continue to diversify away from the U.S. (due to a volatile policy environment, expensive equity markets, and an overvalued dollar), benefiting EM equities. In June 2025 alone, net \$6 billion flowed into EM equity funds,³ and we can see this accelerating in the future, providing broad market support.

Countries to watch

Certain countries in particular stand out as equity markets to watch for the remainder of 2025.

India: After correcting almost 20% from late 2024, some speculative excess has been removed, and the market has begun to recover. We expect to continue to find attractive opportunities at more attractive valuations.

Indonesia: Despite robust economic growth, the Indonesia market has underperformed this year. Both equities and the Indonesian rupiah are undervalued in our analysis, while economic policies are increasingly growth friendly. Instead of trying to time the recovery, we're focused on companies generating strong cash flow and paying attractive dividends— these stocks offer good upside and can be more resilient when markets are slow to move forward.

Saudi Arabia: A weak dollar and soft oil prices have weighed on the Saudi Arabian market, making it one of the worst performers so far this year. We continue to underweight the country favoring high-quality companies on cheap valuations.

Brazil: During our recent visit to companies in Brazil, we noted the country is relatively insulated from tariffs. U.S. exports account for just 1.7% of gross domestic product, and it has deepened trade relations with Asia (China in particular). Valuations remain appealing and interest rates may be near peak, though our focus remains firmly on company-specific opportunities.

China: Disinflationary pressure and overcapacity in some industries persist, but the housing market has stabilized, and the government continues to apply stimulus. Many firms are shifting their focus from top-line growth to margin and return enhancement. We see opportunities for strong alpha generation in this market driven by deep fundamental research and timely stock selection.

China's evolving role in EM exposure

China remains a cornerstone of EM equity exposure at 28% of the index allocation. ⁴While Chinese equities may remain subdued in the second half of the year, due to geopolitical uncertainties associated with their ongoing domestic challenges, there are significant opportunities for generating alpha.

Looking further out, the country's longer-term strategy aims to address structural imbalances: boosting domestic consumption, fostering innovation, and enhancing self-reliance in critical sectors. Meanwhile, China seeks to maintain global trade engagement while reducing vulnerability to external shocks. Despite ongoing macroeconomic and geopolitical challenges, China remains central to global growth themes such as AI, automation, and electrification. Its scale, efficiency, and capacity for innovation make it too strategic to overlook.

We believe a selective investment approach is essential. Our disciplined, bottom-up stock-selection framework is designed to navigate these complexities while capturing the upside of China's evolving growth story.

Structural tailwinds for emerging markets

Flows into EM equities may also reflect a broader structural theme. U.S. exceptionalism is anchored by three key pillars: technological dominance (Big Tech and especially AI), financial leadership (the dollar's reserve currency status and deep capital markets), and strategic alliances (NATO, The World Bank and International Monetary Fund, and bilateral security pacts). Today, all three pillars are being challenged.

Technological advances in Asia, the rise of alternative payment systems, de-dollarization trends, and the growing influence of regional blocs such as BRICS are reshaping the global economic landscape. Three key drivers point to EM countries benefiting from the shift:

- **Demographic advantage:** Younger populations offer long-term potential to boost labor markets and consumption patterns.
- **Strategic reshoring and FDI:** Supply chain diversification is accelerating foreign direct investment (FDI) into EM economies.
- **Digital leapfrogging:** High internet penetration and mobile-first ecosystems are enabling rapid adoption of digital technologies.

Investors who capitalize on these trends could benefit from transformative growth opportunities across EM countries for years to come. By integrating EM equity strategies and increasing overall exposures, investors can position portfolios to harness the full potential of these evolving markets with the goal of achieving attractive long-term returns.

1. Source: MSCI Emerging Markets Index net returns 01-Jan-25 to 30-Jun-25
2. Source: Morningstar, 01-Jan-25 to 30-Jun-25
3. Source: EPFR, 30-Jun-25
4. Source: MSCI Emerging Markets Index, 30-Jun-25

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