

Why invest in emerging and frontier markets in 2026?



2025 was a fantastic year for emerging and frontier markets, which shrugged off trade tensions and geopolitics to deliver returns of 30% and 41% in USD terms respectively over the first 11 months (see Figure 1 on next page). We believe that 2026 will likely be another good year, thanks to a relatively benign macro backdrop characterised by falling rates globally and strong idiosyncratic stories across these markets, from reasonably priced AI enablers in Taiwan and Korea to underappreciated tech leaders in China to fast-growing structural growth stories in India and beyond.



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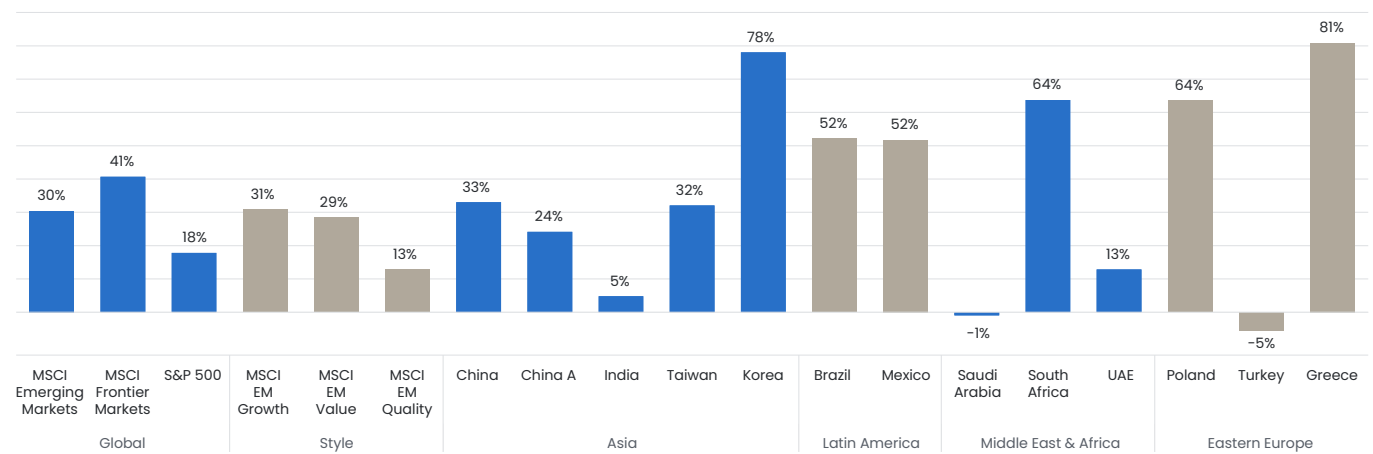


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Figure 1. Total return YTD in USD (%)



Source: Refinitiv, accessed 01.12.25

The great rotation begins?

A major topic in 2025 was whether the “US exceptionalism” narrative had gone too far, with the US reaching 66% of global equity market capitalisation (see Figure 2) despite contributing just 26% of the global GDP. **By contrast, emerging markets (EMs) comprise just 11% of the MSCI ACWI, yet they represent approximately 40% of global GDP and 70% of global real growth.**

Figure 2. Weight of US in MSCI All-World (ACWI) Index



Source: Refinitiv, accessed 01.12.25

Fears of US exceptionalism are stoked by concerns about both the valuations and market concentration of US AI stocks as well as of USD exposure, particularly for non-US investors. Looking ahead, these issues are likely to persist. US stocks remain much pricier than those in other markets, particularly emerging and frontier markets. There are also real questions about whether recent US AI investments will pay off, and the US dollar is not expected to strengthen as the Fed continues to cut rates.

