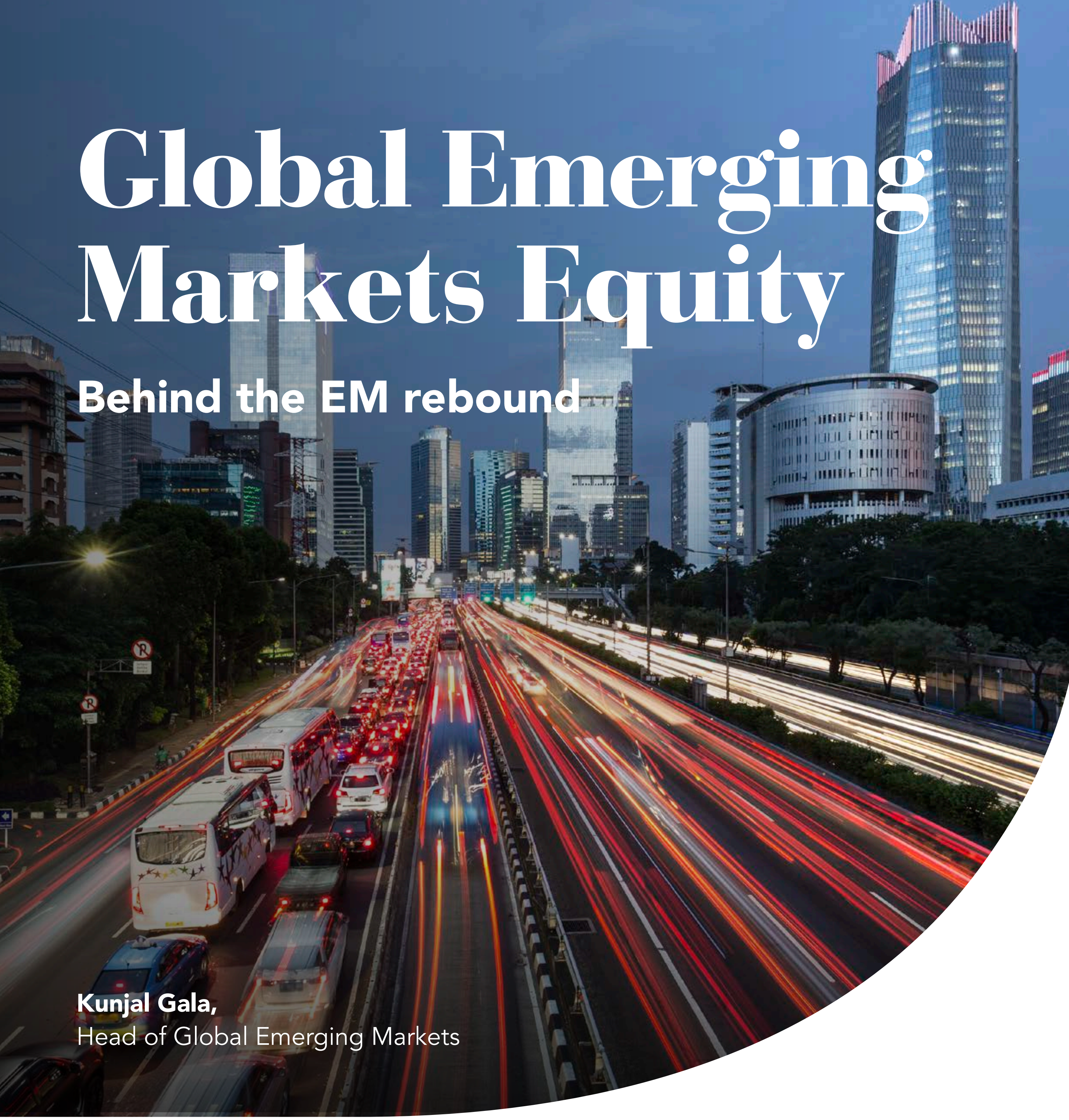

# Global Emerging Markets Equity

## Behind the EM rebound

**Kunjal Gala,**
Head of Global Emerging Markets

Outlook 2026

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Emerging markets (EM) outperformed developed markets (DM) last year on the back of a variety of tailwinds. We believe the EM rally has the potential to be prolonged and significant as we outline in this report.

- A number of large developing markets – China, South Korea, Taiwan, South Africa, Brazil, and Mexico – were central to EM outperformance in 2025. In almost all cases – with the exception of Taiwan – valuations stood out as extremely reasonable, bolstered by distinct factors, such as the tech rally, currency strength, and the commodity windfall.
- The huge sums of capital expenditure (capex) pouring into cloud service providers and data centres stands to significantly benefit emerging markets. This artificial intelligence (AI)-related capex investment will further fuel demand for semiconductors and the knock-on benefits will boost manufacturers of servers, networking devices, liquid cooling equipment, and other electronic components.
- We believe that the conditions for ASEAN[1] outperformance are building – despite the region's limited benefit from the AI boom and rise in commodities. The ASEAN region generally does well when the US dollar is weak, there is an upcycle in global manufacturing, as well as when China pursues supply side reforms.

**A number of large developing markets – China, South Korea, Taiwan, South Africa, Brazil, and Mexico – were central to EM outperformance in 2025.**

[1] **The Association of Southeast Asian Nations**: A 10-member regional bloc founded in 1967 to promote economic growth, security, and cultural development in Southeast Asia. Comprising Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam, it represents a major global economy and is headquartered in Jakarta.

## Emerging markets (EM) delivered a stellar total return of 33.75% in 2025[2], outperforming developed markets (22%[3]) and the tech-heavy Nasdaq (21%[4]) over the course of the year.

A variety of factors helped EM outperform developed markets by more than 10 percentage points in 2025.

