

Five reasons to consider allocating to emerging market equities now



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Emerging market (EM) equities currently offer robust opportunities for both hedging and growth, with the asset class looking more attractive from a valuation perspective than at any time in the last five years. Supported by an evolving macroeconomic landscape and a new phase for the US dollar, EM equities are also benefiting from a revitalised China, which is seeing sustained growth in both technology and domestic consumption, and a resurgent India, where structural reforms are transforming the economy. Here are five reasons why investors should consider incorporating EM equities into portfolios today.

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1. A supportive US dollar: The virtuous dollar cycle has hit a speedbump

Historical analysis suggests that when the US dollar is weak, EM equities tend to perform better relative to global equities. In recent years, however, the US dollar has enjoyed a virtuous cycle, which occurs when US growth and assets are attractive, and capital flows to the US, thus strengthening the dollar, lowering the cost of capital, and boosting US equities. Equity markets usually move quickly as part of the dollar's virtuous cycle, sometimes ahead of the resulting cost of capital changes.

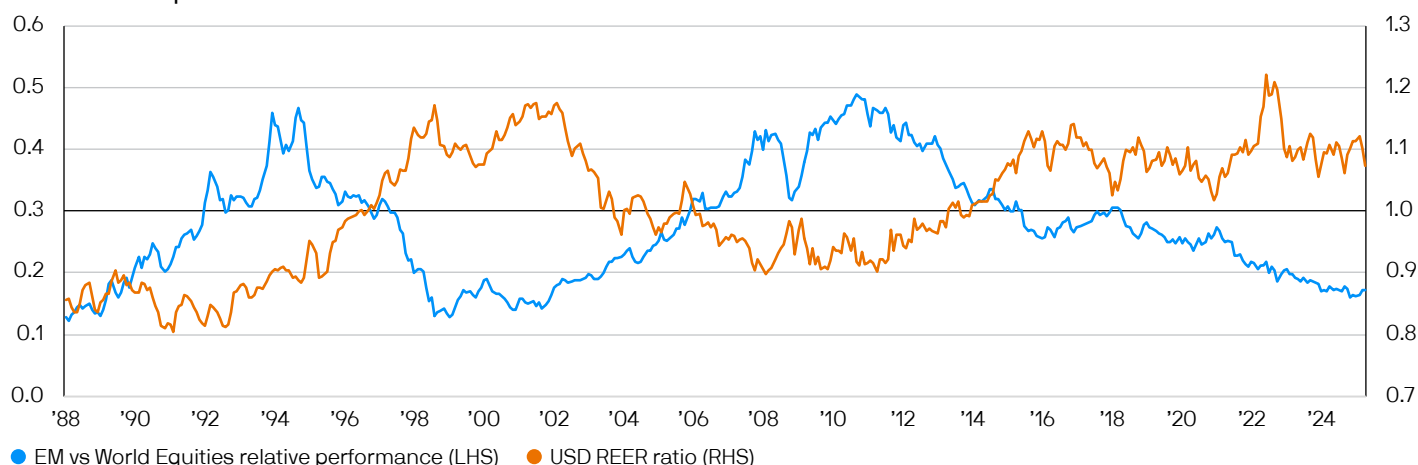


There are now signs that the US dollar's virtuous cycle has been broken. The cycle usually breaks down when US growth is forecasted to underperform the rest of the world, making US assets less attractive. This is now the case, with the outlook for US growth deteriorating since the April tariff announcements, with cuts to consensus US GDP estimates greater in magnitude than for most other economies.

The weaker relative growth outlook for the US, and a reduction in the attractiveness of US assets, implies limited upside for the US dollar. We expect the dollar to weaken based on our valuation tool. A weaker dollar should be beneficial for EM economies and EM equities, especially given the fact that many EM central banks have significant room to stimulate their domestic economies following restrictive monetary policies over the last few years.

