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Nearer the start of a multi-year cycle

2026 Investment Views: Emerging Markets Outlook

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The fast view

- The evidence suggests we are nearer the start of a period of EM outperformance.
- The balance sheets of emerging markets are in decent shape, a commodity upcycle could be brewing, and several of the structural forces underpinning US dollar strength are turning.
- Taken together, the picture is constructive for emerging markets and supportive of relative strength ahead.

Everyone knows emerging markets (EM) outperformance happens in multi-year cycles (Figure 1). The question for 2026 is whether we are closer to the end or the beginning of this EM cycle. We think the latter.

Figure 1: Trends in emerging markets vs. developed market performance have historically been long running

MSCI Emerging Markets Index/MSCI All Country World Index



Source: Bloomberg, December 2025. A rising line indicates outperformance of the EM index.

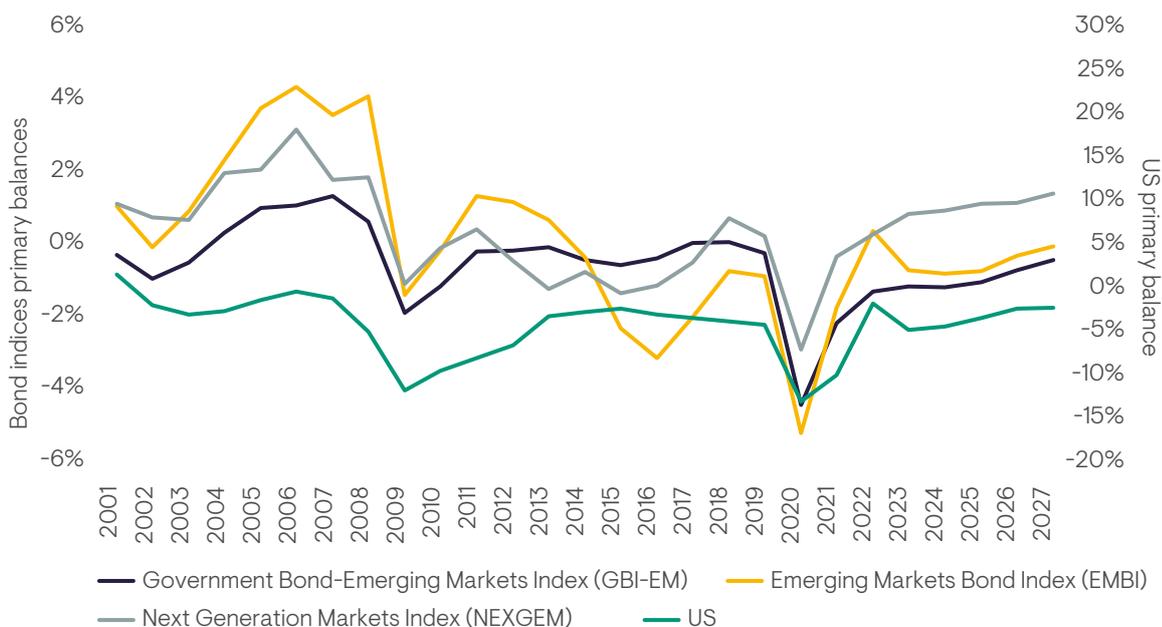
To identify where EM economies are now, we believe investors need to orient themselves around three slow-moving factors: the balance-sheet cycle, the commodity cycle and the US dollar cycle. Together, these tell us how near or far emerging markets are from one of those crisis-resets that have from time to time marked investing in emerging markets. The big-picture assessments need to be complemented with a cyclical assessment of the 12-18 month view, and with bottom-up analysis of the securities and sectors in question. But the big-picture drivers are the crucial starting point.