Indeed, over the next two years (see Figure 3), EMs offer slightly better growth (14.9% earnings CAGR over the two years vs 14.5% for the S&P 500) at considerably lower valuations. Consequently, **the PEG ratio for EMs is just 0.9x, compared to 1.5x for the US and 1.3x for Europe.** Our global EM strategy is cheaper than the benchmark, trading at 0.6x PEG, in line with our approach of finding underappreciated, fast-growing companies at reasonable valuations. Valuations in frontier markets (FMs) are even more appealing: **our Global Frontier Markets fund trades at 0.4x PEG.**

Figure 3. Key metrics for global indices and East Capital global strategies in 2026 and 2027

	Earnings growth (%)		P/E		PEG
	2026	2027	2026	2027	2026-2027
S&P 500	14.4	14.5	21.9	19.1	1.5
Eurostoxx 50	10.2	12.8	15.2	13.5	1.3
MSCI Emerging Markets	17.1	12.8	13.2	11.7	0.9
MSCI China	13.1	13.4	12.5	11.0	0.9
MSCI India	16.6	14.5	21.4	18.7	1.4
MSCI Taiwan	20.2	18.0	16.9	14.3	0.9
MSCI Korea	37.9	9.5	10.1	9.3	0.4
East Capital Global EM Sustainable	22.9	15.9	12.5	10.8	0.6
East Capital Global Frontier Markets	14.7	16.5	6.4	5.4	0.4

Source: Refinitiv, accessed 01.12.25

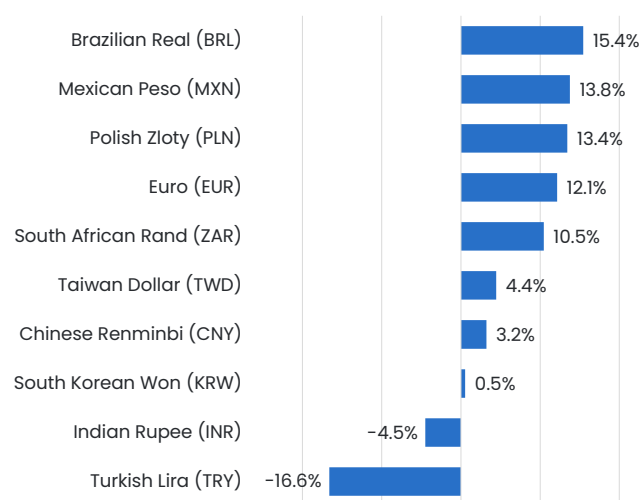
Despite the positive narrative, fund flows have not kept pace. Emerging market equities attracted only USD 21.5 billion in net inflows in 2025¹, leaving EMs at just 5.2% of global equity fund assets under management, compared to their weight of over 11% in the MSCI ACWI. While this is a slight increase from the 4.9% recorded at the end of 2024, it remains below the 5.5% seen in 2023. This global data is consistent with our recent client discussions. The vast majority are “doing their homework” on EMs but generally remain underweight. For the long-term investors we speak to, the key question is not short-term upside, but whether EMs can deliver sustainable returns over time.

The macro backdrop looks benign

In general, on the macro side there have been three common concerns about emerging and frontier markets, namely that when compared to investors’ home markets in developed economies they have (1) more volatile and inefficient politics, (2) weaker and more reckless fiscal management and (3) depreciating currencies, which erode hard currency returns.

However, the last few years have started to dispel these concerns. The third concern is the easiest to disprove, as most currencies have *appreciated* against the USD in 2025 (see Figure 4). As Fed rates continue to fall going forward, the consensus is that the USD will continue to weaken, albeit perhaps at a slower pace than in 2025. Some market participants are even more optimistic: one well-regarded strategist has forecast that the **renminbi could appreciate from 7 to 5 against the USD (i.e. strengthen by 40%!) over the next few years**, driven by strong trade surpluses and broader adoption of the renminbi as a reserve and trade currency.

Figure 4. Total spot return YTD vs USD (%)



Source: Refinitiv, accessed 01.12.25

From a political perspective, the chaos in the US and the divisions within Europe suggest that the political environment in emerging and frontier markets may not be *that* bad on a relative basis. Investors in developed markets have a particularly negative perception of Chinese politics. While this is not entirely unjustified, China’s focus on cutting-edge technologies and their supply chains – such as rare earths mining and processing is underpinned by stability and long-term thinking, and this does appear to be a winning formula that other countries are now seeking to emulate, albeit belatedly. Furthermore, China’s “innovate first, regulate later” approach contrasts starkly with that of the EU and, to some extent, the US. This gives China a clear advantage in technologies such as self-driving cars, AI, robotics, biotech and medicine (such as stem cell therapy).

