

Emerging markets outlook



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Emerging-market equities have for the most part more than recovered from the broad sell-off that occurred after U.S. President Trump announced sweeping global tariffs in early April. The MSCI Emerging Markets Index added 19.0% for the year to the end of August in U.S. dollars. The rebound came after Trump delayed implementing tariffs and reduced some. The U.S. dollar fell 10.6% and there is the potential for further weakness as the dollar Index is still about 20% overvalued based on purchasing power.

The tariffs saga has spotlighted U.S. dependence on imports from several emerging-market countries and has led to what investors are calling the TACO effect: “Trump always chickens out.” TACO occurs when the negative impact of tariffs on the U.S. economy becomes too damaging to ignore, for example in China’s control over rare earths and electronics. The high levels of the U.S. debt and deficits, coupled with a weaker U.S. dollar and the sometimes erratic decision-making process of the Trump administration, has led to some investors to call for the end of the dollar as the reserve currency and potentially the end of U.S. leadership in financial markets. While it may be too early to conclude that we’ve reached that point, it’s clear that there is a deterioration in the relationship between the U.S. and many countries including some of its closest allies.

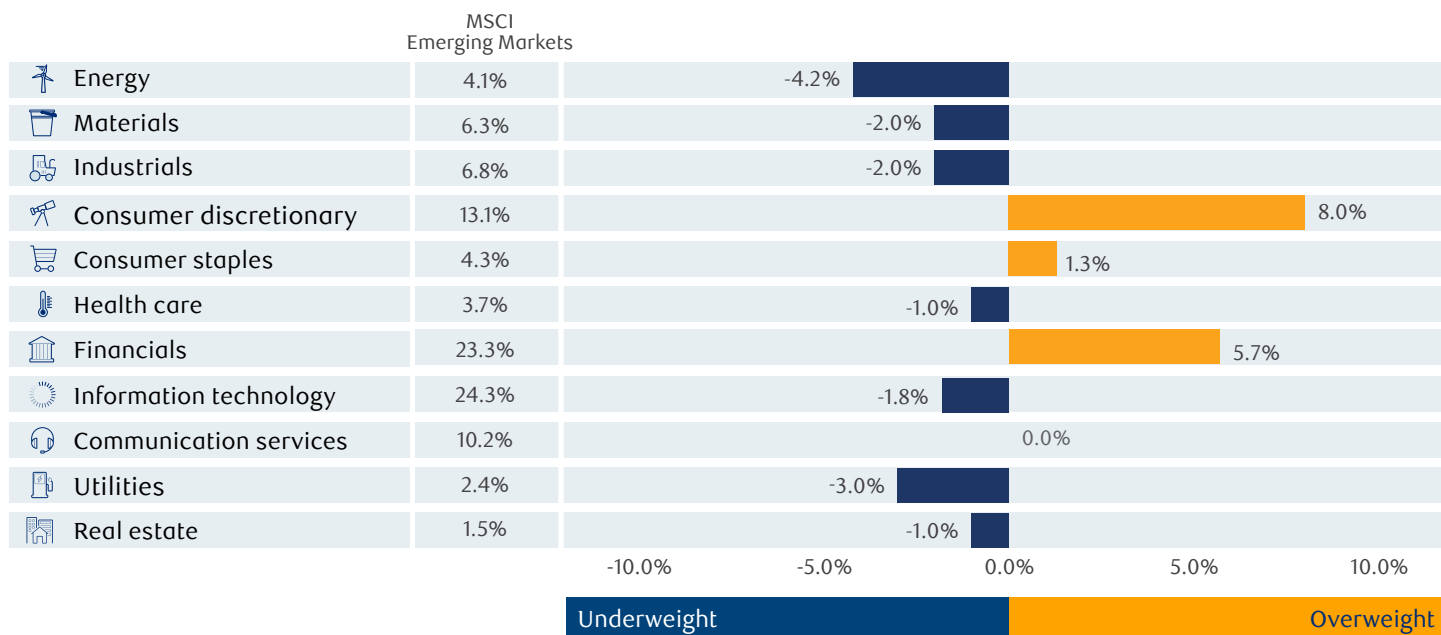
South Korea and Taiwan performed particularly well over the past three months, reflecting their unique position in the manufacturing chain for artificial intelligence. Servers used by Meta Platforms, the owner of Facebook, and Amazon

utilise servers and chips produced in the region. As a result, Taiwanese industry-leading semiconductor makers have benefited. South Korean stocks have also recently gotten a boost given the implementation of much more business- and market-friendly policies. For both countries earnings and growth comes primarily from the Information Technology sector.