The EM balance-sheet cycle

By ‘balance sheet’ we mean both fiscal and external balance sheets. The last boom in EM equity outperformance from 2001-2010 was not just driven by China’s WTO accession (finalised in 2001), the subsequent commodity supercycle (2001-2011) or a period of US dollar weakness with euro and yen strength (which in part supported EM currency strength). It was substantially driven by stabilisation following the balance sheet clean-up after the Asian crisis of the late 1990s. With deleveraging, downsizing, devaluation and – in the cases of Indonesia, South Korea, Thailand and Malaysia – default and restructuring, balance sheets were ready to re-leverage and underpin faster growth.

The EM fiscal balance-sheet cycle can be characterised as mid-stage. It is not as resilient as it was in the early 2000s, when strong growth and primary surpluses were pushing debt to GDP ratios down. On the other hand, the sharp increase in debt since 2020 has been driven by the one-off event of the short-lived 2020 recession, as well as a sharp rise in real rates, which is likely to trend lower as inflation falls. Indeed, for the large middle-income countries that make up the JPMorgan Government Bond Emerging Markets Index (and which are well represented in the MSCI Emerging Markets Index), primary balances are expected to rise to a level that will stabilise debt by the late 2020s (Figure 2). Interest costs as a share of government revenues are trending higher, but are still approximately what they were in the early 2000s.

Figure 2: Primary balances in EM economies expected to return to debt-stabilising levels by the late 2020s



Source: IMF, Ninety One, July 2025.

As for external balances, the picture can be characterised as early cycle and relatively restrained for emerging markets as a whole, with a falling external stock of debt, moderate debt service costs relative to history, and current-account balances that remain positive.

On balance sheets, therefore, EMs are generally reassuringly 'early to middle' rather than at the end of the macro-financial cycle.

The commodity cycle

Commodities matter for EM importers and exporters. They both benefit in the early phase of a commodity cycle: exporters enjoy terms-of-trade gains, while importers profit from robust global demand. Later, high energy costs and over-extension bite, and importers and exporters slow together. Eventually, high prices and rising leverage put strain on EM importers. Global demand slows, commodity prices fall and EM exporters' balance sheets weaken until a reset clears the system – after which the cycle starts again.

Where are we in the current commodity cycle? Global trade is not in a renewed surge: growth in goods flows is positive but subdued, not a synchronised expansion that characterises the start of a new cycle. Commodity prices, particularly for energy and bulk materials, have softened – oil supply exceeds demand, and broad indices are forecast to fall – while the brief rallies in industrial metals such as copper appear driven more by supply disruptions than robust global demand. This seems a market in a mature or steady state, without a significant trend.

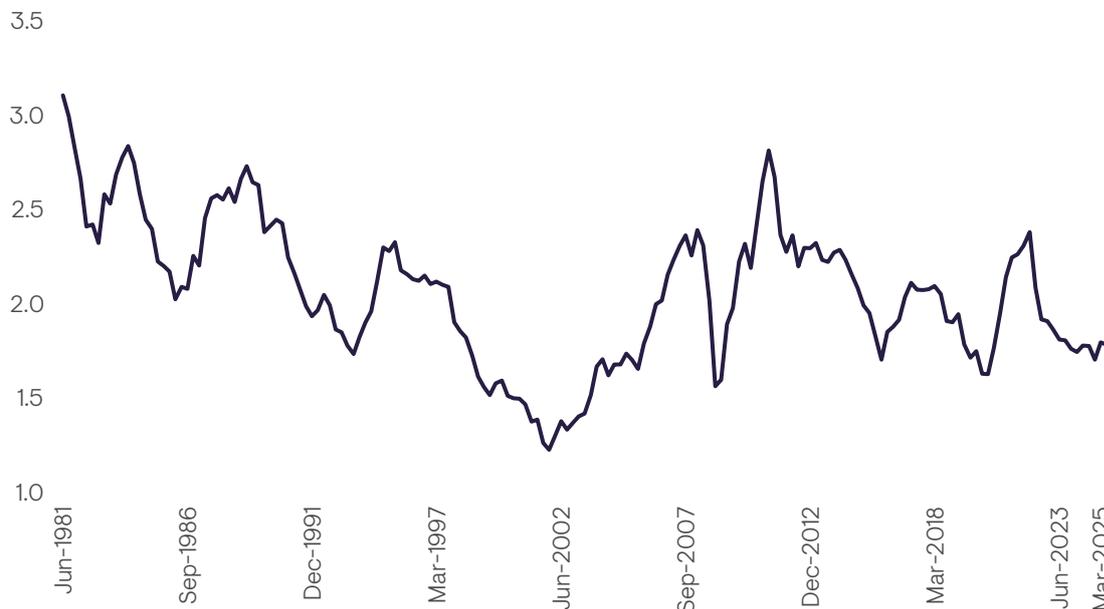
Yet, looked at in the long term, a different picture emerges. Real commodity prices peaked in 2010 and have since generally trended lower since (Figure 3). 2025 looks like the tail-end of a downcycle. One could make the case for a multi-year upswing beginning from here or later this decade, especially given the global capital-expenditure investment cycle now underway.

