March 2026

Reassessing emerging market equity allocations

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Key takeaways

- The conditions that have shaped the relative performance of emerging and developed market equities are changing.
- We believe several factors provide a supportive backdrop for EM equity allocations: a new US dollar cycle, robust earnings growth and relative valuations at historically cheap levels.
- EM equities can be volatile. Allocations need to be structured in a way that provides broad exposure to the return-potential of the asset class while managing risks. We favour a bottom-up approach that combines both fundamental and quantitative insights.

Evaluating the EM equity outlook

Recent meetings with asset allocators highlight a question on many minds: is it time to further broaden equity portfolios beyond the US? Emerging market (EM) equities outperformed developed markets stocks last year for the first time since 2020. The issue for allocators is whether 2025 was just a blip or the start of a trend. And if the latter, how best to implement an EM allocation.

Looking beyond the US

For some years, one asset class has dominated equity returns: developed markets, particularly the US. As a result, portfolio positioning has become heavily oriented towards US equities. 2025 marked a divergence from the recent norm, with the MSCI Emerging Markets Index returning 34%, comfortably ahead of the S&P 500 Index (17%) and the MSCI ACWI Index of global equities (22%)[1].

To expect last year to be more than a temporary reversal in the trend of developed market outperformance, underlying conditions need to have changed. We think they have.

A different backdrop

First, there is evidence the US dollar may have entered a new cycle. Historically, the US dollar has had an inverse relationship with EM equities. Over the past 15 years the trade-weighted US dollar (which compares the dollar with currencies widely used in international trade) has appreciated by about 40%. That has been a major headwind for EM equities. Now, though, changes in US trade policy may be triggering the first major US dollar downcycle since 2002 (see our analysis here). This matters because dollar cycles are long. They vary, but the average length is 18 years.

Second, earnings at EM companies are improving. Having bottomed in 2023, EM corporate earnings have maintained positive momentum through 2024 and 2025. EM companies are forecast to deliver c.40% cumulative earnings-per-share growth for FY2026 and FY2027, which is a positive signal for

[1] For further information on indices, please see the Important information section.

equity index returns if historical relationships hold true[2]. The headwind of heavy net equity issuance in China, which diluted returns and weakened the link between earnings growth and equity performance in the early- to mid-2010s, has now largely faded, increasing the likelihood that earnings growth translates into returns. Finally, valuations are supportive: the relative value of EM equities vs. US equities is at a low (within the 10th percentile of datapoints over the past 35 years). That indicates an advantageous starting point for an allocation: historically, when EM valuations have been in the top quintile (20%) of 'cheapness' relative to US equities, EM equities have on average outperformed US equities by >50% over the subsequent five-year period[3].

How to implement an allocation

For those that decide to allocate to EM equities, there are multiple options. We think a useful starting point is to recognise that this asset class is cyclical and can be volatile: over the past two decades, EM equities have often tended to be one of the best- or worst-performing equity segments in any given year. However, the return profile an investor will experience is partly determined by the nature of the investment approach. The following are some of the building blocks to consider.

Active vs. passive

In a recent paper, we examined 'Why it pays to be active in EM equities'. The short answer is that EM equity markets are less efficient than developed markets: structural and behavioural inefficiencies mean asset prices are less likely to reflect all available information, creating opportunities for skilled investors to generate alpha. Structural inefficiencies are driven by features such as financial infrastructure and governance practices; liquidity (and hence greater susceptibility to price swings); and analyst and data coverage. Behavioural inefficiencies arise partly because of higher retail participation in equity markets, as we discuss next.

Quant and fundamental

Active EM equity approaches can vary between purely quantitative strategies and fundamental stock-picking. Both can work well in emerging markets.

With high retail participation in equity markets like China and South Korea, there can be greater short-term price volatility in EMs as retail investors are generally more reactive to short-term news and speculative trends. Quantitative models can be particularly good at detecting and exploiting such behavioural inefficiencies. Other EM inefficiencies are more likely to be identified via fundamental analysis: this includes those arising from the fact that, in emerging markets, corporate disclosures can be inconsistent, ownership structures more concentrated and minority shareholder protections uneven. Our investment approach combines the two: we use quantitative tools to identify patterns and pricing anomalies across large datasets, and conduct forward-looking fundamental research to assess company-specific alpha potential and risks[4].

Maximising potential

Another consideration is how to get meaningful exposure. Emerging markets account for about 80% of the world's population and 60% of global GDP, but EM equities account for only 13% of the MSCI ACWI Index[5]. This is scant representation for such a broad and diverse opportunity set. For investors with conviction in the asset class, a dedicated global EM allocation will provide better access to both the beta and alpha potential of EM equities. It also avoids the challenge and complexity of trying to implement regional EM allocations. The MSCI EM Latin America equity index, for example, returned +33%, -26% and +55% in 2023, 2024 and 2025[6], respectively. Getting the timing right on that allocation would have been extremely difficult.

A matter of breadth

Breadth of portfolio is also a factor to consider. More concentrated portfolios express conviction by having a smaller number of holdings. When those convictions prove correct, the approach can deliver significant outperformance, though it may also mean greater variability in returns. More diversified, core approaches provide broader exposure across the emerging markets opportunity set. This can help reduce the impact of any single holding on portfolio outcomes and may lead to a more consistent return profile over time, while still capturing the benefits of active stock selection. Both approaches aim to capture the alpha potential available in emerging markets, but offer different ways of accessing the opportunity set depending on investors' objectives and tolerance for return variability.

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[2] Source: Bloomberg, Ninety One, January 2026. Analysis based on comparing MSCI Emerging Market Index level and consensus earnings per share estimates from 2007 to 2028(e).

[3] Source: Factset, December 2025. Valuation spreads calculated as EM discount to DM on P/E. Relative returns represent EM minus US performance over a 5-year horizon. Returns shown in USD. Past performance is not a reliable indicator of future results.

[4] For further information on investment processes, please see the Important information section.

[5] As at February 2026.

[6] Source: MSCI. Data sourced March 2026. Returns in USD.

Time for a closer look

We believe the conditions that shaped the relative performance of EM and developed market equities over the past decade and more are changing fast. But it is important to structure an allocation carefully, as this asset class is cyclical and can be volatile. We favour an investment approach that we believe maximises alpha potential and the ability to manage risk. In practical terms, this means an investment strategy that:

- Accesses the full global opportunity set of EM equities of c.1,300 companies.
- By design, seeks to make stock-picking the primary driver of performance through the cycle so that the return-profile is not dominated by shifts in market regime.
- Incorporates quantitative and fundamental investment approaches, both of which are well-suited to the market inefficiencies inherent in emerging markets.

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03/26 MACS20410