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What's in store for emerging markets?

The first decade of the 21st century was an outstanding one for emerging market (EM) stocks. From 2001 to 2010, the MSCI Emerging Markets Index outperformed the MSCI World Index by a wide margin. Since 2011, however, EM equities have lagged. As a result, many investors have steered away.

That first decade of great returns in EMs was fuelled by unique circumstances. Mostly, the story was about China and its incredible growth. That boosted global economic activity and enriched commodity-producing EM countries like South Africa.

In the same period, developed markets struggled to perform. They were recovering from the 'dot.com' bubble bursting in 2001, only to endure the sub-prime disaster in 2007. The US dollar also weakened significantly during this time, which further boosted EM performance.

Coming out of the Global Financial Crisis (GFC) of 2008 and 2009, many investors held the view that US dominance – after two huge stock market crashes in one decade – was over. EM countries were going to be the future.

We know now that this could not have been more wrong in the decade that followed. Since 2011, developed markets have massively outperformed, led by huge gains in the US.

The question we're asking ourselves now is whether the next decade will be a more rewarding one for EM investors. We believe so. Over the past few decades, emerging markets have witnessed remarkable economic growth, driven by factors such as demographic trends, urbanisation, technological advancements, and globalisation. We expect this growth trajectory to continue.

The expected recovery of EM stocks will, however, be propelled by a very different set of dynamics. Three essential trends will potentially define the next EM era.

Technological innovation

We are in the midst of a technological revolution and emerging markets will be central to this, in terms of innovation and as beneficiaries.

Compared with developed economies, emerging markets enjoy three distinct advantages related to adopting new technologies:

1. They likely won't have to upend existing infrastructure or legacy systems.
2. They have young populations that are digitally savvy and open to implementing these technologies.
3. Governments in some of the larger emerging markets are actively partnering and supporting entrepreneurial efforts in new technologies as a way to nurture local talent and skills.

Urbanisation, environmental adaptation and sustainability

Many emerging countries have been pursuing green reform agendas to address environmental challenges and transition toward more sustainable development models. Achieving these ambitious goals requires massive investment in wind and solar power, EVs, smart power grids, and other green technologies.

Paradoxically, building climate resilience can be commodity-intensive, depending on the specific measures and strategies employed. Some aspects of climate resilience initiatives require significant use of commodities such as steel, timber, metal alloys, rare earth metals, lithium, silicon and plastics. Commodity-producing EM countries such as China, Brazil, Chile, Indonesia, South Africa, and Korea are therefore likely to be economic beneficiaries.

Geopolitical shifts and global trade dynamics

The outlook for emerging markets is intricately linked to the evolving dynamics of global trade. Rising protectionism, trade tensions, and shifts in supply chains pose both risks and opportunities for EM economies.

In particular, we are increasingly seeing companies adopting the 'China Plus One' strategy to diversify their manufacturing or sourcing beyond China by adding at least one additional country to their supply chain. This approach aims to mitigate risks associated with an overreliance on China.

Closely related is the increasing trend of reshoring and onshoring. Reshoring refers to the practice of bringing back manufacturing operations and jobs to a local country from overseas locations. Onshoring focuses specifically on sourcing inputs from a local location rather than from overseas.

EM countries are essential to these shifting supply chain dynamics, particularly India, Mexico, Indonesia and Vietnam.

Conclusion

The next decade will be a transformative and positive period for emerging markets — a journey marked by resilience, adaptability, and shared aspirations. Both economically and geopolitically, power is shifting to emerging markets such as Brazil, Mexico, Greater China, South Korea, India and some parts of Southeast Asia. The time is now right for investors to raise their EM exposure to capture this second wave in the evolution of emerging markets' growth.

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