

Emerging markets outlook



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Emerging markets will likely end 2025 having outperformed developed markets for the first time in five years, and we are confident that the long-term drivers are in place for a new cycle in favour of emerging markets. Since the late 1980s, there have been two extended periods during which emerging markets outperformed developed markets and two in which they underperformed. The most recent weak cycle, beginning in 2010, has been the longest of the four. The key question going is whether today's emerging-market outperformance is sustainable.

The performance of the U.S. dollar has been a significant factor in these long-term cycles. Historically, emerging-market equities have tended to rise when the U.S. dollar falls, as has been the case this year, and vice versa. Prolonged weakness in the dollar would support further emerging-market outperformance and provide emerging-market central banks with opportunities to ease monetary policy.

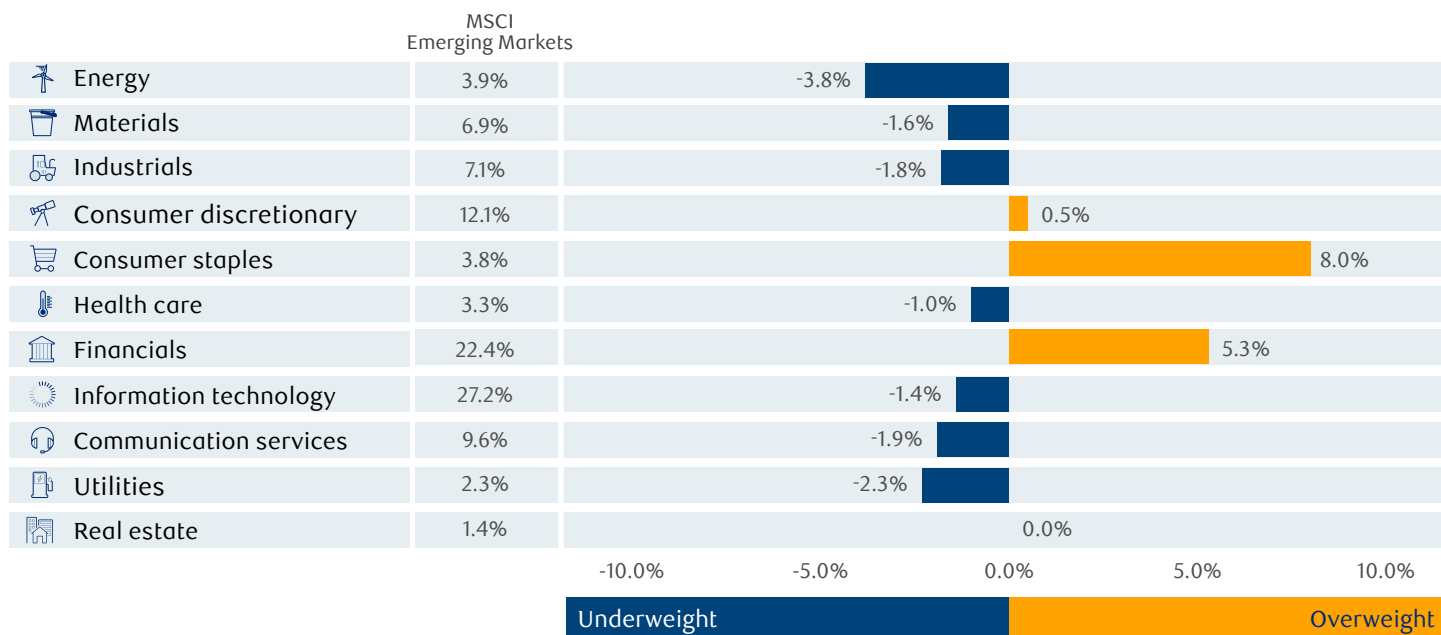
Return on equity (ROE) is another important factor in the improvement of relative returns in emerging markets. Historically, higher relative ROEs in emerging markets have correlated with emerging-market outperformance, but ROEs have been declining on a relative basis in emerging markets since 2010. Over the past year, the improvement has been due to earnings growth and ROE expansion in large Asian markets like China, South Korea and Taiwan. We have seen a number of emerging-market countries focus more on shareholder value, boding well for relative returns in emerging-market equities.