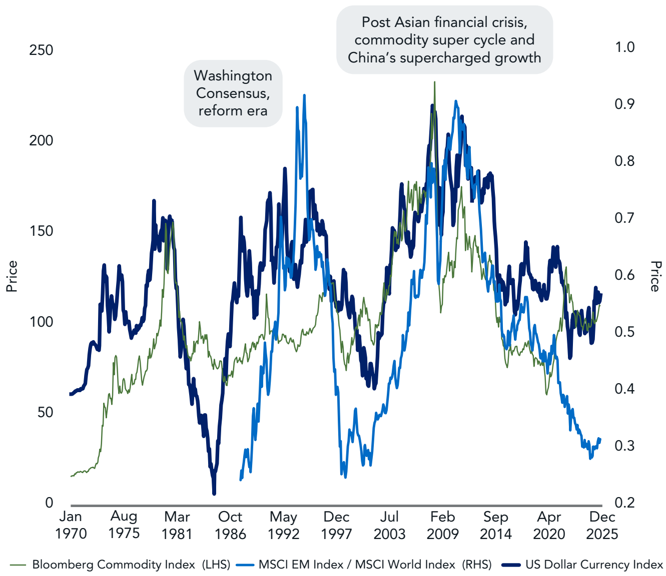
- Asian suppliers benefited from the US-led AI boom
- China's AI tech cycle flourished following the 'DeepSeek moment'[5]
- The pace of reform in key countries picked up, notably in South Korea
- The US dollar weakened by 11%[6] (reversing the historical trend)
- Commodities rallied (apart from oil)
- Leading central banks cut rates and eased policy

We can look at previous prolonged periods of EM outperformance – such as the late 1980s or the early 2000s – and find various similarities with the present time:

- A weaker US dollar acting as a tailwind, improving external financing conditions and boosting capital flows.
- Robust demand for commodities and manufacturing, disproportionately benefiting EM exporters.
- Rapid industrialisation in Asia and urbanisation supporting sustained growth.
- Post-crisis and policy-driven reforms strengthening fundamentals.

(We saw a short period of EM outperformance following the 2008-09 global financial crisis (GFC), driven by Chinese government stimulus, while other instances of EM outperformance – such as 2010, 2012, 2017 – have been volatile and brief.)

**Figure 1:** EM has underperformed DM over last decade (coinciding with US dollar strength)




US Dollar Currency Index not to scale and inverted. Source: Bloomberg as at 31 December 2025. **Past performance is not a reliable indicator of future results.**

[2] MSCI Emerging Markets Index, as at January 2026.
[3] MSCI World Index, as at January 2026.
[4] Bloomberg, as at January 2026.
[5] In January 2025, DeepSeek, a Chinese artificial intelligence (AI) startup, released its latest model, DeepSeek R1, which it said rivalled technology developed by ChatGPT-maker OpenAI in its capabilities, while costing far less to create. Its popularity and potential rattled investors and called into question whether American firms would dominate the booming AI market, as many assumed they would.
[6] The US dollar vs the euro (1 Jan to 31 December 2025), Bloomberg

We believe the current EM rally has the potential to be prolonged and significant.

A number of large developing markets – China, South Korea, Taiwan, South Africa, Brazil, and Mexico – were central to EM outperformance in 2025. In almost all cases – with the exception of Taiwan – valuations stood out as extremely reasonable, bolstered by distinct factors such as the tech rally, currency strength, and the commodity windfall.

- **South Korea** posted spectacular returns on the back of sweeping corporate governance reforms and the AI boom helping memory chip manufacturers deliver outsized profits;
- **Taiwan** performed well because of its critical position in the global semiconductor space and AI server supply chain;
- **China,** meanwhile, rebounded, helped by a stable policy environment, domestic AI innovation and surprisingly limited impact from trade tensions with the US;
- **Latin America** was bolstered by supportive currency movements; while
- **South Africa** benefited from a rise in the price of precious metals and domestic reforms.

Despite concerns about the sustainability of the AI boom, we expect the majority of the big themes that underpinned markets last year to prevail throughout 2026.

## Will outperformance continue?

The **Beijing government** continues to prioritise a stable policy backdrop that helps private enterprises to flourish . (Although further action may be required to stabilise the property sector and boost subdued consumer confidence.)

The **South Korean government** – led by President Lee Jae Myung, who was elected in June – continues to prioritise and implement a range of significant corporate governance reforms (while the ongoing AI boom continues to help memory players immensely.)

In **Brazil**, real interest rates remain very high, and inflation expectations are lower, which should support equities amid expectations that the Central Bank of Brazil will cut rates in 2026. However, the general election in October could spur some volatility.

**Mexico**, meanwhile, is hoping a favourable renewal of the United States-Mexico-Canada Agreement (USMCA) will kick-start a new investment cycle in the economy.

More broadly, we are expecting an upcycle across multiple industries that will help boost growth in EM. We will discuss these cycles in subsequent sections.

## EM drivers and improving growth prospects

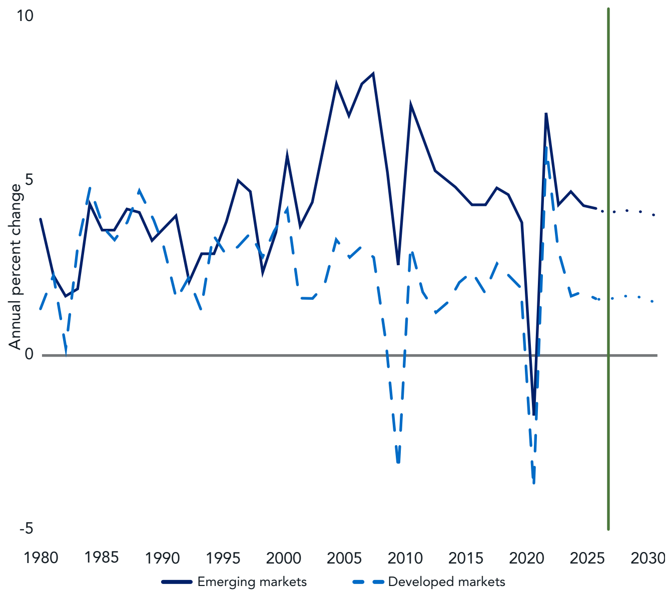
Over the course of the year, we expect the performance disparity between DM and EM to continue, supported by further policy improvements and growth across EM.

Many developed markets remain burdened by bloated welfare obligations, rising government debt and past policy missteps, which continue to constrain their economies.

In contrast, many emerging economies are expected to flourish on the back of sizeable domestic markets, efficient supply chains and reliable energy sources, less hindered by geopolitical constraints and benefiting from far-sighted policy calls.

Emerging market economies are forecast to grow by 4.2% in 2026 and 4.1% in 2027, according to the International Monetary Fund (IMF), compared to advanced economies (1.8% in 2026 and 1.7% in 2028).[9]

**Figure 2:** EM vs. DM – real GDP growth




Source: IMF, (including forecasts through to 2030). **Forecast cannot be guaranteed.**

[7] The Kospi rose 83% (1 January to 31 December 2025), USD, Bloomberg

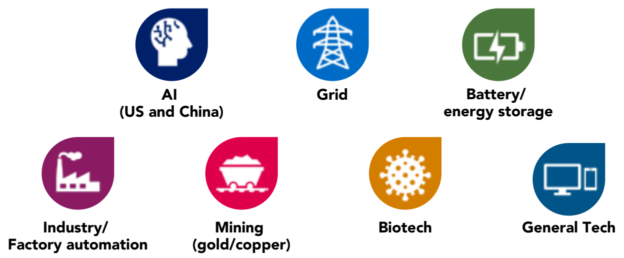
[8] A raft of supportive policy announcements over the last couple of years have made it clear that the crackdowns formed part of President Xi Jinping's 'common prosperity' agenda (2021-2022) are in the past.