In fiscal terms, with the US running deficits above 8% of GDP, it is not a big leap to suggest that emerging and frontier markets *don’t look so bad*. Indeed, successive crises have prompted many EM and FM countries to improve fiscal discipline, with the aggregate fiscal deficit for EMs forecast at around 4.2% of GDP in 2026. This deficit appears manageable, especially given lower debt levels of 72% of GDP for EMs versus 110% for developed markets, according to the IMF.

AI in China remains underappreciated

As we entered 2025, the general narrative was that China was completely out of the AI race, partly due to its restricted access to Nvidia’s chips. However, this changed in January with the launch of Chinese large language models from Hangzhou-based DeepSeek, which showed that China could not only compete but it could do so in a more efficient and cost-effective manner. This was probably the main fundamental driver of growth for the Chinese equity market in 2025.

However, as the year progressed, a wide gulf emerged between the US hyperscalers, who are throwing money at chasing AGI (artificial general intelligence), and Chinese companies, which are focusing on open source, cost-efficient models and the practical applications of these models, which are not just being used in China. For example, Airbnb CEO Brian Chesky recently revealed that his company “relies a lot on Alibaba’s Qwen model” for its AI customer service agent, saying “we use OpenAI’s latest models but we typically don’t use them that much in production because there are faster and cheaper models”. Later in the year, the focus shifted to power availability. Nvidia CEO Jensen Huang stated that “China will win the AI race with the US”, on the basis of abundant power and lighter regulation.

¹ Up until end of October 2025. Source: EPFR Global.

We think it is too early to call winners but, for the time being, market valuations clearly suggest that Mr Huang's view is not supported.

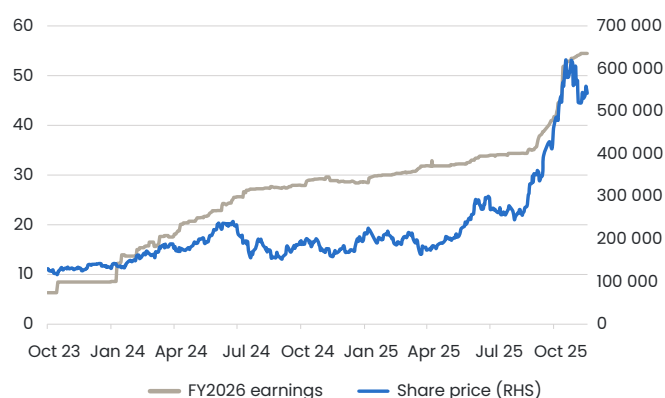
For example, Alibaba is the largest cloud provider in China with a 34% market share, it operates a globally leading LLM and has a recovering ecommerce business with over 800 million users, driving expected EBITDA growth of 45% in 2026. The company is trading at 17x P/E for the next fiscal year, compared with Amazon at 29x P/E.

AI enablers are a safer option than hyperscalers or Nvidia

While the long-term returns of hyperscalers and Nvidia's competitive advantage are the subject of ongoing debate, we are more focused on where they will be buying from. All the latest specialised AI processors (GPUs and TPUs) are fabricated by TSMC in Taiwan, and the AI servers are assembled mostly by Asian companies such as Foxconn using components manufactured across Asia. These chips rely heavily on memory from Korean manufacturers. Currently, Hynix supplies around 90% of the high-bandwidth memory for Nvidia's latest AI GPUs and 100% of the memory for the current generation of Google TPUs. However, this share may decrease with future versions. More interesting still, we are seeing the beginning of a broader upcycle in memory, driven by the huge demand for computing power and consequently, for more conventional memory. For example, server DRAM increased by 25% in November 2025 alone.

This has driven a wave of earnings upgrades, which are best evidenced by Hynix's expected earnings for 2026 (see Figure 5).

