

TODAY'S EMERGING MARKETS OPPORTUNITY, QUANTIFIED



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EXECUTIVE SUMMARY

The decade-long run of outperformance enjoyed by emerging market equities in the early 2000s came to an end as global growth slumped following the Global Financial Crisis (GFC). With emerging market economies experiencing an even more pronounced post-GFC slowdown, emerging market equities became hindered by margin compression and currency headwinds. The impact of these conditions has lasted longer than anticipated, so while emerging markets have historically been favored due to their relative inefficiency and low correlations to developed markets, asset owners haven't been rewarded for their emerging markets allocations for quite some time until recently.

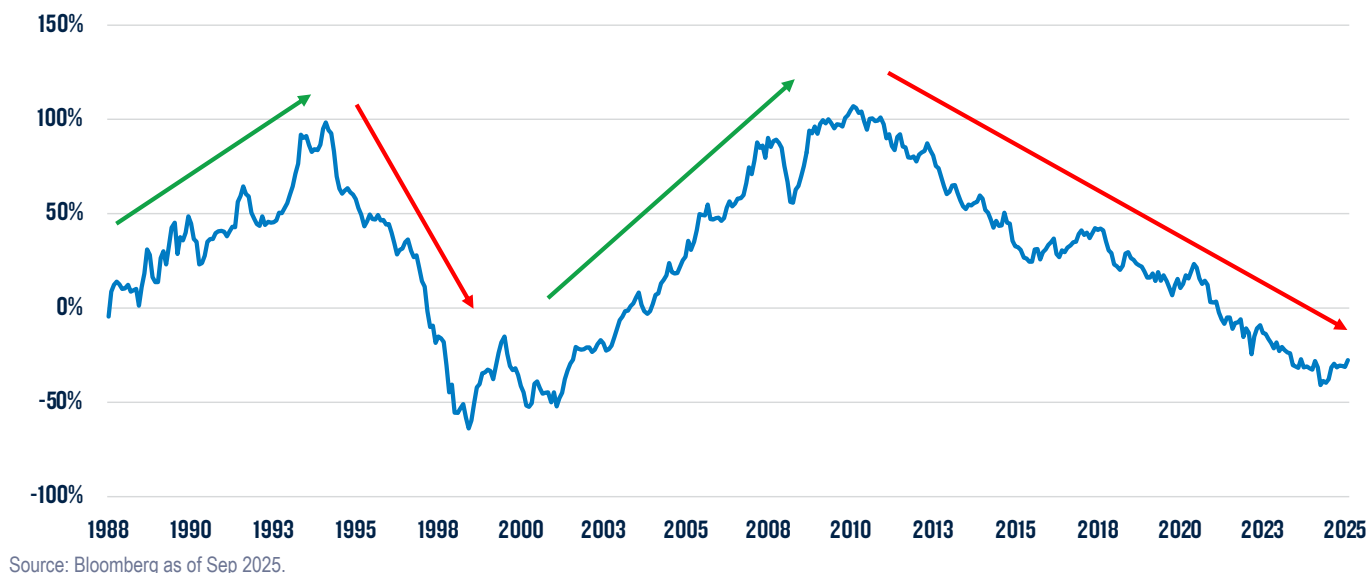
While timing asset class allocations is notoriously difficult, we believe now is a good entry point for long-term investors to consider a more constructive position on emerging markets even with the recent rally. Our perspective is anchored in three key pillars:

- **Historic Valuation Opportunity:** The valuation differential between emerging and developed markets is now at its most extreme since the dot-com era, sitting over one standard deviation cheaper than historical norms—creating a compelling entry point.
- **Future Growth Expectations:** Buoyed by favorable demographics and a growing middle class, emerging markets' contribution to global economic growth will continue to rise. Improvements in corporate governance will help translate GDP growth into corporate earnings growth.
- **Macro Tailwinds:** Lower than expected inflation and the current interest rate cutting cycle have already reduced demand for the US Dollar. Coupled with a resilient global economy, emerging markets equities are poised to benefit from these tailwinds.