[9] World Economic Outlook Update, January 2026: Global Economy: Steady amid Divergent Forces; World Economic Outlook 2026/003

## Industry upcycles

The expanding EM-DM growth differential – bolstered by the weakening US dollar, and expected US Federal Reserve policy easing – adds to our optimism about a range of industry upcycles that stand to benefit EM.

**Figure 3:** In addition to AI, we are expecting a strong upcycle in several industries…



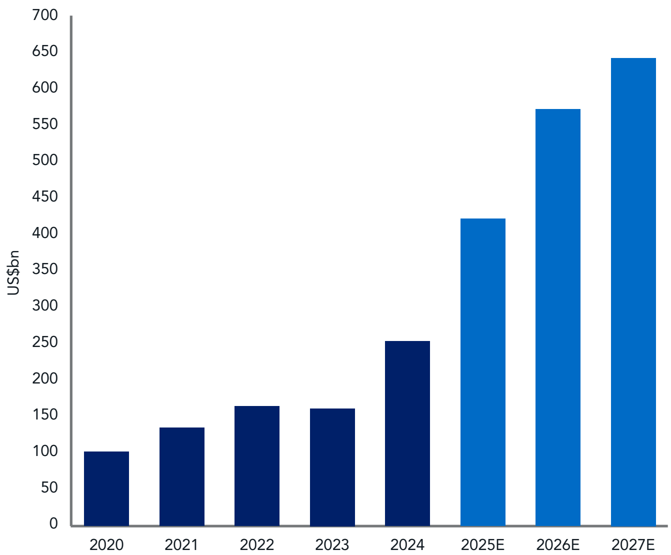

We saw some of these industry upcycles inflect positively in 2025 and we expect that momentum to continue into 2026 and beyond.

## Technology – AI and the big memory squeeze

The AI boom maintained its positive momentum during 2025. We expect the huge demand for AI data centres and the rollout of agentic AI capabilities – autonomous AI systems that can act independently – to continue this upward trend in 2026, supported by the steady uptake in AI adoption across a range of industries.

Of course, there will be consolidation in the AI sector at some point but we remain optimistic about the medium- to long-term prospects of the AI industry thanks to the improvements in productivity it represents (which, in turn, will drive growth).

**Figure 4:** Hyperscalers[10] capex forecast to grow by 36% in 2026 (and another 13% in 2027)



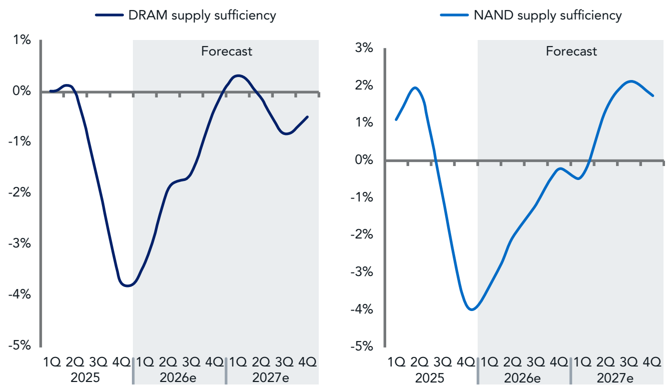

Source: Bernstein and Trendforce.
**Past performance is not a reliable indicator of future results.**

The huge sums of capex pouring into cloud service providers and data centres (see Figure 3) stands to significantly benefit emerging markets. This AI-related capex spend will further fuel demand for semiconductors and the knock-on benefits will boost manufacturers of servers, networking devices, liquid cooling equipment, and other electronic components.

In addition, there is a global shortage of DRAM (Dynamic Random-Access Memory) and NAND Flash memory chips, because of limited capacity expansion in the past, as well as the meteoric rise in demand for memory capacity in AI chips.

The pent-up demand has pushed up the average selling price (ASP) of memory products and, as a result, we expect many manufacturers to expand capacity, which, in turn, should boost companies that supply related equipment.

**Figure 5:** DRAM and NAND chips supply sufficiency estimates



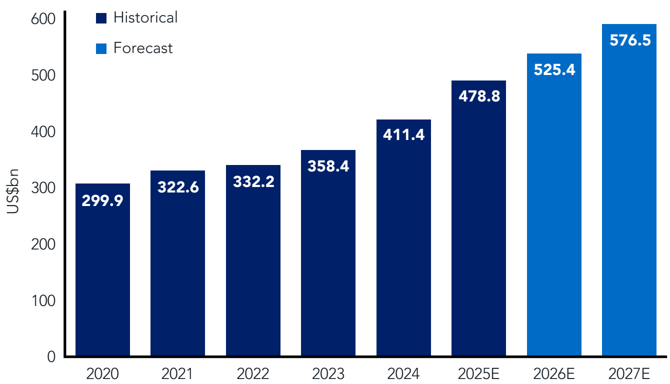

Source: HSBC estimates, W5T5, TrendForce. **Forecast cannot be guaranteed.**

## Grid – a multi-year investment cycle

The power grid is perhaps one of the world's most under-invested assets. Yet the surge in energy demand – from electric vehicles (EVs), AI data centres, and renewables – has put additional pressure on grid infrastructure.

We believe that investment in the grid represents a multi-year opportunity because of the complexity of the asset and shortage of critical components.

**Figure 6:** Power grid investment continues to surge




Source: BloombergNEF. **Forecast cannot be guaranteed.**

[10] Hyperscalers: massive cloud service providers – such as Amazon's AWS, Google Cloud, Microsoft's Azure, IBM Cloud, and Oracle Cloud – that operate enormous data centres.

Since 2021, investment in the grid has grown at a 13% compound annual growth rate (CAGR)[11].

Grid operators are ramping-up investment to meet rising demand and accommodate more distributed sources of energy generation. Many countries are grappling with intermittent power generation and an ageing grid infrastructure that needs to be upgraded.

Going forward, most analysts – including leading energy consultancies – forecast double-digit growth in spending on grid infrastructure through to 2030[12].