Figure 5. FY2026 earnings expectations and stock price for SK Hynix (KRW trillion)



Source: Refinitiv, accessed 05.12.26

This indicates that valuations for these AI enablers remain very reasonable versus their US counterparts, as shown in Figure 6. Hynix is trading at just 6.6x P/E for next year compared to 23.6x P/E for Nvidia, despite similar metrics in terms of profitability and growth. TSMC also represents good value at 18.1x P/E as it has the strongest "moat" in the entire AI value chain. There is simply no other company that can fabricate such complicated chips, nor is there anyone trying to do so.

Figure 6. Key metrics for AI enablers for 2026

	Market Cap (USD bn)	EBITDA margin	EBITDA growth	EV/EBITDA	RoIC	P/E
SK Hynix	267	65%	65%	4.1	51%	6.6
NVIDIA	4,301	65%	68%	19.1	120%	23.6
TSMC	1,165	68%	22%	10.9	37%	18.1
Intel	193	26%	24%	13.3	1%	67.7

Source: Refinitiv, accessed 05.12.26

Investing in the future

Despite the above, the story of emerging markets is not just about AI. China is now an outright leader in many of the world's most important technologies. The Australian Strategic Policy Institute estimated that China leads in 57 out of 64 critical technologies, compared to just three 16 years ago. Our portfolios contain many examples of such leading companies. For example:

- China accounted for 11 million EVs sold worldwide in 2024 – close to two out of three. Geely, one of the fastest-growing EV brands globally, saw EV sales increase by 59% YoY in Q3 2025.
- Chinese CATL controls around 40% of the global battery market.
- Hesai is the largest LiDAR (light detection and ranging) company, a key technology for self-driving cars. It controls around 33% of the global market, and an even higher share of the robotaxi market (around 61-74%).
- Hansoh Pharmaceutical, one of China's largest biotech companies, has signed agreements worth billions of dollars in the last 12 months with companies like Roche, Merck, GSK and Regeneron for the development of a range of innovative drugs.

We often highlight that the long-term sustainability of returns in EMs, particularly China, is driven by their huge potential market size and the current industry leadership. Given their scale and dominance, it is likely that many of these companies will become considerably larger over the next decade, supporting long-term earnings growth and stock market returns.

Is Korea following in Japan's footsteps?

If this year has taught us anything, it is that good corporate governance has become even more important. South Korea is one of the best performing markets in the world year-to-date, partly as a result of a new pro-market government sweeping into power and championing governance reforms. These reforms mean that board members are now legally required to act in the interests of all shareholders (rather than the company, often understood to be the main shareholders), and include a raft of other changes such as requiring companies to define and publish capital allocation plans, and lowering dividend tax.

Importantly, this is not only happening in Korea. China has introduced similar regulatory initiatives and reforms aimed at encouraging listed companies to improve shareholder returns and corporate governance." The most significant change has been to tighten the placement requirements, slowing the previously relentless (and dilutive) supply of equity. Chinese companies are now conducting more equity buybacks than placements of A shares (domestic listed shares). Many of our discussions with corporates focus on buybacks and stock cancellations. Interestingly, companies with a valuation below 1x P/B are now required to publish value-up reports that discuss how they will improve their market valuations.

Will the headwinds turn into tailwinds for India in 2026?

Following a very strong decade, India "took a breather" in 2025 due to challenging geopolitics, a cyclical slowdown, elevated valuations and limited AI exposure. However, during our recent visits to Chennai and Mumbai, we found the general mood to be surprisingly optimistic, even among typically bearish local investors. It appears that, in 2026, these headwinds could whip around and turn into tailwinds. For example, a trade agreement is expected soon, and government stimulus measures are already providing a much-needed boost to consumption. Valuations also look more appealing as earnings growth has continued despite muted performance. Notably, in light of concerns about an AI bubble, many investors now view India's lack of AI exposure positively, with one broker describing it as the "ultimate non-AI" investment play.



Visit to the production site for portfolio holding Continental Coffee in Chennai, India (November 2025).