Mexico’s stock market was also resilient over the past few months, as President Sheinbaum has won praise for her handling of tariff negotiations with Trump, leading to optimism that manufacturing links between the U.S. and Mexico will be preserved.

Chinese equities have also done well, with stocks jumping 14% in U.S.-dollar terms in the three months ended August 31, 2025. China is one of the few countries that has been standing up to the U.S. as the Chinese believe that the U.S. is more dependent on Chinese products than the other way around. Rare-earth minerals and electronic products are essential

Emerging markets – Recommended sector weights

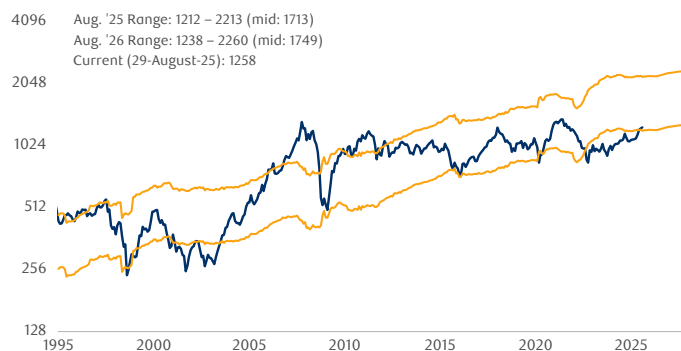


Note: As of August 29, 2025. Source: RBC GAM

“Valuations are not as attractive as they were earlier this year, and we will need to see better earnings growth in the coming years to improve the odds of sustained returns.”

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

and can't be replaced by production elsewhere anytime soon. The situation has been made worse for the U.S. by the fact that China has been preparing since the Trump's first trade war in 2017, which prompted many Chinese businesses to locate manufacturing capabilities outside China. It appears that many goods manufactured outside China by Chinese companies are making their way to the U.S.

The major economy that has lost out the most since Trump came to power is India. Returns have stumbled in recent quarters after several years of incredible stock-market performance and a large rise in valuations triggered by economic reforms. The economy began to soften last year as the government slowed major infrastructure projects, and poor stock-market performance was triggered in part by a slowdown in local portfolio investments. More recently, a lack of bargaining power with the U.S. over trade and a close relationship with Russia has led to potentially high tariffs for the country. The direct impact is relatively small on the mostly domestically driven economy, but high valuations remain a challenge for Indian stocks. We have turned more cautious on Indian stocks and expect further underperformance in the short term.

The Information Technology sector remains the best performing, and now represents 25% of the emerging-market index and is the biggest sector in the benchmark. Consumer-oriented companies continue to lag as inflation remains an issue in most emerging markets, with China being the only country to experience disinflation due to weak demand at the retail level. Earnings growth for technology companies will in our view remain the highest in 2025, and the huge

gap in valuations with developed markets continues to look extreme. We expect earnings estimates to be raised amid recently announced record earnings and increased capital expenditures. Overall, we remain positive on the Information Technology sector but have been selective in our stock-picking after a strong run.

Valuations for emerging-market equities have become somewhat stretched during the rally and some measures are now above their long-term averages. The price-to-book-value ratio sits at 1.9 and the price-to-earnings ratio is at 13 forward 12-month earnings, up from the long-term average of 11.4. Valuations have increased, however, as earnings have lagged stock gains. Nevertheless, emerging-market equities remain much cheaper than developed-market equities. We also continue to look favourably on efforts by emerging markets to focus more on equity-market returns. Two of the largest emerging markets, China and South Korea, have taken actions that could drive up valuations in the coming years.

Emerging-market equities have so far overcome the trade and psychological barriers presented by Trump's trade war given a realization that the impact will likely be limited for most countries. The weaker U.S. dollar has been beneficial to recent performance, and history shows that additional weakening in the greenback would be positive for emerging-market equities. Valuations are not as attractive as they were earlier this year, and we will need to see better earnings growth in the coming years to improve the odds of sustained returns. The recent reforms by the Chinese and South Korean governments, Taiwan's dominant position in chip technology and the trade war together may be catalysts for continued outperformance versus developed markets.

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