## Battery and energy storage – surging demand

Battery demand remained robust in 2025. European EV-related battery demand surged and energy storage systems (ESS)[13] saw strong sales.

It is worth noting that battery demand forecasts – from agencies like the International Energy Agency (IEA) and research organisations like BloombergNEF, as well as investment banks – have consistently been too conservative over the last few years. We believe this is because:

1) Renewables pricing continues to be very low

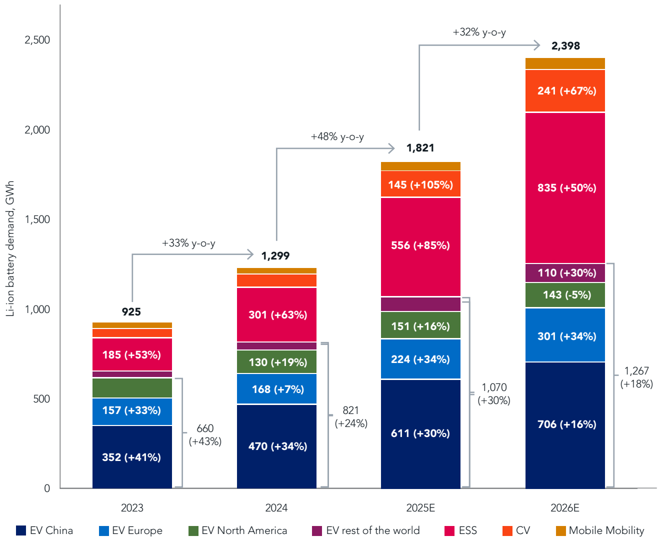
2) ESS pricing continues to be very low

3) Electricity demand had surprised on the upside

4) Grid instability – and energy price volatility – has become more apparent at grids that have been at the forefront of incorporating renewables[14].

It has led to a significant tightening in the market for batteries because capital investment has been muted across the entire supply chain for a number of years. As a consequence, we expect a re-inflation in battery pricing over the next 12-18 months.

**Figure 7:** Lithium-ion battery demand forecast to grow 32% YoY in 2026




Source: SNE Research, Bloomberg, Bernstein estimates and analysis. **Forecast cannot be guaranteed.**

## Factory automation – upcycle with new drivers

The Chinese industrial automation cycle bottomed out in H1 2024 and has been gradually recovering ever since.

As the automation industry rebounded early last year, robust demand for computers, consumer electronics and automobiles was counteracted by weak demand in the solar and battery sectors.

In recent quarters there have been clear signs of recovering capital expenditure into the battery segment and we expect demand for solar will bottom out in 2026. It should help the current upcycle to continue despite headwinds from 'traditional' manufacturing cycles (such as chemicals and building materials).

**In previous industry upcycles we have seen new drivers emerge that encourage growth.**

The last upcycle saw capex pour into the battery segment, amid strong demand for solar and new energy vehicles (NEVs).

This time around, the AI sector has driven demand – machinery for printed circuit boards (PCB), for example – as well as excitement about the potential of humanoid robots.

It is important to note that leading Chinese manufacturers – such as Inovance – have been gaining meaningful market share from Japanese and European competitors.

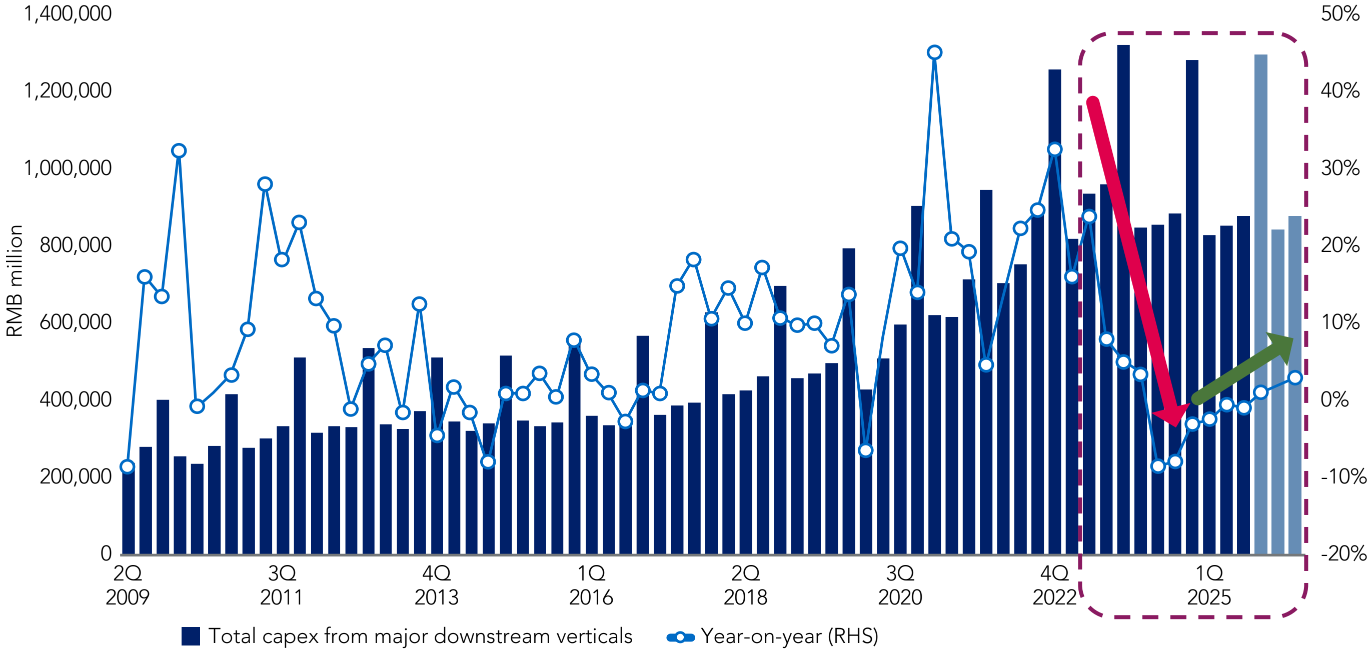
[11] BloombergNEF

[12] Global Grid Investment Could Top $470 Billion for the First Time in 2025: BloombergNEF | BloombergNEF

[13] Energy storage systems (ESS): racks of battery modules regulated by management software, help national electricity networks — as well as individual homes, businesses and factories — cope with fluctuating wind and solar energy supplies.