HISTORIC VALUATION DISPERSION

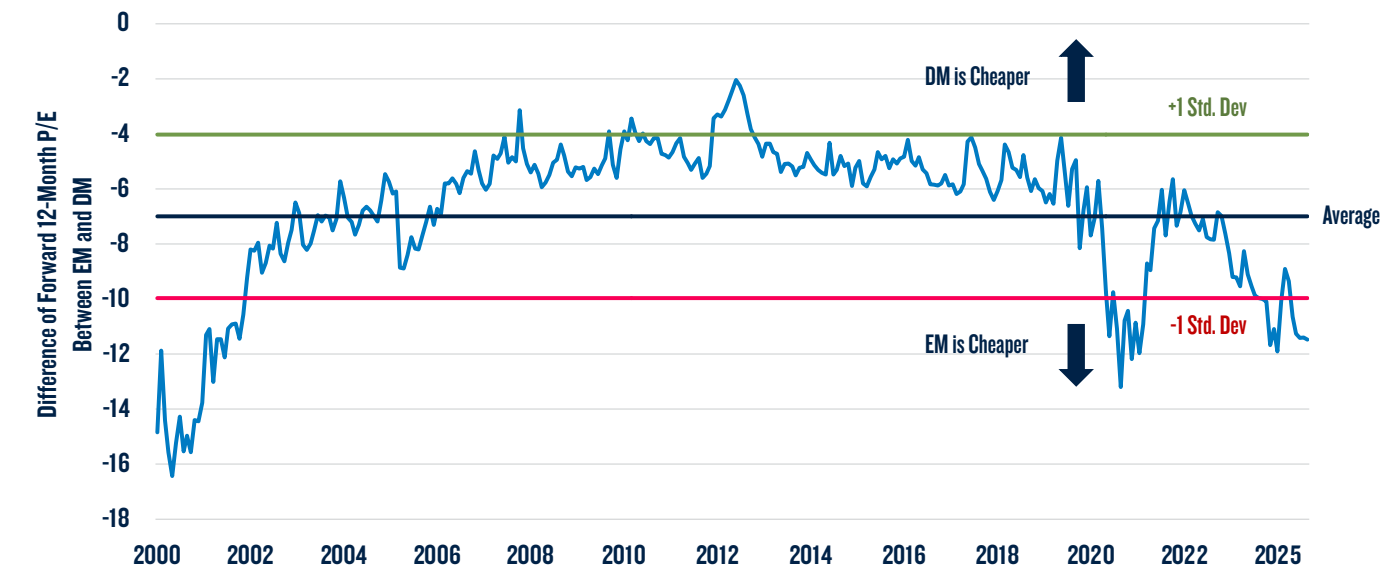
During the nearly 40-year period starting in 1987, the performance differential between emerging and developed markets has occurred in long, multi-year cycles. Since that time, there have been four super cycles of performance differential, with the average duration lasting about nine years. The current cycle of underperformance for emerging markets has lasted 13 years, notably longer than the historical average, as seen in Figure 1.

Figure 1: Performance Differential Super Cycles: Emerging Markets vs. Developed Markets
Relative Performance Between EM and US Equity Market



