FRANKLIN TEMPLETON

Why Now Emerging Markets

Moving from the edge to the centre of the global economy

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Perspective from Templeton Global Investments

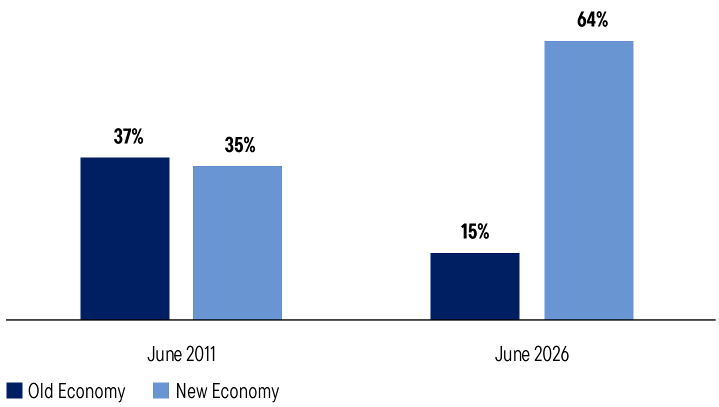
Emerging markets are quietly having their best decade in a generation, and most global investors still don't own enough. The case for investing in emerging markets today is not the tired characterisation of a high growth, low valuation opportunity. It is a much more exciting story about a set of countries and companies that have moved from the edge of the global economy to its centre, and where the numbers match the story on the ground.

A Changing Opportunity

Fifteen years ago, over a third of the emerging market (EM) equity universe sat in old-economy sectors: energy, materials and industrials. Today, those sectors have halved to 15%, while new-economy sectors: technology, consumer, health care, and communication services make up 64%. Over the same period, the universe of high-quality companies, those earning a return on equity above 15%, has more than tripled.[1]

Exhibit 1: Changing Structure of Emerging Markets

New Economy Sector Weights Have Almost Doubled



Sources: MSCI, FactSet, Based on weightings in MSCI EM Index. New economy as defined by consumer discretionary, consumer staples, health care, information technology and communication services. Old economy as defined by energy, materials and industrials. As of June 2026c.

This shift is visible across individual markets: Taiwan and Korea are the world's biggest suppliers of advanced chips and memory used in AI data centres. China dominates electric vehicles and batteries used in transportation and storage. India provides most of the world's vaccines and much of its outsourced software services. These are no longer emerging economies producing raw materials and components for export, they are producing the high value-added final goods for the fourth industrial revolution.

1. Sources: Factset, MSCI. Data as of March 31, 2026.

Your Life Powered by Emerging Markets

Emerging markets play a large role in your life. When you drive your car to the office or shops, it relies on advanced semiconductors, critical materials and potentially batteries produced in emerging markets. The coffee you drink, the phone you use, and the digital services you depend on all trace back to countries that have become the engines of global growth and innovation.

Yet what makes this an especially attractive investment opportunity is the disconnect between their importance and the attention they often receive from investors. While developed economies remain important, much of the world's future economic expansion is expected to come from emerging markets. These countries are investing 32% of their GDP into infrastructure technology and innovation,[2] creating capacity and long-term growth opportunities.

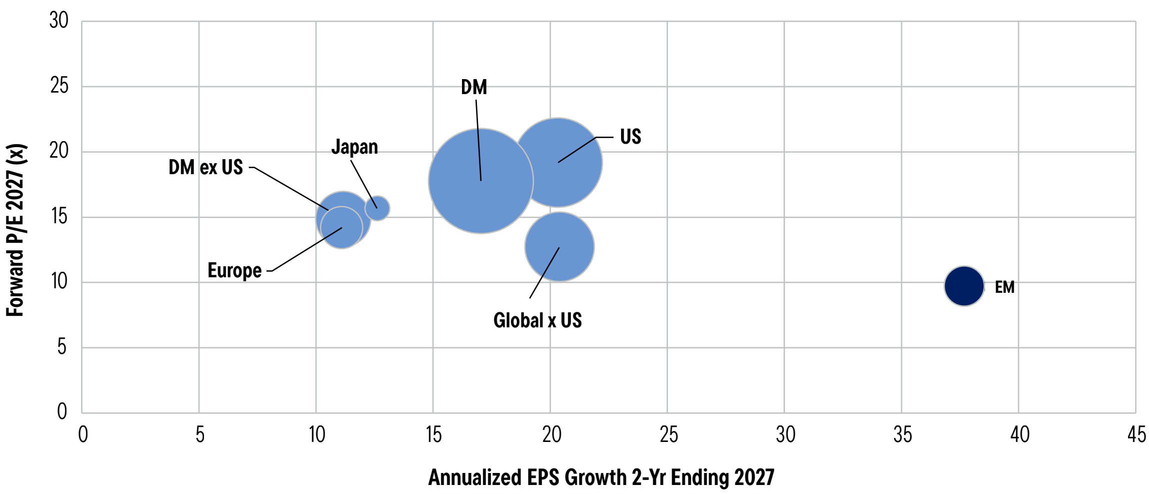
The Earnings and Valuations Story

The most important driver of equity market returns over the long run is earnings. Emerging market equities are expected to deliver 2026 earnings growth of 50%, almost double that in the United States.[3] After a lost decade for earnings between 2012 and 2022, structural forces are now driving close to 40% annualized increase in earnings per share growth over the next two years.[4] Despite this growth outlook, they trade at a 38% discount to developed markets on a price-to-earnings basis.

And there is a new lever: emerging market companies, particularly in China and Korea, are increasingly shareholder focused. China is demanding higher returns on equity from state enterprises. Korea has passed new commercial law which makes directors accountable to shareholders and reformed dividend tax. Net buyback yields,[5] long negative across the region, have turned positive for the first time in a decade.