EM equities tend to perform better relative to global equities when the US dollar is weak

Exhibit 1: EM equities and the US dollar



Source: Bloomberg, J.P. Morgan Securities, MSCI, J.P. Morgan Asset Management. Data is as of 31 May 2025. REER is Real Effective Exchange Rate, a trade-weighted and inflation-adjusted index of the dollar that we compare to historical averages for a valuation tool. A REER ratio above 1 is considered expensive vs. its fair value. EM vs World Equities relative performance (LHS) is based on the indexes: MSCI Emerging Markets Index and the MSCI ACWI (All Country World). **Past performance is no guarantee of future results.**

2. Tariff resilience: Many EM economies have some resilience to tariff-led unpredictability

Tariff-related uncertainty is set to continue to cause volatility in global markets. Additionally, concerns remain over how US consumers will adjust to higher prices and how US industrial and manufacturing capacity can be created in time to substitute imported products. Until these questions are answered, ongoing uncertainties around US consumption, economic growth, labour markets, interest rates and deficits will continue to weight on US assets.



That said, it is worth noting that the revenue exposure of most emerging markets is primarily oriented towards their domestic economies, ranging from around 75% to 95%. This domestic focus provides some insulation against US tariffs. However, the potential impact will vary across regions. In China, for example, it is evident that the current US trade stance is targeting Chinese exports. As a result, China's export model will be challenged based on the level of tariffs. However, tariff worries are also accelerating Beijing's stimulus timeline.

Latin America, on the other hand, has emerged as a relative winner, with most countries in the region subject to a 10% import tariff because they either have trade deficits or small surpluses with the US. And while Mexico is extremely dependent on the US, the US administration's commitment to the United States-Mexico-Canada Agreement (USMCA) has proven to be a protective barrier.

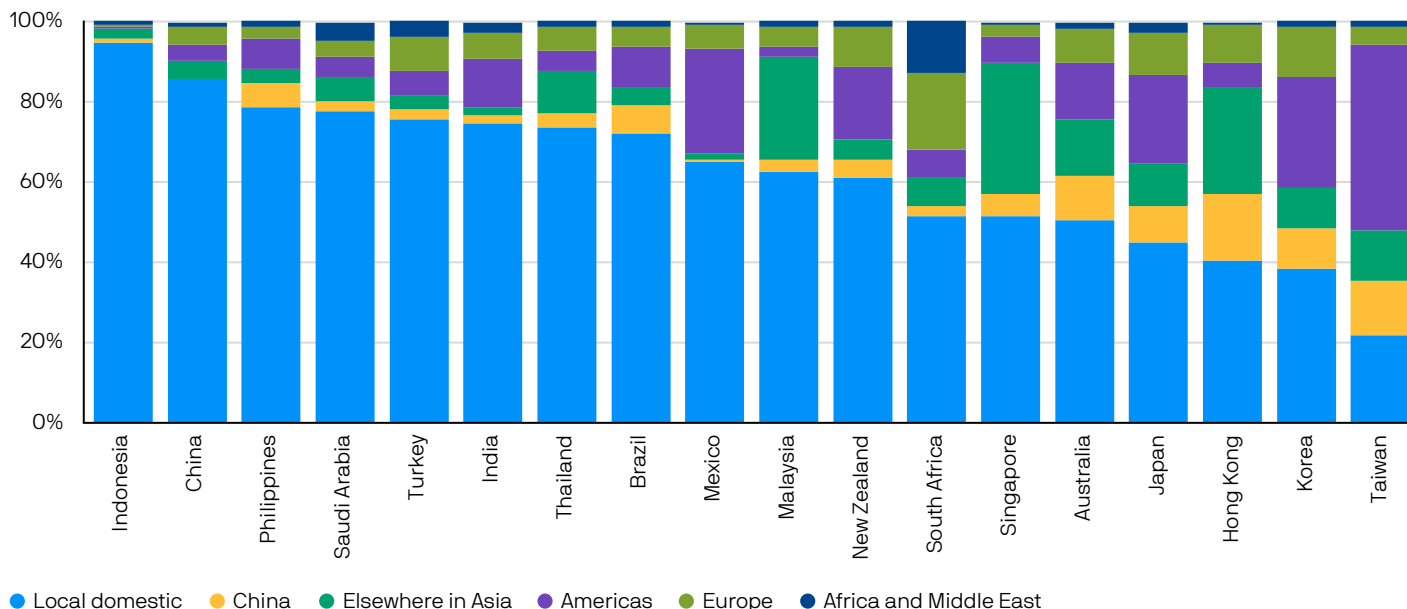
For India, although the initial tariff seems high, the country is continuing its trade negotiations with the US and is working towards a favourable outcome. Domestic consumption continues to be the main driver of the Indian economy, contributing around 60% to nominal GDP and 75% to equity market revenues.