From an investment-behaviour perspective, the case for being early in the cycle is even stronger. Capital deployment among natural-resources companies is currently conservative and disciplined, with them requiring a higher hurdle rate before expanding capacity. This is different to behaviour in a late-cycle context, which typically sees less disciplined capital expenditure and higher capital raising.

On balance, taking a longer-term view, the commodities cycle likely indicates that EMs are early stage.

Figure 3: Real commodity prices are trending down

CRB Commodity Index/Consumer Price Index



Source: Bloomberg, July 2025.

The US dollar cycle

Finally, where are we in the US dollar cycle? In our view, we are at the end of a long US-dollar upcycle that began in 2011, the third such upcycle since 1970. Dollar cycles are long, typically lasting around 7-12 years. This one is now in its 14th year, sustained by economic outperformance and higher yields, cross-border asset flows, repeated global shocks that reinforced safe-haven demand, and the baseline geopolitical and geo-economic centrality of the US. The result has been a structurally strong and overvalued US dollar, along with overvalued US assets, which markets know fondly as ‘US exceptionalism’.

Now, several of the structural forces that underpin US dollar strength are turning. Interest-rate differentials are normalising following a period of secular stagnation and weak growth drivers in Europe and Japan. The US twin deficits are widening again, echoing past US dollar peaks in 1985 and 2002, while tariffs risk slowing growth and fiscal expansion risks undermining confidence in the US policy mix.

Meanwhile, investors are heavily overweight US assets, setting the stage for capital to rotate abroad as other regions regain competitiveness. History shows the US dollar only reverses when geopolitics and trade dynamics, rate differentials, investment flows and foreign-exchange policy all shift together. In our view, markets are waiting for the foreign-exchange policy shift, something akin to the 1985 Plaza Accord, the 1971 Nixon Gold Shock, or the rise of the euro in the early 2000s. Many candidates could play that role. From a US dollar perspective, therefore, 2026 is very much 'early cycle' for emerging markets.

An encouraging backdrop

To sum up: on balance sheets, EMs are early to mid-cycle, with manageable external positions and mid-stage fiscal health; debt is higher than in the early 2000s but will largely stabilise as real rates ease. Commodities are early cycle, marked by subdued global trade and easing prices in the context of rational price behaviour by commodities firms. In contrast, the US dollar cycle appears late-stage, with overvaluation and fading US exceptionalism suggesting the next turn could favour EM currencies and assets.

Taken together, the picture is reasonably constructive for emerging markets from a structural macro-financial view and supportive of relative strength ahead.

EM fixed income: think local

Disinflation, high real policy rates and still-light foreign positioning create a constructive backdrop for local bonds.

The opportunity in EM fixed income is likely to favour local rates, given persistent disinflation in emerging markets while the Fed is cutting rates only gradually. The case for EM local bonds rests on relatively benign inflation and still-restrictive policy. Real policy rates (that is, monetary policy rates adjusted for inflation) remain near 20-year highs, giving central banks room to ease through 2026. While inflation remains above target in some Latin American and Central and Eastern European economies, it is also true these economies can 'work' at relatively higher policy rates. Foreign positioning in local debt has also not recovered to pre-2020 levels – powerful supports if sentiment improves. That combination – lowish inflation, high real yields and light foreign positioning – sets up a constructive duration story even if EM currencies only grind sideways.