[14] It's worth noting that grid instability and price volatility at countries at the forefront of the green energy revolution (such as Spain, Australia, and the UK) has led to favourable policy changes.

**Figure 8:** China's capex by downstream sectors




Source: Jefferies

## Mining – cycle shifting into high gear

The mining capex cycle is beginning to accelerate, due to tightening balances and rising prices across many metals, led by particularly large moves in precious metals and copper.

In some cases, such as gold, the metal price has materially surpassed the incentive price, leading to robust internal rates of return (IRR) on most development projects.

**Figure 9:** Metals spot price vs. historical incentive levels

| Commodity | Metric | Spot | Historic Incentive Levels | Spot vs. Incentive |
|---|---|---|---|---|
| **Copper** | US$/t | 13,068 | 8,000 | 63% |
| **Gold** | US$/oz | 4,732 | 1,400 | 238% |
| **Iron Ore** | US$/t | 104 | 65 | 59% |
| **Nickel** | US$/t | 17,954 | 18,000 | 0% |
| **Zinc** | US$/t | 3,402 | 2,000 | 70% |
| **Aluminium** | US$/t | 3,144 | 2,200 | 43% |
| **Silver** | US$/oz | 82 | 24 | 240% |

Source: Bloomberg, JP Morgan estimates. Spot prices as of February 2026.

The copper market is a case in point. Global demand for copper is forecast to grow at about 3% CAGR over the next five years (4.4 million tonnes per annum [MTPA]) , driven by a huge increase in demand for use in electrification. EV adoption – in China, EV penetration is already 45%  – and renewables power generation have both been significant sources of copper demand growth in recent years.

The rapid build-out of data centres around the world is likely to further drive the rising demand for copper for use in electrification. In the US, electricity use has grown four-fold since Covid-19 pandemic (at approx. 2% per annum) and is forecast to accelerate further – averaging approx. 6% per annum – through to 2030. More than half of this growth comes from data centres, where copper accounts for about 6% of the capital cost .

Copper used in data centres is forecast to reach 500 kilotonnes per annum (KTPA) in 2026 and grow to 3 MTPA by 2050 – about 7% of global supply .

However, the big driver of the copper price over the last year or so has been concerns that new supply will not keep up with burgeoning demand.  A number of leading copper mines – including Grasberg in Indonesia, Kamoe-Kakula in Congo, El Teniente in Chile and Cobre Panamá – have seen production outages, which has led to forecasts of a massive deficit of approx. 400 kilotonnes this year .

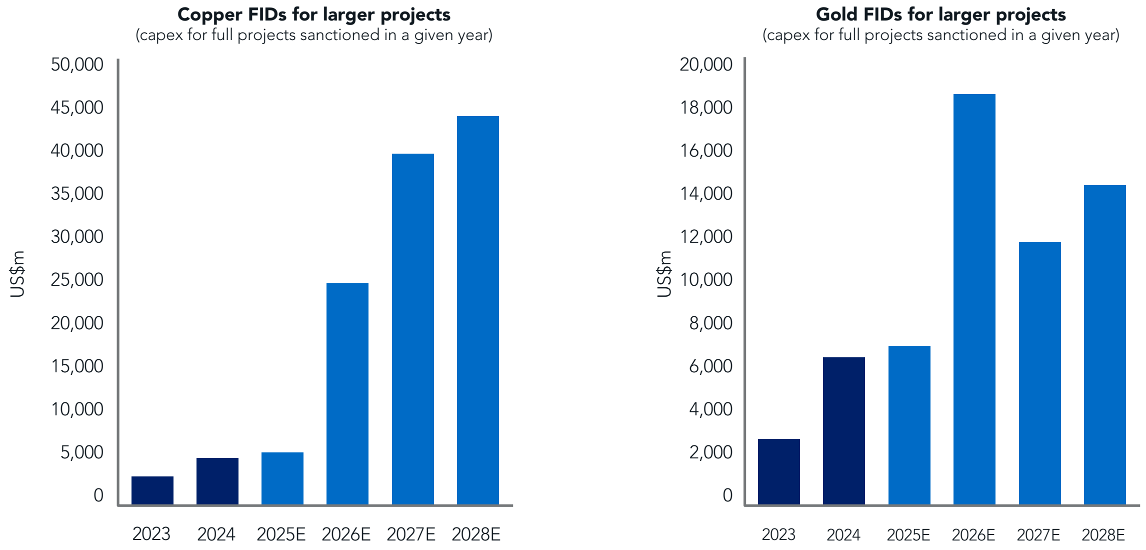
[15] Wood Mackenzie
[16] EV Strategies in the US Europe and China | BCG
[17] BMO, CEIC, EIA
[18] Why AI tools and data centres are driving copper demand
[19] NBCM, Wood Mackenzie

Over the longer term, there is a lack of large, quality, brownfield and greenfield projects in the pipeline. The copper price – which rose by more than 40% in 2025[20] – has moved beyond the incentive price, which will likely spur more project final investment decisions (FIDs).

The price of gold meanwhile saw a phenomenal increase in 2025 – rising more than 60%[21] – supported by concerns about fiat-currency debasement, expectations of rate cuts, relentless buying by central banks, and net inflows into gold exchange-traded funds (ETFs). This trend is unlikely to change anytime soon, particularly as governments run up large fiscal deficits.

**The huge rises in the gold and silver price has led to a flurry of related project FIDs in the mining sector, which we expect to translate into new equipment orders in the coming years.**

**Figure 10:** Copper and gold mining capex is rising



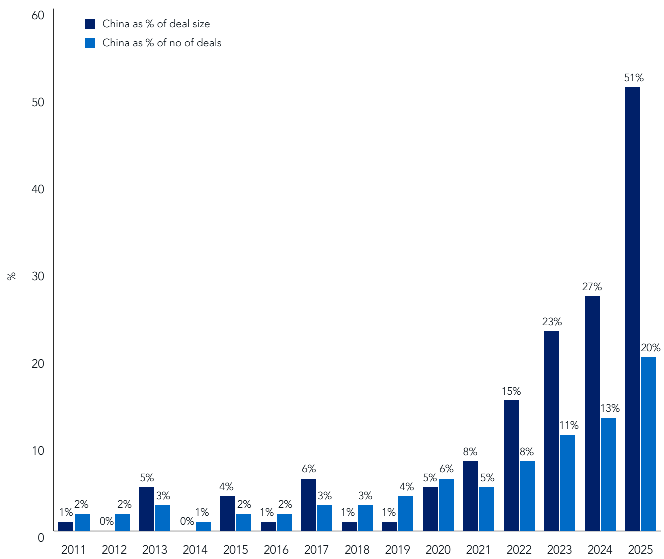

Source: Barclays Research estimates, WoodmacBiotech

## Biotech – the rise of China

The overhaul of China's healthcare and biotech industry began back in 2015. The China Food and Drug Administration (CFDA) set out a plan to simplify and accelerate the drugs approval process and establish a fast-tracking system for innovative drugs. At the same time, the Beijing government included biopharma as one of the ten critical sectors in its 'Made in China 2025' strategic plan, providing a shot in the arm to biotech innovation. The government offered the industry billions of dollars in direct financial support through research and development (R&D) funding. Talent recruitment was also prioritised. Competitive packages were offered to top Chinese scientists and foreign experts.