Some economies in Southeast Asian nations are more globally sensitive with higher revenues from exports. Nevertheless, medium- to long-term opportunities exist as companies reshore to take advantage of some of the region's lower labour costs and existing manufacturing capacity.

The revenue exposure of most emerging markets is primarily oriented towards their domestic economies

Exhibit 2: Geographic revenue exposure of EM equity markets

Revenue exposure of MSCI Indices



Source: MSCI, Factset, J.P. Morgan Asset Management. Guide to the Markets - Asia. Data as of 31 May 2025.

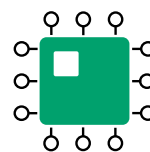
3. China: The worst looks to be behind us

China's macroeconomic landscape and technological advancements create an interesting dichotomy for investors. On one hand, China's technological and manufacturing prowess remain world class; on the other hand, property market excesses and weak consumption remain a challenge.

While China continues to remain the factory of the world, its technology ecosystem is second to none in terms of dominance and efficiency. The recent launch of the DeepSeek chatbot has bolstered confidence in China's artificial intelligence (AI) capabilities. Tech innovations by Chinese companies, such as BYD and CATL's rapid electric vehicle chargers and Xiaomi's swift pivot to electric vehicles from manufacturing mobile phones, surpass global counterparts, with patent approvals in the country vastly outnumbering those in the US. Despite political challenges, China's thriving tech ecosystem presents significant opportunities for global investors.

China's economic backdrop is also slowly improving. Since September 2024, China has rolled out fiscal and monetary stimulus targeted at supporting the property sector, consumers and capital markets. While this substantial support will take time to filter through, key economic indicators, such as real estate inventories returning to average levels, are encouraging. Recent policies focus on boosting consumer spending, with ongoing stimulus expected to provide a drip feed of support, both in response to US tariffs, and in order to help reach domestic policy goals.

Finally, Chinese companies are increasingly prioritising shareholder returns and capital discipline over growth at any cost. Dividend and share buyback spending has more than doubled in the past decade. This shift addresses past concerns about shareholder dilution and highlights a focus on shareholder returns across sectors. The result is 30%-50% of Chinese companies now pay dividends. Given the more supportive macro and corporate backdrop, an increase in active exposure to China from current levels may therefore hold investors in good stead.



China's thriving tech ecosystem provides significant opportunities



Chinese companies are increasingly prioritising shareholder returns and capital discipline

The companies above are shown for illustrative purposes only. Their inclusion should not be interpreted as a recommendation to buy or sell.

4. India: Riding the growth wave as structural reforms transform the economy

Over the last decade, multiple structural reforms have moved the Indian economy to a higher orbit, laying the foundation for macro durability. Key among these reforms have been financialisation, formalisation, deregulation and investment in infrastructure. Indian company managements are routinely the best in an EM context, as seen in Indian corporate results, which consistently show a high return on equity – even higher than the US in many cases. The result has been a significant increase in valuations, with large-cap valuations at the end of 2024 close to levels last seen before the Global Financial Crisis. A large part of this increase in multiples can be attributed to euphoric domestic market investors, as retail equity flows have turned positive since 2020, after two decades of outflows.

The recent mid-cycle pause in valuations, caused by a multitude of domestic and global factors, has provided some much-needed breathing space, and has created an opportunity for patient stock pickers, given India's increasing market depth and relative corporate maturity. In particular, investors are able to maintain healthy dialogues with Indian companies, while—most importantly—many industrial and basic service sectors offer significant scope for able management teams to achieve productivity gains.

Additionally, the private sector looks well poised to take the capital expenditure (capex) story to the next stage, supported by 12-year high capacity utilisation, robust balance sheets, low debts, a healthy banking system, and strong capital markets. At the same time, India is enjoying an economic tailwind from lower crude prices, while liquidity is set to improve as the Indian central bank moves from neutral to accommodative. With inflation also falling, and the Indian currency appreciating, India appears uniquely positioned in a global context.