Strategically, we favour markets with credible monetary policy and high ex-ante real policy rates. These include Brazil, Mexico, South Africa and Peru. We are more cautious on parts of Central & Eastern Europe, where fiscal stances are looser and where EU fiscal spending can keep growth and term premia elevated.

In hard currency sovereigns and corporates, spreads tightened meaningfully in 2024-2025 and credit has 'priced out' a significant portion of US recession risk. However, EM sovereign yields remain competitive vs. other US dollar-denominated spread assets. Our 2025 outlook made this point explicitly – EM hard currency debt could still deliver decent returns even with limited additional spread tightening because outright yields remain attractive and the post-COVID default cycle is largely behind us – and that logic still applies in 2026. Relative value remains better in many EM sovereigns than in parts of US high yield, and spreads in the EM bond index are not egregiously rich in the context of the macro drivers, keeping carry central to the total-return thesis. Position sizing should respect the fact that risk-appetite indicators are already elevated, which typically tempers forward excess-return expectations.

What could be a spoiler? A rampant US economy and a hawkish Fed is one straightforward answer. An opposite scenario of a much weaker economy and a much higher US fiscal deficit could prompt weakness in global trade and rising term premia, which would steepen yield curves and constrain risk appetite. 2025's April 'Liberation Day' shock would also be a spoiler: a policy driven tariff escalation and broader trade restrictions would tighten US financial conditions at the margin, complicate EM export cycles and mechanically support the USD: a headwind for EM currencies. Even though we think the risk of a tariff-driven escalation is falling, the risk from tariffs keeps us more disciplined on the foreign-exchange and biased to local duration where domestic disinflation dominates.

Emerging markets equities: positive breaks in the trend

The global backdrop is supportive for EM equities, especially if we see a material US-dollar downtrend, while net-issuance headwinds have faded.

2025 was an unusual year, featuring three simultaneous breaks in trends for EM equities. First, EM equities outperformed global equities for the first time since 2020, notching the largest calendar-year outperformance since 2009. Second, the US dollar dropped steeply, and finally Chinese equities recovered sharply.

The question for investors is whether 2025 was the start of a multi-year trend-break for EM equities, or merely an odd year. The proximate cause of EM outperformance was the benign macro environment, despite the weaker valuations at the start of the period due to expectations of a negative growth impulse from Trump's tariff policies. Instead, emerging markets benefitted from a weaker US dollar, accompanied by loosening global financial conditions supported by benign fiscal policy and significant earnings growth. Taiwan and, unusually, South Korea were stand-outs, propelled by an AI hardware upcycle in the context of low relative valuations and, in the latter's case, the prospect of corporate-governance reforms. China's policy stimulus and its substantial AI leadership underpinned gains in Chinese equities. While Indian equities were constrained by high starting valuations, they still ended 2025 in the positive single digits. Nearly every EM equity index ended the year in positive territory.

A benign backdrop

How will EM equities do in 2026? Geoeconomics is no longer centre-stage, given that the negative tariff impulse from the White House is behind us, while the US-China détente has reduced tail-risks relative to the start of the year. A more conventional analysis of the macroeconomic environment is therefore a better starting point for thinking about EM equity performance in 2026. Typically, EM equities do best when the global macroeconomic and liquidity environment is benign; EM growth is outperforming developed markets growth; EM local rates are high; EM currencies are cheap; and volatility is expected to be low; at a time when sentiment and flows are improving; and developed markets growth is neither deteriorating or accelerating.

For the most part, a benign macroeconomic regime looks like the picture now. Advanced economies are likely to be in a regime of stabilising, if slowly rising, inflation. Growth is strong-ish, and policy rates in the US are restrictive but heading lower. Meanwhile, the emerging/developed market growth premium is likely to be stable at around 2.2-2.5%, justifying the perceived higher risk for developed markets investors allocating to EM equities. While this is not as high as the 4% of the early 2000s, it is high enough, and forecasts have been rising recently¹. In such reflationary environments, the MSCI Emerging Markets Index has tended to generate positive single-digit returns.