More generally, we see that India remains the "classic" emerging market, offering abundant structural growth opportunities. We recently toured the production site of our portfolio holding, Continental Coffee, which is located about a three-hour drive from Chennai. This company is one of the world's leading instant coffee producers and is a great example of the structural growth we are looking for. **On average, Indians consume just 30 cups of coffee per year, compared to the global average of 200 cups (and the East Capital employee average of at least 600 cups!).** Currently, Continental Coffee is covered by only two small local brokers, though we expect this to change going forward given their strong offering.

High interest rates and the 2026 elections in Latin America

A similar "non-AI" investment case applies to Latin America, where valuations are notably lower than in India and most other regions. This is partly due to some of the highest real interest rates globally, which are currently at 10% in Brazil.

In Brazil, attention is already centred on the presidential election in October 2026, which could signal a turning point following years of political mismanagement. One portfolio manager we spoke with on our last trip to São Paulo believes that if the pro-business candidate, São Paulo Governor Tarcísio, wins, the market could rally by as much as 100%.

Much like India, Latin America offers numerous compelling structural growth opportunities. Consider Smartfit, the region's largest gym chain, which is growing at around 30% annually. Currently, only 5% of Brazilians hold gym memberships, compared to the mid-teen figures seen in both the US and Europe. Despite this impressive growth, the company is valued at just 16x forward P/E due to elevated interest rates. If Smartfit were based in the US, its valuation would likely be at least double this, if not higher.

Eastern Europe – the peace dividend remains key

Eastern Europe has featured some of the top-performing markets in 2025, as investors sought structural growth opportunities beyond the US and anticipated a possible resolution to the war in Ukraine.

Poland is poised for a strong 2026, with GDP growth forecast at 3.5–4% and inflation within target. Loan growth is accelerating and fiscal concerns are easing as EU funds drive investment across the country. Equity valuations remain attractive, trading at a significant discount to those in Western and Northern Europe, as well as to other Ems, due to the risk premia associated with geographic location. Despite higher taxes, banks are positioned for robust returns.

Meanwhile, Turkey's inflation has dropped sharply from 44% at the start of the year to 31% currently and is expected to fall further. Meanwhile, the economy has avoided a hard landing and could grow by around 4% in 2026. Valuations are deeply discounted, creating interesting opportunities for investors such as ourselves.

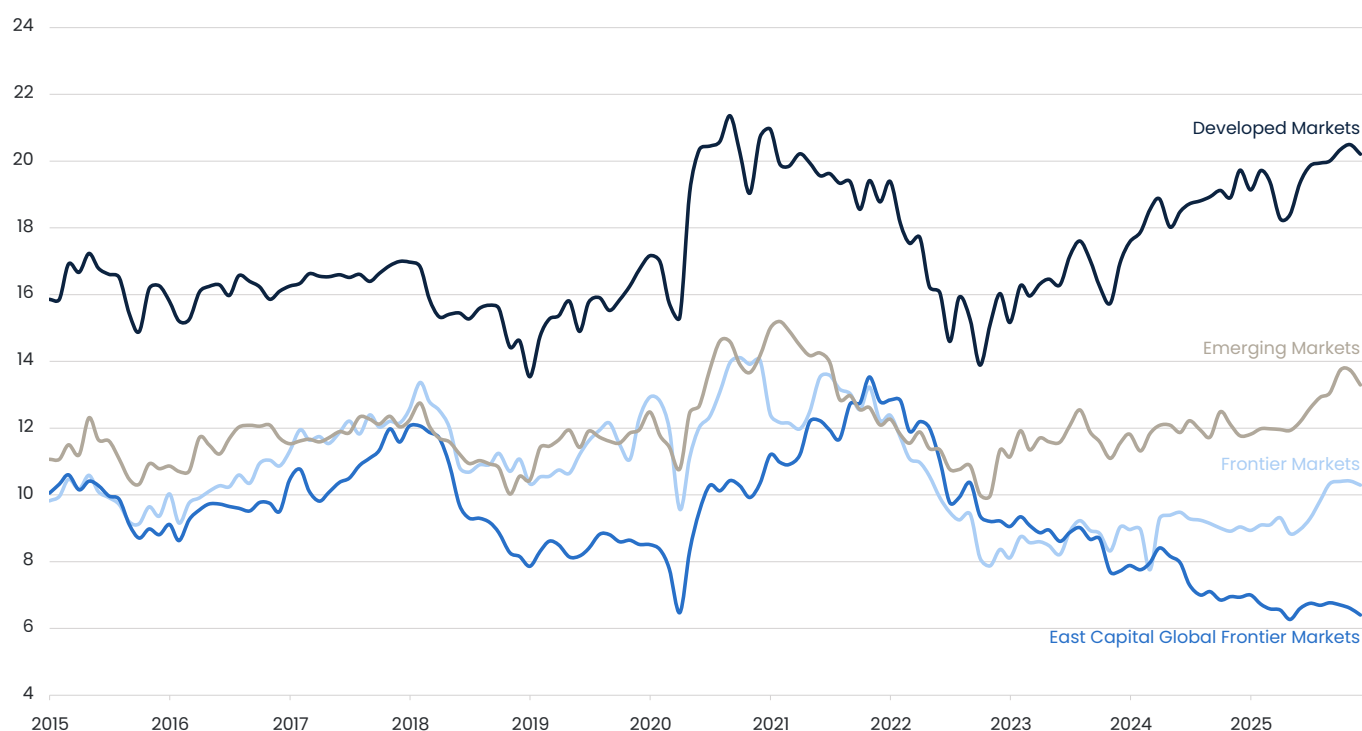
Greece is expected to be upgraded by the MSCI and will likely not remain an emerging market for much longer. It remains reasonably valued and an attractive investment destination given its expected GDP growth of around 2.4% for next year. Continued EU fund deployment and investment-grade status support capital inflows, while tourism and infrastructure drive growth.