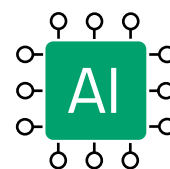


Retail equity flows have turned positive since 2020, after two decades of outflows



India appears uniquely positioned in a global context

5. AI leadership: EM technology companies are underwriting the global AI revolution



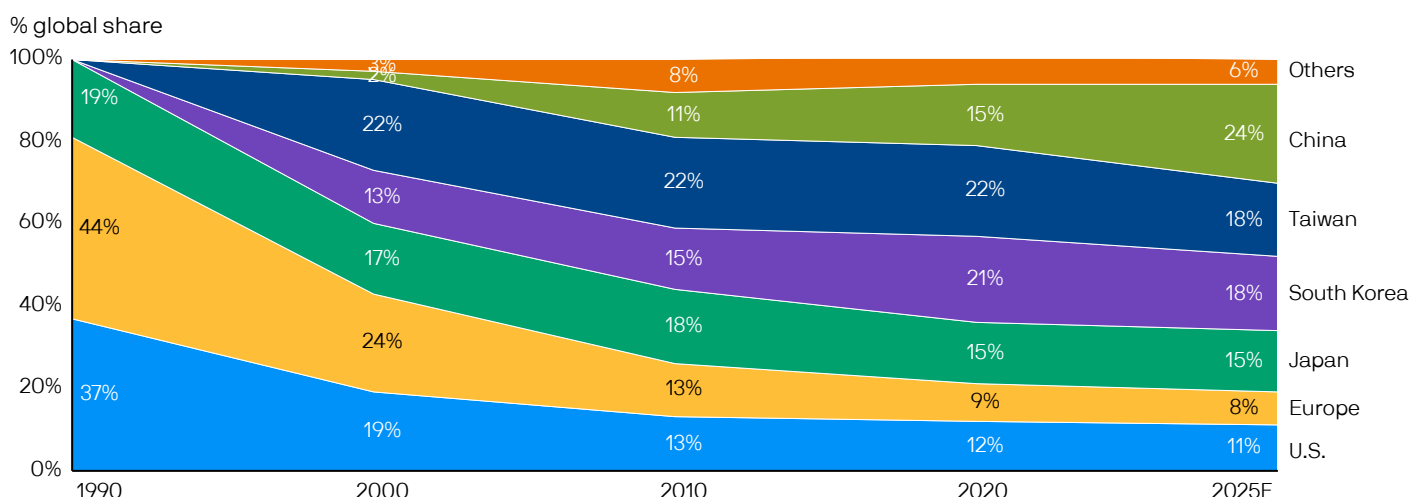
The technology sector makes up around 22% of the MSCI EM index, which makes tech the second largest sector after financials. The EM tech sector encompasses world-leading companies in semiconductors, electronics, hardware, software, outsourcing and cloud technology. While the software services story is well known, it's imperative to understand that EM tech companies are also underwriting the AI revolution that is now well underway.

The structural boost for AI-related products is providing a tailwind for Asian tech manufacturers. Taiwan, for example, produces ~90% of the world's advanced semiconductors, while South Korea is responsible for ~50% of the world's supply of solid-state memory.^{1,2} While the US and Europe were dominant regions for semiconductor production in 1990, with a share of just over 80%, today both regions account for only 23% of global semiconductor production. The rest is accounted for by Asia. Additionally, up to 75% of suppliers to the Magnificent Seven are located outside of the US, particularly in east Asia and south-east Asia.³

EM investors can gain access to this growing theme through exposure to companies with the same dominance, growth exposure and quality as US tech companies, but for a fraction of the price.

Asia's share of semiconductor production has increased rapidly since the 1990s

Exhibit 3: Semiconductor share by location



Source: VLSI Research Projection; SEMI second-quarter 2020 update; BCG analysis, J.P. Morgan Asset Management. Guide to the Markets - Asia. Data as of 31 May 2025.

¹ <http://theguardian.com/world/article/2024/jul/19/taiwan-semiconductor-industry-booming>

² <https://www.reuters.com/technology/samsung-sk-hynix-wont-need-approvals-supply-us-chip-gear-china-2023-10-09/>

³ https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/market-updates/on-the-minds-of-investors/how-vulnerable-is-mega-cap-tech-to-tariff-turmoil/?email_campaign=310790&email_job=565602&email_contact=1765111&utm_source=clients&utm_medium=email&utm_campaign=ima-mi-wmr-ar-ri-04142025&memid=7220927&email_id=87495&decryptFlag=No&e=ZZ&t=&f=&utm_content=OTMI

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