The onset of the pandemic led to a spike in licensing transactions between 2019 and 2021. The last few years has seen an increase in licensing growth which has been accelerating as China's biotech industry becomes bigger and more important.

**Figure 11:** China's biotech industry has become a big global player




Source: Citi Research, PharmaCube, Jefferies.

[20] Copper prices: What next for the red metal as LME prices hit record
[21] Gold and silver see rollercoaster end to blockbuster year - BBC News
[22] The silver price increased more than 140% in 2025

## How will EM laggards fare in 2026?

While emerging markets have had a pretty good year, **India**, **Southeast Asia** and the **Middle East** lagged the wider asset class in 2025. Below, we discuss our outlook for these regions and where we see opportunities.

### India

We were not surprised by India's underperformance in 2025. We were positioned for it and had moved India to an underweight in Q1 2024.

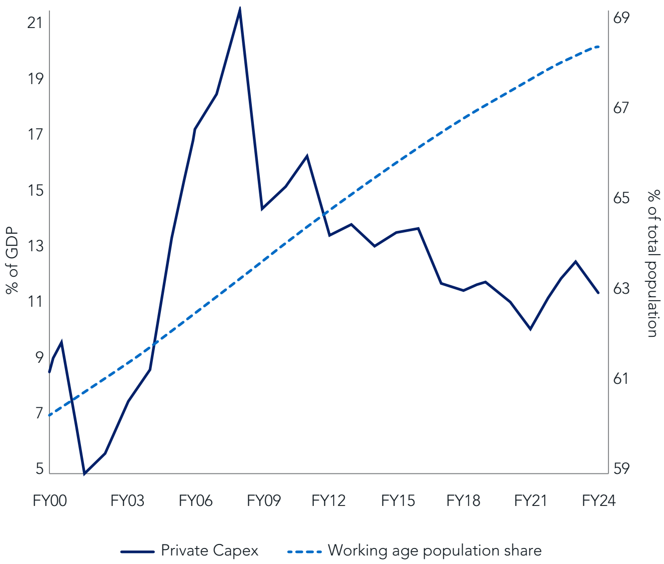
Several of our concerns – in particular sub-par growth and elevated valuations – have become broader market concerns and foreign investors have been pulling out of the country.

Some of India's challenges are cyclical. But we also see a number of significant issues with the country's economic trajectory and further reforms are needed to address them.

The goods and services tax (GST) regime has been simplified, new labour laws have been passed and crucial reforms to the agriculture and electricity distribution sectors are pending. However, there is an urgent need to reform India's judiciary system and overhaul the education sector to reduce the country's skills mismatch. India needs to boost vocational training at scale.

However, the government has been unable to invest significant sums of money to address some of these issues as it prioritises fiscal stability. At the same time, leading corporates have been focused on cash flow and return on equity (ROE) to maintain market valuations – at the expense of research and development (R&D) and product innovation. The country is stuck in risk-averse mode.

**Figure 12:** India's capex remains weak despite good demography




Source: CMIE, Nuvama research. Note: Private capex refers to household capex share of gross capital formation (GFC)

Overall, we believe that India will find it challenging to meaningfully improve its growth rate.

The country has a lot of work to do to address the challenges of global warming; compete in a world becoming driven by self-sufficiency in critical technologies and resources; and adapt to a radically changing business environment as AI proliferates.

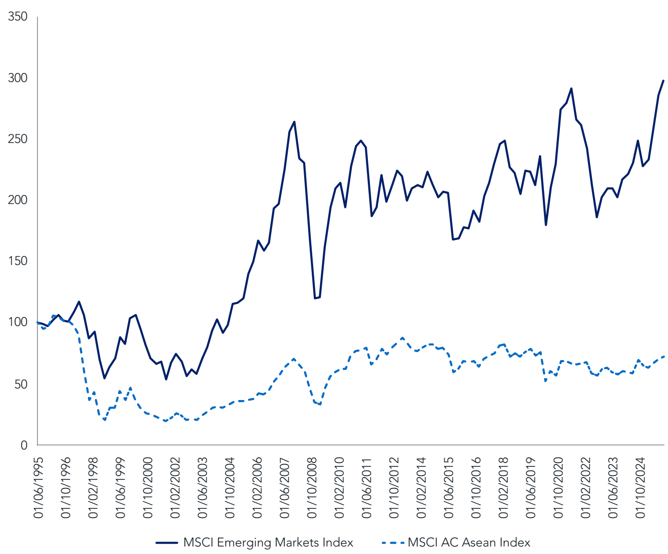
While we remain underweight Indian equities, we still see opportunities in companies that provide solutions to some of the structural constraints that the country faces – such as power transmission, water treatment, housing, financial inclusion, and technological innovation.

### Southeast Asia

For more than a decade, equities in the ASEAN region have not generated meaningful returns. Many countries have been held back by volatile domestic politics and an absence of economic dynamism, as well as other idiosyncratic factors.

**Figure 13:** EM vs. ASEAN over the last 30 years

**MSCI AC ASEAN Index vs. the MSCI Emerging Markets Index**




Source: Bloomberg, as at 31 December 2025. Price normalised to 100, in US$.
**Past performance is not a reliable indicator of future results.**

However, we believe that the conditions for ASEAN outperformance are building –despite the region's limited benefit from the AI boom and rise in commodities.

The ASEAN region generally does well when the US dollar is weak, there is an upcycle in global manufacturing, as well as when China pursues supply side reforms.

The US Federal reserve is expected to cut rates further this year, making it likely that the US dollar will continue to weaken. Moreover, the region boasts an effective supply chain covering electronics, autos, textiles and semiconductors and the ongoing supply side reforms in China should boost certain ASEAN countries.