Frontier markets have become even cheaper despite incredible performance

Frontier markets (FMs) have enjoyed a stellar run over the past few years, particularly if you take East Capital's view and include small, overlooked EM countries such as the Philippines. Our strategy has delivered a 79% return in USD over 5 years, closely matching the 82% return from developed markets. This performance came with lower volatility of around 11%, versus 13–14% for developed and emerging markets. This reflects the low correlation among frontier countries. Although this may seem counterintuitive, consider that the local equity market in Nigeria or Romania, for example, is not influenced by whether Nvidia is up or down on any given day.

Notably, despite these strong returns, valuations have continued to decline (see Figure 7), with East Capital Global Frontier Markets standing out with a PEG ratio of just 0.4x.

Figure 7. 12 month forward P/E ratio



Risks

After nearly three decades of investing in emerging and frontier markets, we have learned to “expect the unexpected”. Current conditions resemble a classic late-cycle environment, which has been extended by the AI boom. Stretched valuations and significant retail participation are driving markets higher across the world. Naturally, this increases the risk of something going wrong.

However, the most significant risk for emerging and frontier markets is the possibility that the US economy surprises and picks up again in 2026. This could revive the “US exceptionalism” narrative and take the expected Fed interest rate cuts off the table.

Geopolitical risks are likely to persist, but after a year of intense geopolitical unrest, it is quite difficult to see how things could deteriorate much further, particularly relative to events such as Trump’s “Liberation Day” in April.

Conclusion

We believe that 2026 has the potential to be another good year for EMs and FMs. This is supported by favourable valuations, light positioning, a strong macro backdrop and a wide and diverse range of growth drivers. In many ways, we believe the main appeal of EMs lies in their diversity. On a simplistic level, you can split the market into:

- › 1/3 AI “picks and shovels” in Taiwan and Korea
- › 1/3 China: the vast majority of companies would be Chinese or global technology leaders, spanning everything from EVs and batteries to electricity meters and dental implants.
- › 1/3 uncorrelated company-specific growth stories, such as those in India or Brazil.

Unlike investing in the US, investing in EMs does not require you to put all your eggs in the AI basket. However, a shift has taken place and EMs are no longer just about economic convergence and consumption growth stories.

Frontier markets are in a category of their own and remain totally overlooked by the vast majority of investors. However, for the more adventurous of us, there are extremely appealing valuations, strong opportunities and lower volatility, particularly when blended within a broader portfolio.

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