Net issuance headwinds fading

The bear case for EM equities hinges on whether or not earnings growth will follow. As we have [pointed out before](#), that depends on whether net issuance will contribute to returns. Despite solid revenue growth, EM equities were held back in the 2010s by heavy **net issuance**, which erased nearly six percentage points a year from returns as costly IPO waves – especially in China – and index-inclusion events diluted performance. These headwinds have now receded: China's net issuance has declined, and buybacks are rising. Also, IPO valuations are more reasonable, and index-inclusion pressures have generally normalised. With dilution no longer overwhelming fundamentals, EM returns can better reflect underlying revenue growth, especially given China's large index weight, improving governance and more shareholder-friendly capital management.

Upside risks

There is also potential upside risk to earnings if EM growth rates outperform expectations. This is because record-low EM inflation, particularly in Asia, affords flexibility for governments to manage any growth weakness. Strikingly high real rates, particularly in Latin America, provide a further cushion for investors. Real rates are high in emerging markets because investors have not quite anchored themselves to the new environment of structurally lower EM inflation, while there has also been a recent acceleration of inflation in a few countries like Indonesia and South Africa.

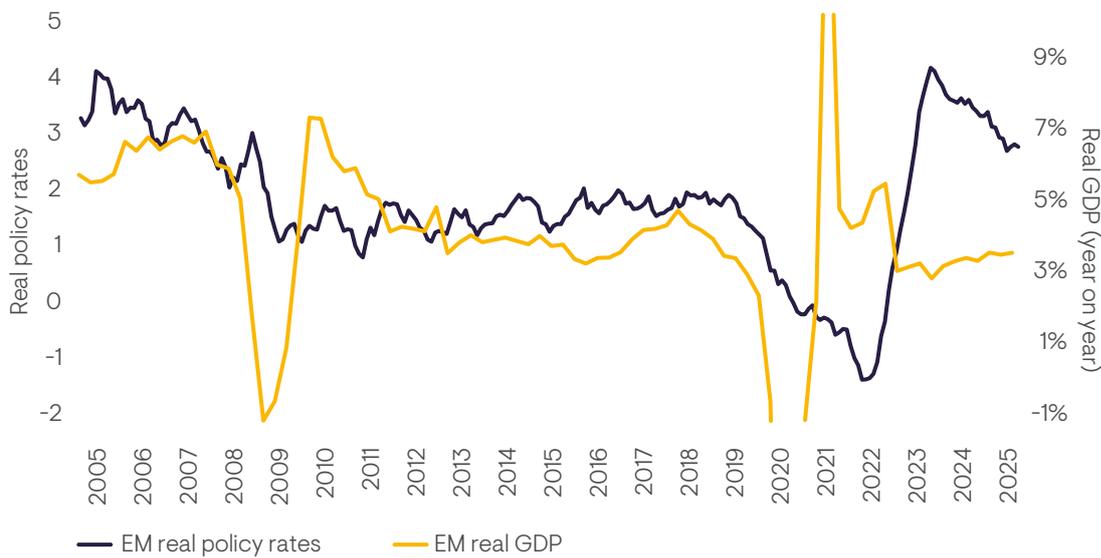
1. EMDM Forecast Revision Index – [JPM](#).

As these issues settle, there is room for real rates to come down, which could happen in 2026. Should they decline by several hundred basis points, which is possible given the historical relationship between real policy rates and real GDP (see Figure 4), the outperformance of EM cyclicals could be steep.

Record-low EM inflation and the greater policy flexibility described above should also support operating leverage (Figure 6). MSCI Emerging Markets Index margins are expected to rise to 8.8%, with EM ex-China rising towards 10.2%, with low inflation helping top line growth translate into wider margins and stronger earnings-per-share in 2026.