On top of this, we expect a more stable political environment in Indonesia and Thailand. Indonesian President Prabowo Subianto received criticism last year after unpopular policies led to riots and foreign outflows. The government has since backtracked and sought to reassure the market about being fiscally prudent and we expect further reforms and less noise this year. Thailand, meanwhile, saw a border conflict, natural disasters and the ousting of a prime minster, and we anticipate a more supportive backdrop in the country following February's general election which saw a surprise victory for Prime Minister Anutin Chanrvirakul's ruling conservative party.

Tourism flows into the region have recovered from the pandemic, leading corporates are in a good shape, and ASEAN is less exposed to some of the recent geopolitical upheavals.

We have positioned the portfolio with an overweight to Thailand spread across a hospital group, a telco and a retailer – as well as exposure to a Southeast Asian internet platform – and a neutral allocation to Indonesia via a private sector bank.

## The Middle East

Saudi Arabia underperformed EM by a wide margin in 2025 due to a combination of factors: a lower oil price, expensive valuations (P/E ratios in the high- teens PE at the start of the year; and earnings per share growth under 10%), and a disconnect from popular investment themes (such as AI, precious metals and reforms).

**Figure 14:** Saudi Arabian valuations have de-rated

**MSCI Saudi Arabia Index P/E ratio**


Source: Bloomberg as at January 2026. Forward PE estimates. **Past performance is not a reliable indicator of future results.**

However, Saudi valuations have de-rated, and began 2026 at approximately 14x P/E with the market forecasting earnings-per-share growth in the low teens.

If there are no further increases to oil supply, it's likely that crude prices will stabilise.

In addition, Saudi policymakers are opening the country's equity markets to all categories of foreign investors. Over time, this shift will diversify the investor base and boost overall investment flows.

We also expect the impact of the 'Saudi Vision 2030' programme – the country's long-term strategy to develop and diversify its economy away from oil – will begin to be reflected in economic metrics, earnings and boost overall GDP growth. We have a neutral allocation to Saudi through a telecoms group and an insurance business, which both stand to benefit from the diversification of its economy.

## Investment shifts and key considerations

The wider investment backdrop has shifted because of geopolitical upheaval, economic and social realignment and rapid technological change. As a consequence, we believe no one market factor – such as quality, growth or value – will totally dominate future investor concerns[23].

As we outlined in last year's GEMs Outlook report, we believe three significant challenges currently weigh heavily on the global economy.

- Productivity
- Climate risk
- Demographic shifts

In our opinion, companies that can provide solutions to these three key challenges – while generating a reasonable profit and ROE – should deliver strong returns to shareholders.

Therefore, our focus is not only on these market factors but also, crucially, on the direction that the world is shifting, as well as the longevity of any investment proposition.

The global economy is increasingly driven by tech – across IT, industrials, communications, and biotech, as shown in Figure 15 below – and many EM companies are leaders in critical areas. It represents a significant shift from the past where the West dominated innovation and the East focused on low-cost manufacturing. Many EM countries still boast competitive supply chains but have moved up the value curve because of a sustained focus on R&D and innovation.

We have been carefully tracking these changes and have adapted and transformed our Strategy. The portfolio now has approximately 50% exposure to intellectual property (IP)-led businesses that stand to benefit from industry upcycles (as outlined in the previous section).

We believe that companies positioned to benefit from these structural tailwinds are typically well placed to grow and expand their margins.

The balance of the portfolio is spread across:

- Well-capitalised financial institutions that stand to benefit from higher levels of economic activity because of rate cuts and rising credit penetration as more people enter the formal economy.
- Consumer discretionary businesses that are making rapid progress in EVs and agentic AI or adding new business segments to accelerate growth.
- Gold/silver and natural gas.

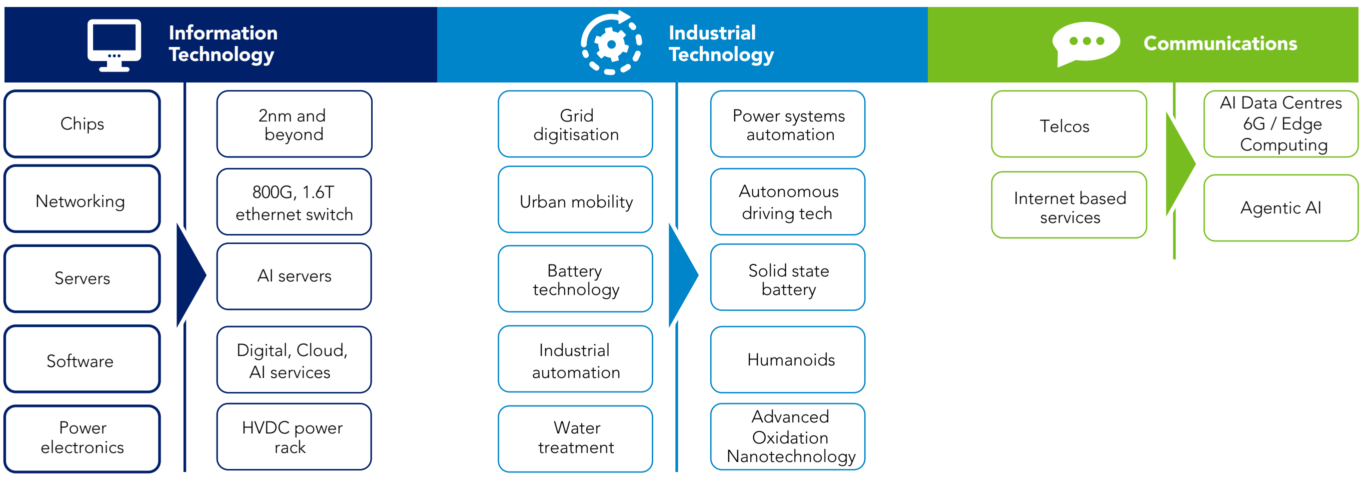
Quality as defined by MSCI – high ROE, stable earnings growth, and low leverage –has underperformed growth and value over the last few years because elevated valuations have capped re-rating possibilities, in addition to limited exposure to market-moving themes[24].