Exhibit 2: MSCI EM 2-Year Earnings Growth Is the Highest Globally

EM Has High Earnings Growth and Attractive Valuations



Sources: MSCI, FactSet. Circle size reflects market capitalization. Data as of June 30, 2027.

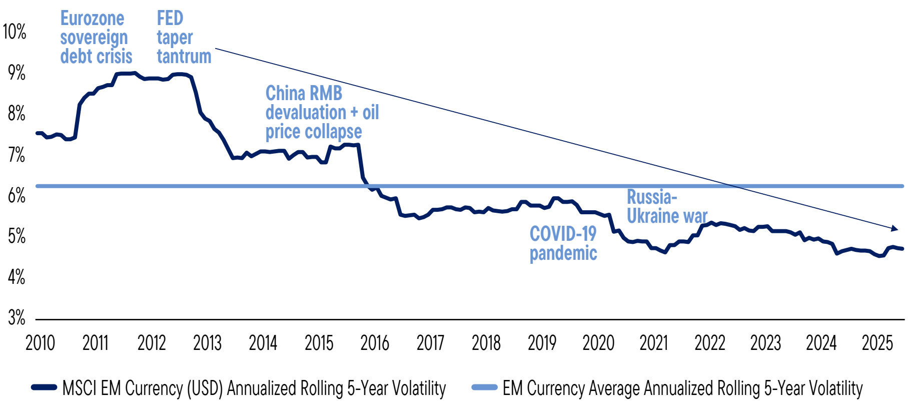
2. Source: IMF World Economic Outlook. April 2026.
3. Sources: FactSet, MSCI. Data as of April 29, 2026.
4. Ibid.
5. Defined as share repurchases divided by market capitalization.

The Common Objections, Honest Answers

Are emerging markets too risky? The volatility gap versus developed markets has collapsed from seven percentage points a decade ago to just one point today. Currency volatility has fallen from 9% to 5% and continues to trend down.[6]

Exhibit 3: MSCI EM Currency Volatility—5-Year Annualized Rolling

EM Currency Volatility Has Fallen Dramatically



Sources: MSCI, FactSet. Data as of June 30, 2026.

Do you need a weaker dollar to make money? Not necessarily. Historically, emerging markets have delivered their best weekly returns when the dollar is stable or moving within a normal range.

What's changed is that many emerging markets have become increasingly self-financed and policy-disciplined, with stronger central banks, larger reserve buffers, flexible currencies and deeper local investor bases.

Are earnings expectations too optimistic? Forecast growth in earnings are elevated. The primary driver is the AI infrastructure boom, driven by information technology and industrials. Worth watching, not dismissing.

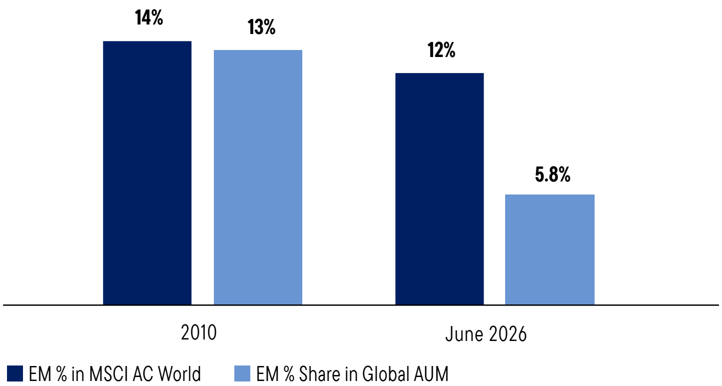
6. Source: Franklin Templeton Capital Market Insights Group. Data as of March 31, 2026.

Positioning Tells the Final Piece of the Story

Emerging markets are 12% of the MSCI All-Country World Index but only 5.8% of global investor allocations, well below the 13% allocation in 2010.[7] Global investors remain underweight an asset class that is generating the majority of the world's growth, a substantial portion of the world's critical goods[8], and the highest earnings forecasts. We acknowledge flows have returned to emerging market equities over the past year,[9] yet global investor allocations remain well below 10-year average levels. Flows do not start equity market rallies, but they establish them.

Exhibit 4: EM % Share of Global AUM vs. Weight in MSCI AC World Index

Investor Allocation to EM Has Fallen Sharply Relative to Index Weight.



Sources: EPFR Global, MSCI, Refinitiv Eikon, J.P. Morgan. Data as of 31 December 2025.

The Risk Lens

Similar to developed markets, emerging market investing comes with risks. Earnings forecasts could prove to be too optimistic, currencies could weaken and corporate governance reforms could reverse. Nevertheless, valuation levels in emerging markets create a margin of safety that could limit the downside if any of these catalysts moves into reverse.

To maintain a negative view on emerging markets over the next couple of years assumes US hyperscaler's AI investment will decline meaningfully, the dollar strengthens significantly and the resilience of the US economy falters. While each are possible, the downside for developed market equities is arguably larger in such a scenario given there is no margin of safety in their equity valuations.

The Investment Case

The case for investing in emerging markets at this point in the cycle rests on four fundamental factors: the importance of new economy sectors as a market driver, faster earnings growth, a structural decline in the risk spread to developed markets, and increased attention to minority shareholder interests and returns on equity. This is in addition to the structural drivers of a rising middle class increasing consumption, higher penetration of financial services, and the renewable energy transition, including the electrification of everything. Taken together, the factors signal an attractive risk-versus-reward opportunity in emerging markets, even after taking into account recent gains.

7. Sources: MSCI, JP Morgan. Data as of April 2, 2026.
8. Defined as semiconductors, batteries, hydrocarbons, and solar panels.
9. Source: JP Morgan. Data as of April 2, 2026.

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