The possibility of a new long-term cycle favouring emerging markets combined with the potential for a peak in relative U.S. economic growth and stock-market capitalization ("U.S. exceptionalism") has renewed investor interest in emerging markets. The large concentration of the U.S. stock market in global equity benchmarks presents risks for global investors if the trillions of dollars of capital expenditures targeted at artificial intelligence do not result in adequate returns.

Valuations

Emerging-market equity valuations have expanded in line with the recent strong performance. The MSCI Emerging Markets index now trades about 2 times price to book value, up from around 1.5 at the beginning of 2024. Even so, emerging-market equities trade at a 45% discount to developed-market stocks based on this measure. Historically, valuation has not been a strong predictor of emerging-market performance, but the substantial valuation discount should provide a level of support and margin of safety.

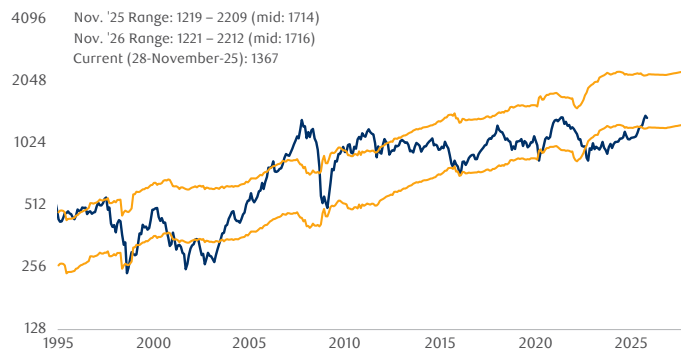
Emerging markets – Recommended sector weights



Note: As of November 30, 2025. Source: RBC GAM

“Emerging-market equity valuations have expanded in line with the recent strong performance.”

MSCI Emerging Markets Index Equilibrium Normalized earnings and valuations



Note: The fair value estimates are for illustrative purposes only. Corrections are always a possibility and valuations will not limit the risk of damage from systemic shocks. It is not possible to invest directly in an unmanaged index. Source: RBC GAM

Tariffs

The overall impact of tariffs on most emerging-market economies is likely to be less significant than many investors expect. U.S. exports as a percentage of GDP for emerging-market countries represent less than 15% of GDP. In the case of China, the figure is 2.5%. Mexico, whose exports to the U.S. account for 28% of GDP, is the main exception.

Our view is that Mexico is well-positioned to benefit from the tariff environment and the relocation of global supply chains. The USMCA trade agreement plays a crucial role in this view, as the vast majority of Mexico's exports fall under its terms and are exempt from tariffs. The renegotiation of this trade agreement in 2026 will be important to watch.

India, Brazil, and China are the three emerging markets that stand out for having notably higher effective tariff rates compared with other emerging markets.

- **India:** Tariffs were increased to 50% from 25% given U.S. dissatisfaction with India's Russian oil imports. A willingness by India to reduce this reliance would likely lower the tariff level.
- **Brazil:** Tariffs were hiked to 50% from 10% over political tensions, though recent dialogue hints at potential improvements.
- **China:** The tariff situation remains fluid. Developments around restrictions on rare earths and sanctions on semiconductor chips will be important to monitor.

China

We are now about one year into a rally in Chinese equities. Over the past 20 years, there have been six notable periods of sustained gains in Chinese stocks, and the market as a whole has had trouble gaining traction. This year, however, a combination of fiscal support, favourable liquidity conditions and a strong Information Technology sector has underpinned the gains.

While technology valuations have risen, the consumer sectors remain more attractively valued, and a broadening-out of performance to other areas of the stock market could add another leg to the gains. China has effectively navigated the trade war by strengthening its trade relationships with countries beyond the U.S. Over the past five years, China's trade surplus has more than doubled, and exports have become more diversified and profitable. Additionally, the number of countries trading more with China than with the U.S. has significantly increased.

India

After several years of strong performance and rising valuations, India's equity market has underperformed emerging markets this year. Several factors have contributed to this underperformance, including slower GDP growth, high equity issuance and expensive valuations. However, India remains attractive from a macroeconomic perspective, supported by a young population, stable political environment, ongoing structural reforms and robust long-term growth potential. India's equity market continues to trade at a premium to the rest of emerging markets, although the gap is now at the lower end of its historical range.

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