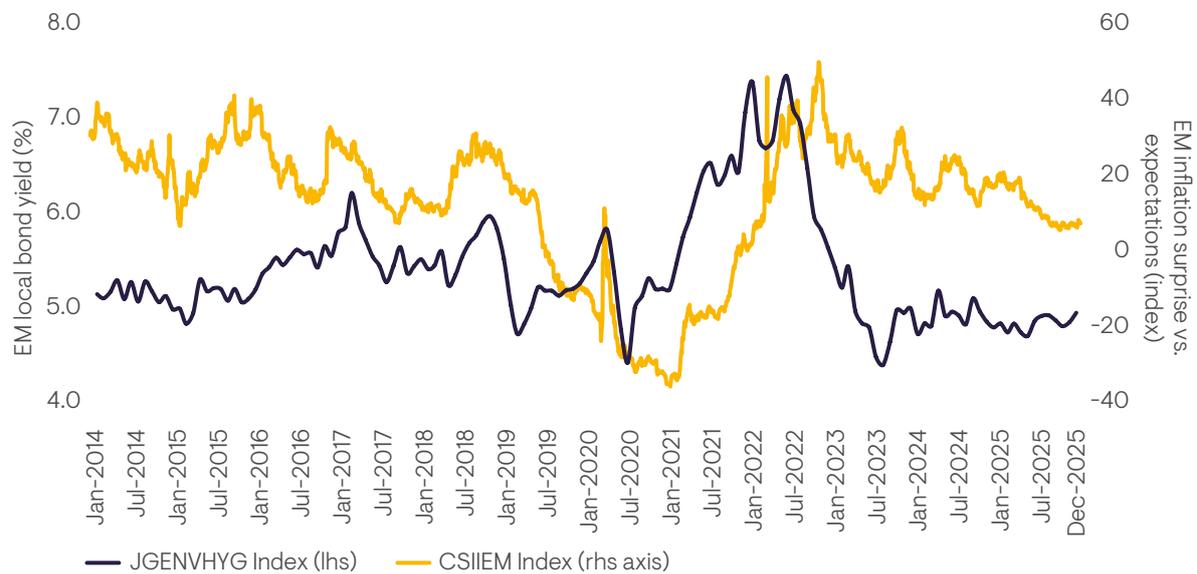
Figure 4: Real rates may be ‘too high’ in large parts of EM

GBI-EM real policy rates vs. real GDP



Source: IMF, Ninety One, November 2025. Policy rates and GDP are weighted as per government bond indices.

Figure 5: EM assets will continue to benefit from falling inflation



Source: Ninety One, December 2025. Note: Inflation surprise reflects the difference between actual inflation outcomes and consensus expectations; negative values indicate inflation undershoots.

Most of the returns for EM equities in 2025 came from increasing valuations as equity investors anticipated better earnings in the future. In absolute terms, the EM 12-month forward price-earnings ratio of 14x sits in the ninetieth percentile of its post-2011 history, which argues against a broad rerating. But against developed markets, emerging markets still trade at a deep discount (a 32% price-earnings discount vs. the MSCI World Index), a cushion that would support relative performance if earnings came through.

The current consensus is for earnings in emerging markets to reaccelerate in 2026 as margins rebuild. Earnings growth is expected to be just under 15% for 2026, with leadership expected from technology stocks (21% forecast earnings-per-share growth), and materials (19%), with healthcare and real estate close behind.

Diversify AI exposure

How should investors handle the risk to emerging markets from a potential reappraisal of the AI capital-expenditure trajectory? That matters because IT is the largest sector in the MSCI Emerging Markets Index and it is expected to drive outperformance. First, as a mitigating factor, AI beneficiaries in emerging markets – companies like TSMC, SK Hynix and Samsung – are generally more lowly priced than their Western counterparts, have falling not rising inventories and, for now, their capital expenditure is more disciplined. There are also entire segments of emerging markets, for instance companies from India and the ASEAN bloc, where earnings growth is not particularly driven by AI spending. Investors can take advantage of that dispersion and maintain a balanced exposure between AI and non-AI segments within emerging markets.

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