

Zooming In

Zooming In on the rising importance of emerging markets in the new world order

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Neha

Hi everyone! Welcome to a brand new episode of our CIO Zooming In series, where we discuss burning market and investor questions. Today's topic of discussion is the rising importance of emerging markets in investor portfolios, especially in the 'new world order' of heightened geopolitics. To discuss about emerging markets, today, I'm joined by Alastair Pinder, who is the head of EM and global equities at HSBC's Global Investment Research division. Alastair, a very warm welcome and thanks for joining us today.

Alastair

Thanks for having me Neha.

Neha

So Alastair, you mentioned in one of your recent research reports that 2025 was potentially a structural turning point for emerging markets' performance. What factors, in your view, brought about this turning point, and why do you expect EM earnings to outpace S&P 500 earnings in 2026? Is it because of the broadening AI trade and rising trade optimism?

Alastair

It's a really good question. And I think one of the reasons why we expect emerging markets to structurally do better right now is because the global growth backdrop is going to remain supportive for emerging market equities. Fiscal policy remains constructive. A range of measures should underpin global activity, including the One Big Beautiful Bill Act, which is likely to support US business investment and consumer spending. But it's not just in the US where we're seeing fiscal stimulus. Japan is pushing through 110 billion dollar fiscal package. China is also doing a 1.4 trillion debt package, and Germany is pushing through with their 150 billion dollar of government investment. Now, as you mentioned, the tariff headwinds should also ease this year. The average effective tariff rate rose by eight percentage points in 2025, but the drag on growth in 2026 should diminish. And that I think will be very positive for EM earnings. And in addition to all this backdrop, I think as you mentioned, the AI story is going to be really important in driving healthy earnings growth into 2026. AI should remain a really powerful driver, particularly in North Asia. EM offers some of the broadest exposure across the global AI supply chain. Mainland China hosts software and platform leaders, already benefiting from Deep Seek's momentum. 75% of global semiconductor manufacturing is based in Asia, and data center construction is accelerating across ASEAN and the GCC. The other thing, which I think can really drive stronger earnings this year for emerging markets is the fact that we're also seeing the commodity cycle improve. And again, that will have tailwinds for emerging markets in 2026.

Neha

In today's new world order of heightened geopolitics and greater policy uncertainty not all emerging markets are likely to find themselves on an equal footing. So, I wonder if this rising global fragmentation is likely to lead to a preference for safer EM countries? How does this new, complicated reality impact our overall positive view on EM?

Alastair

I think you've touched on one of the really important themes for emerging markets this year. And, just before we go into the details, it's worth highlighting that geopolitics has historically been a big headwind. Any kind of rise in uncertainty has put pressure on EM equity markets. But this year, actually, our argument is that the geopolitical shifts that we're seeing globally could actually start to benefit EM equities. So, if we take the Trump administration's geopolitical agenda, what we start to see is that it's playing an important role in driving different performance across EM equities. President Trump has also been pushing for a ceasefire in Ukraine,

and particularly in the CEE, we believe those kind of markets would benefit the most from a reconstruction effort or a normalisation in economic activity. However, again, there's caveats to this because a lot hinges on the structure of any deal.

Neha

So last year, policy divergence between emerging markets and developed markets played a key role in emerging markets' outperformance, as did the weakening of the US dollar. But if this year the Fed holds its rate cutting cycle and the dollar stabilises somewhat, or even strengthens, what implications is that likely to have on emerging assets' performance? Are they still likely to outperform in 2026, Alastair?

Alastair

Dollar angle Neha is really important. And a softer dollar is typically one of the most important prerequisites for EM equities to outperform. Now I do think a stable dollar is still an okay environment for EM equities. But a stronger dollar is quite challenging.

Neha

Data shows that most investors are under allocated to EM assets and over allocated to US assets because of their exposure to the global benchmark. This is leading to rising investor concerns over US assets' concentration risk. Do you expect to see greater allocations and flows going into emerging markets this year because of this concern?

Alastair

EM equities are heavily underowned. Despite their outperformance in 2025, foreign investors still pulled 35 billion dollars out from EM equities. However, we do see signs that the sentiment is starting to shift. Global funds, for example, have started to increase their allocation to emerging markets, albeit slowly. And it's quite interesting that global investors are looking to rotate into EM equities as they search for non US stocks tied to the AI theme. And perhaps, more importantly, though, is that it's not just the foreign investor that's important for EM equities, but there is also a big theme of the domestic investor also buying EM equities. And this is particularly true in Asia where Asia buys Asia. For example, in mainland China, individual investors are becoming a large force in the equity market. Chinese savers hold 23 trillion dollars in deposits, nearly 8 trillion dollars in excess savings, even a small portion of that being redirected into equities could generate a substantial multi-year liquidity boost. Even in India, despite the market underperforming lately, domestic investors have been directing nearly 3 billion dollars a month into the equity market.

Neha

After over a decade of underperformance, 2025 proved to be an inflection point for emerging markets when they outperformed their developed market counterparts. And we expect this trend to continue. Here's why. The macro economic backdrop for emerging markets remain supportive, aided by their strong growth and supportive fiscal and monetary policy regimes. Emerging market valuations remain attractive and structural market drivers like AI should boost earnings growth in emerging markets, especially across ASEAN and North Asia in 2026. Emerging markets offer one of the broadest exposures to the AI global supply chain. Data centers' construction is accelerating both in the GCC and ASEAN. As such, emerging markets now act as a diversifier to the US AI exposure in portfolios. A softer US dollar has already been aiding emerging markets' performance. And despite this outperformance that we have seen in 2025, emerging market equities still remain quite under owned by global investors. We therefore expect greater allocations to emerging market equities in 2026. Thank you, Alastair, for sharing your razor sharp insights on emerging markets with us today.