

Emerging markets outlook



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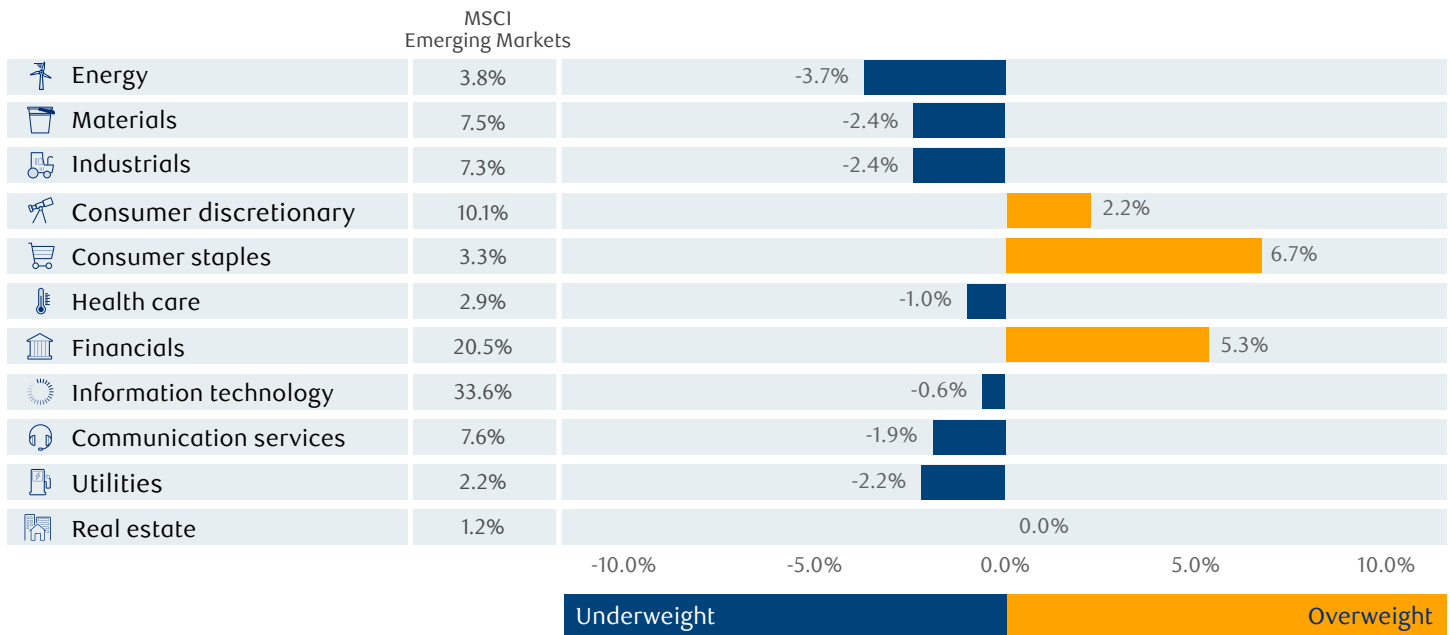
Emerging-market equities delivered strong returns in 2025, outperforming both developed markets and U.S. equities by a significant margin. While notable, this strength should be viewed against the backdrop of nearly 15 years of relative underperformance. Historically, emerging-market returns have unfolded in long, powerful cycles rather than short bursts, suggesting that if a structural shift is underway, recent gains may represent an early phase of gains rather than their culmination.

In previous periods of outperformance, notably in 2010 and 2016, emerging-market equities failed to sustain their momentum, raising the question of whether current conditions differ sufficiently to support a more durable cycle. Several factors suggest that this time may indeed be different, including stronger absolute and relative earnings growth; a weaker U.S. dollar; increased investor comfort with exposure to emerging markets after a period of prolonged under-allocation; reform progress across major emerging markets; and valuations that remain attractive relative to developed markets.

These supportive drivers coexist with risks, including geopolitical tensions, domestic political uncertainty in some countries, a potential slowdown in artificial-intelligence (AI)-related capital expenditures and the possibility that resilient U.S. growth re-energizes the dollar and delays global monetary easing.

The most compelling pillar of the emerging-market investment case is the shift in earnings growth. After more than a decade of subdued expansion, corporate earnings in emerging markets are expected to grow about 20% in 2026, making emerging-market stocks the fastest-growing major area for equities for a second consecutive year and marking a clear break from the low growth of the previous cycle. Technology, mining and improving domestic demand have been the primary contributors. Within technology, Taiwan and South Korea remain powerful drivers, as companies in these countries produce critical semiconductors and electrical components for the AI supply chain. Emerging markets therefore provide broad exposure to the infrastructure layer of AI, benefiting from rising capital expenditure by technology firms regardless of which platforms ultimately win out. AI-related activities are expected to account for a substantial share of revenues and an even larger share of profits, providing a durable engine of earnings growth.