**Figure 16:** Quality has underperformed in recent years…

| MSCI EM Factor Index performance – gross returns % (31 December 2025) | | | | |
|---|---|---|---|---|
| annualised | | | | |
| | 10 years | 5 years | 3 years | 1 year |
| EM | 8.86 | 4.67 | 16.98 | 34.36 |
| Growth | 9.03 | 2.03 | 16.48 | 34.78 |
| Value | 8.59 | 7.48 | 17.46 | 33.89 |
| Quality | 7.28 | 3.01 | 10.93 | 14.60 |

Red boxes illustrate when the factor has underperformed the overall index and green boxes show when the factor has outperformed. Source: Bloomberg, as at January 2026. Forward PE estimates. **Past performance is not a reliable indicator of future results.**

**Figure 15:** The world is increasingly dependent on technology and EM companies are leading the way

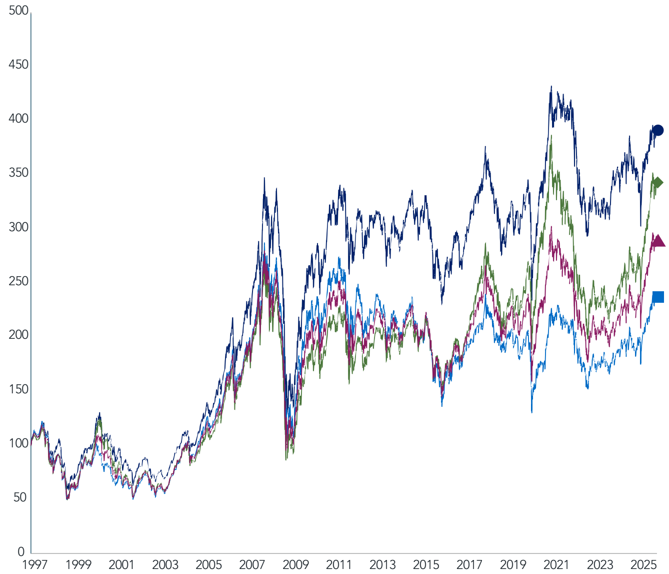



[23] The Kospi rose 83% (1 January to 31 December 2025), USD, Bloomberg
[24] such as inflation hedges, rate cut beneficiaries, high yields and AI.

However, over the long term, quality as a factor has significantly outperformed.

**Figure 17:** Over the long-term, quality outperforms

**MSCI Emerging Markets Growth Index vs. the MSCI Emerging Markets Value Index vs. the MSCI Emerging Markets Quality Index**




Source: Bloomberg as at January 2026. Forward PE estimates. **Past performance is not a reliable indicator of future results.**

We believe that quality stocks still have a crucial role to play in an uncertain world that is full of economic risks.

In the near term, a slowdown in the AI boom could spur a rotation into quality – steady compounders – until value remerges or new themes come to the fore.

The Federated Hermes Global Emerging Markets Equity Strategy adopts a blended approach to investing, focused on quality/growth stocks (at a reasonable price) and value stocks (with the right catalysts).

The muted global investor interest in EM over the last few years has helped us because it has allowed us to invest in innovative and dynamic businesses, often at a fraction of the valuation of their global peers.

In our view, emerging market economies are a net beneficiary of the various structural shifts underway at the present time.

Moreover, geopolitical upheaval, trade tensions and currency fluctuations have made diversification essential to protect portfolios from unnecessary volatility.

As a result, we believe that quality EM companies – with stable growth and strong balance sheets – will become the preferred option for global investors returning to the EM asset class.

## The medium- to long-term outlook for EM

We believe the medium- to long-term performance of EM will be driven by:

- The EM-DM growth differential
- The trajectory of interest rates
- The direction of the US dollar
- The successful rollout of EM reforms

However, one additional driver has become increasingly relevant: Innovation.

The 2025 World Intellectual Property Organisation's Global Innovation Index[25] highlights the remarkable progress made by emerging economies:

- South Korea (ranked four) joined the top five
- China (ranked 10) entered the top 10 for the first time (displacing Germany)
- The UAE joined the top 30
- The Philippines climbed into the top 50

India, Turkey, Vietnam, the Philippines, and Indonesia were among the fastest climbers since 2013.

**Figure 18:** EM countries are rising up the innovation rankings

| | Global Innovation Index | Institutions | Human capital and research | Infrastructure | Market sophistication | Business sophistication | Knowledge and technology outputs | Creative outputs |
|---|---|---|---|---|---|---|---|---|
| **USA** | **3** | 16 | 13 | 32 | 1 | 1 | 3 | 5 |
| **South Korea** | **4** | 20 | 1 | 7 | 5 | 4 | 9 | 4 |
| **China** | **10** | 44 | 20 | 6 | 13 | 8 | 1 | 14 |
| **UAE** | **30** | 7 | 17 | 9 | 19 | 28 | 57 | 35 |
| **India** | **38** | 58 | 54 | 61 | 38 | 64 | 22 | 42 |
| **Turkey** | **43** | 100 | 38 | 44 | 41 | 41 | 48 | 30 |

Source: The World Intellectual Property Organization (WIPO)

As long-term investors in emerging markets, we were not surprised to see China ranked as one of the top 10 innovators in the world. While China tops R&D spend and global patent filings, many companies in China are commercialising innovation at scale and it has made China a global leader in a number of critical industries.

With an ongoing focus on reforms enhancing the quality of institutions, the ease of doing business, infrastructure, and investment in human capital, we expect emerging economies will continue to climb the innovation ladder and move up the value chain.

[25] Global Innovation Index 2025. Innovation at a Crossroads.

## Summary

Emerging markets continue to navigate a complex macro backdrop, shadowed by uncertain US trade policy, slowing global growth, and elevated interest rates.

The scattergun rollout of tariffs has dampened consumer demand and delayed corporate investment, while structural concerns in the US – a rising deficit, stubborn inflation, and treasury market instability – have contributed to a weaker US dollar (typically a tailwind for EM assets).

Despite these challenges, we are constructive on EM, particularly for quality and growth-oriented investments. A series of long-term drivers support our outlook:

- EM equities remain under-owned and trade at a meaningful discount to developed markets.
- Consumption in EM remains strong.
- Many EM countries have invested heavily in infrastructure; and rapid digitisation continues to drive growth.
- A weaker US dollar supports EM countries reliant on foreign financing.
- Many EM governments are pursuing pragmatic reforms, reducing investor risk premiums.

The global economy is undergoing a profound transformation. Over the next five to ten years, the composition of leading indices will change, and new winners will emerge.

Our investment approach – high active share, a long-term focus, with an emphasis on future-ready businesses – is designed to compound earnings and book value steadily. As index constituents grapple with challenges from leverage, disruption, climate risk, and regulation, we remain laser-focused on finding tomorrow's leaders, while at the same time avoiding structurally-challenged or overvalued names.

> **Emerging markets continue to navigate a complex macro backdrop, shadowed by uncertain US trade policy, slowing global growth, and elevated interest rates.**

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