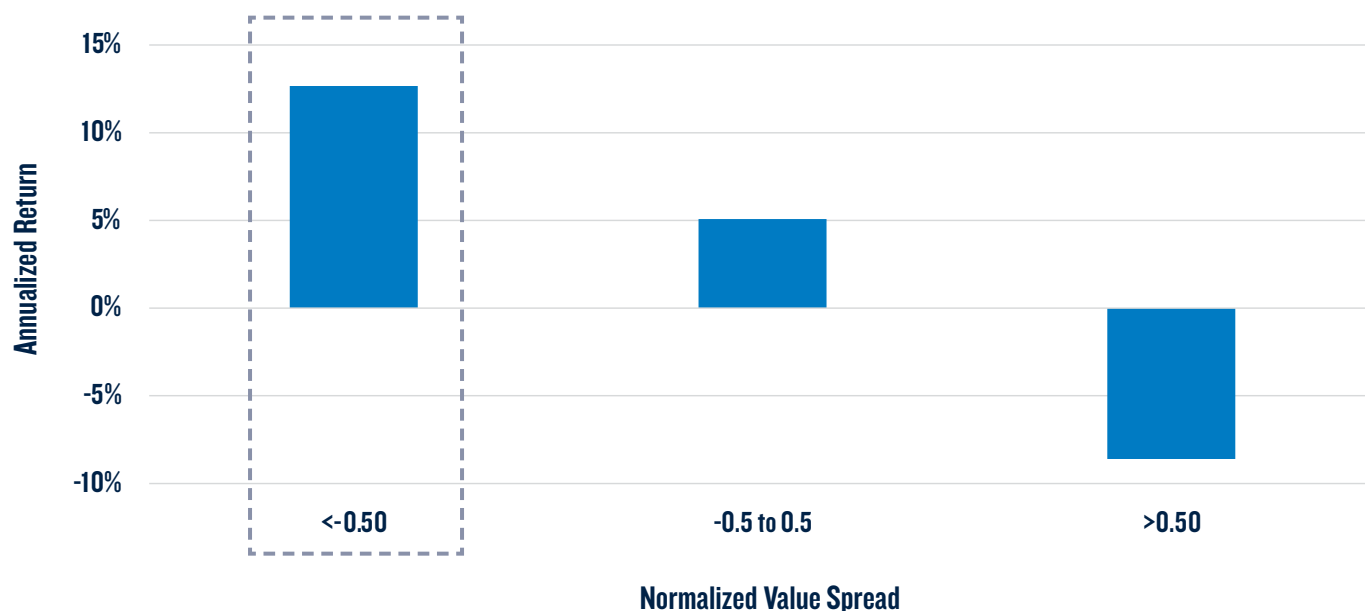
Playing the mean reversion game is challenging, however, as cycles often persist longer than anticipated. In conjunction with mean reversion, we also consider historical relative valuations to understand when the mispricing is at its widest. Figure 2 illustrates the valuation spread between emerging and developed markets over time. Notably, the Y-axis shows that while emerging markets consistently trade at a valuation discount to developed markets, this discount is currently greater than one standard deviation, a level not seen since the dot-com era.

Figure 2: Emerging Markets Relative Valuations
Current EM is Attractively Cheaper Than DM Since Dot-Com Era



To provide further context around the potential value opportunity in emerging markets, we analyzed the normalized valuation spread relative to the forward five-year return differential since 1999. Figure 3 depicts that, on average, when the normalized value spread, or z-score, is less than -0.5, the forward five-year return of emerging compared to developed markets is 12%. As of September 2025, the z-score is -1.2, suggesting that now is a favorable time to lean in to emerging markets based on valuation.

**Figure 3: Mean Five-Year Return of Relative Valuation Z-Scores
EM vs. DM Forward Five-Year Return**



Source: Bloomberg as of Sep 2025.

FUTURE GROWTH EXPECTATIONS

Emerging markets have historically outpaced developed markets in real GDP growth, a trend we believe will not only continue but possibly strengthen. These countries have larger working-age populations (15-64) compared to developed nations, a gap the IMF projects will only widen.¹ This demographic advantage, coupled with robust GDP growth, is fueling the rise of an expanding middle class poised to become the global consumers of tomorrow. Additionally, the national balance sheets of emerging market nations are healthier than those of their developed counterparts, with meaningfully lower debt-to-GDP ratios. Given these tailwinds, why have emerging markets trailed developed over the past decade?