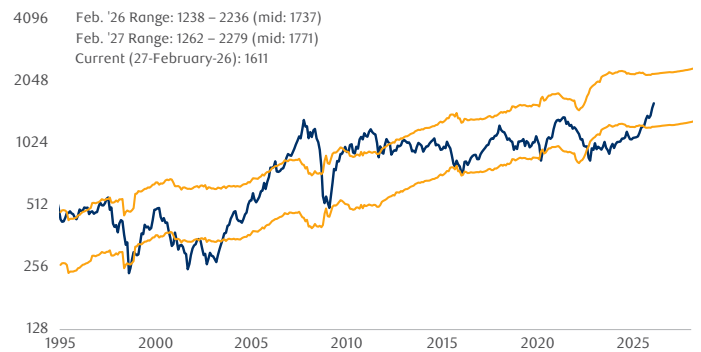
Emerging markets – Recommended sector weights



Note: As of February 28, 2026. Source: RBC GAM

Currency dynamics provide another important tailwind. A weaker U.S. dollar has historically been associated with stronger performance in emerging markets. Many emerging-market economies carry significant dollar-denominated debt, so dollar depreciation eases financial conditions, reduces inflationary pressures and allows central banks greater scope to lower interest rates. Emerging-market indexes are also more weighted toward commodities such as precious metals and copper, which tend to benefit from dollar weakness. Several structural factors suggest the dollar may remain under pressure, including expectations of monetary easing, relatively strong growth outside the U.S. and persistent U.S. fiscal deficits. Currency cycles typically last many years, and the previous dollar bull market was unusually long, so a sustained fall in the dollar could lift emerging-market assets for an extended period. The dollar also appears expensive based on purchasing power relative to many emerging-market currencies, implying scope for currency appreciation in emerging markets.

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

Positioning further reinforces the outlook as years of lagging returns mean that investors remain underweight emerging markets. Historically, asset allocators do not immediately reverse such positioning when performance improves: early gains are often dismissed as temporary. However, sustained outperformance tends to trigger “performance-chasing behaviour.” With emerging markets entering a second year of relative strength, investors are likely to move more money into them, creating the potential for a self-reinforcing cycle. Early signs of capital rotation are already evident in AI-linked technology stocks, which attract investors due to strong earnings prospects, disciplined capital spending and significantly lower valuations compared with U.S. peers.

Valuations remain an important component of the investment case. Even with the recent gains, emerging-market equities continue to trade at substantial discounts to both U.S. and broader developed-market indexes based on forward earnings multiples, while offering higher dividend yields. Although valuations are elevated relative to history, many emerging markets—particularly in Latin America, parts of Europe, the Middle East and segments of Asia—trade at discounted levels. Some increase in valuations may be justified by changes in index composition, as growth-oriented sectors such as Information Technology now represent a larger share of market capitalization than in the past. In addition, the prospect of declining interest rates across emerging economies could lower the cost of equity and support even higher valuations.

The Information Technology sector highlights the investment opportunity most clearly. Emerging-market technology companies trade at a significant discount to their developed-market counterparts on both earnings and book-value measures. This gap reflects differences in market perception and ownership rather than a lack of growth potential. If demand for AI infrastructure remains robust, the discount could narrow further as investors seek diversified exposure beyond U.S. mega-cap companies. Conversely, should technology sentiment weaken, lower starting valuations and lighter ownership may provide some resilience, even though valuations in parts of North Asia have become stretched following strong performance.

Beyond technology, economic reforms in emerging markets support medium-term growth prospects. Several countries are implementing policies aimed at improving corporate governance, increasing shareholder returns, increasing foreign ownership and stimulating domestic demand. These initiatives are intended to enhance productivity, attract foreign investment and strengthen governance, thereby supporting both earnings growth and valuations over time. Examples include efforts to improve capital discipline in China, a consumption-led expansion in India, economic diversification in the Middle East and South Africa’s plan to spend tens of billions of dollars on infrastructure. Finally, we note that South Korea has passed rules to improve corporate governance and shareholder returns, similar to what Japan has done over the past decade.

Geopolitical tensions and trade frictions present meaningful risks, particularly if protectionist policies weigh on global growth. However, an important structural shift has been the expansion of trade within emerging markets. Trade between countries in the Southern Hemisphere, where emerging markets are concentrated, now accounts for a large share of global exports. This trend reduces dependence on developed-market demand and provides a buffer against unexpected geopolitical shocks. In Latin America, strategic competition between the U.S. and China may intensify, but this rivalry could also benefit regional economies by increasing capital inflows and diversification.

Taken together, the outlook for emerging markets rests on a combination of cyclical economic recovery and reform. Strong earnings growth—particularly from AI-related sectors—a potentially weaker U.S. dollar, improving investor positioning and still attractive valuations all point to the possibility of sustained relative outperformance after a long period of disappointment. While risks remain significant, especially from geopolitical developments and U.S. macroeconomic conditions, the balance of factors suggests that emerging-market equities may be entering the early stages of a period of sustained gains rather than a temporary rebound.

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