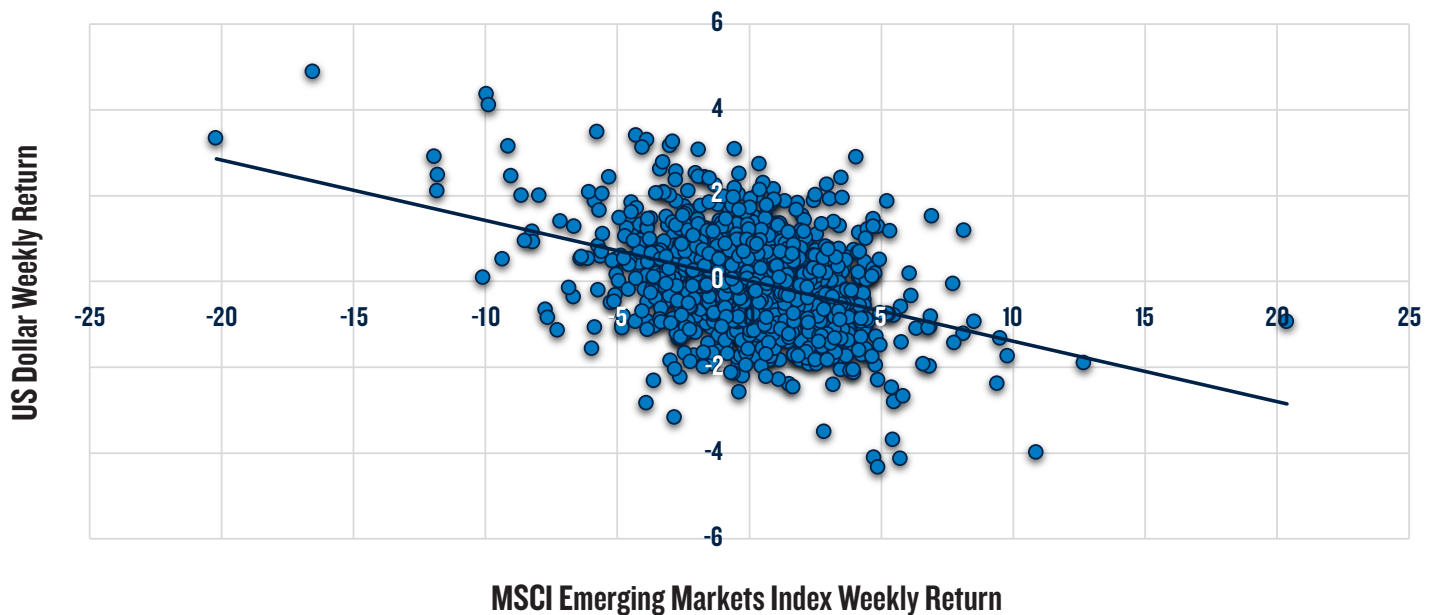
Despite historically higher GDP growth, corporate earnings growth in emerging markets has lagged. For most of the last 12 years, year-over-year earnings growth in emerging markets has consistently trailed that of the US. Weaker corporate governance, poor capital discipline, and deficient shareholder protections have been the primary contributors to muted corporate earnings. However, the earnings drought in emerging markets appears to have bottomed out, with company fundamentals beginning to strengthen. This turnaround can be attributed to recent improvements in corporate governance and financial reforms that focus on greater capital discipline, enhanced shareholder value, investor protections, and information disclosure and transparency.

¹ [World Must Prioritize Productivity Reforms to Revive Medium-Term Growth \(imf.org\)](https://www.imf.org/en/News/Articles/2023/04/27/23-04-27-world-must-prioritize-productivity-reforms-to-revive-medium-term-growth)

MACRO TAILWINDS

Many of the cyclical headwinds that have challenged emerging market corporations are beginning to shift to tailwinds. The multi-faceted monetary easing measures recently announced by the People's Bank of China aim to stabilize the country's economy, the largest of the emerging markets. In addition to the anticipated benefits from China's economic revitalization, the weakening US dollar is also expected to bolster the broader emerging market universe. Historically, the value of the US dollar has shown a strong negative correlation with the performance of emerging market equities, as illustrated by Figure 4. With the Federal Reserve starting its monetary loosening cycle, the impressive bull run of the US dollar over the last decade seems to be drawing to a close. Additionally, the debt burden of emerging economies, predominantly priced in US dollars, could be alleviated by a weakening dollar, paving the way for potential future fiscal stimulus. These factors, coupled with a resilient global economy, are expected to create a favorable environment for emerging market equities.

Figure 4: US Dollar Strength Inversely Correlated with Emerging Market Returns



Source: Bloomberg as of Sep 2025.

THE BOTTOM LINE

The prolonged and cyclical underperformance of emerging markets compared to developed markets is finally showing signs of abating. And while the valuation differential has historically been appealing, it has now widened to a point where investors are being adequately compensated to take on this exposure. Coupled with enhanced corporate governance mechanisms that are expected to translate country GDP growth into corporate earnings growth, along with an improving macroeconomic backdrop, we believe now is an opportune time for investors to revisit their allocations to the emerging markets asset class.

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