HSBC Private Bank

CIO Academy

Emerging Market Equities, Unbundled: Why investors should move beyond 'indiscriminate EM beta'

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Highlights: Emerging market equities are no longer a single, homogenous, portfolio building block that historically acted as a portfolio diversifier to developed markets. With around 45% of MSCI EM index comprising the technology sector, broad EM allocations can embed more "tech beta" than investors assume. The practical implication for multi-asset portfolios is straightforward: *indiscriminate exposure to EM equities beta* can deliver unintended concentration. For discerning investors, the right response to this new dynamic is to avoid relying on market-cap index to get exposure to EM equities. Instead, treat EM as a menu of distinct factors, thematics and macro exposures that can be tactically adjusted.

What's changed in EM equities and why it matters?

- **Concentration:** Returns are increasingly driven by a narrow set of large tech names (notably North Asian semis & memory at ~30% of the index). This can amplify swings and drawdowns.
- **Correlation**: Tech-heavy EM may act as a satellite expression of the global AI capex cycle, reducing diversification. As such market expectations & leverage matter as much as earnings.
- **Macro sensitivity**: Tighter financial conditions (yields/USD/liquidity) and geopolitics – collectively raise the hurdle rate for EM risk assets.

Portfolio implications: With the old EM equities playbook ageing, a new framework is needed:

a.) **Don't outsource portfolio construction to the index:**

- **Know what you own and attribute drivers**: split exposure into tech/AI hardware, commodities, financials, domestic demand.
- **Stress-test for**: USD strength, higher US yields, liquidity tightening and AI volatility.

b.) **Diversify within EM by factor and macro regime. Build a blend across:**

- AI ecosystem exposure (selectively sized) + real assets/commodity sensitivity + fundamentals-led markets with stronger policy credibility/external buffers.

c.) **Separate "growth" from "value traps":** Prefer markets where earnings durability is supported by credible policy frameworks, resilient external balances and domestic fundamentals, especially as global financial conditions tighten.

What do we like? Selective EM Asia AI/tech; EMs seeing cyclical recovery; Deep value plays with stronger fundamentals vs performance; Energy exporters vs importers that display *Energy and Resource resilience*.

From an ageing EM equities playbook: to a new investor framework

For years, an index allocation to EM equities earned its place in multi-asset portfolios for a simple reason: it didn't behave like developed markets. EM returns were driven more by domestic growth catch-up, commodity cycles, policy and FX regimes, and a broader set of country-specific outcomes—so EM often provided a distinct return stream versus DM equity risk, even if it came with higher volatility.

That logic is less reliable today. As EM benchmarks have become more concentrated and more dominated by tech and AI hardware supply chains, a broad EM exposure can end up behaving like a 'bundled factor trade' rather than a diversified 'EM growth' sleeve.

That's why we argue for unbundling the EM equities exposure: Investors need to treat it not as one allocation, but as a menu of exposures - from the AI ecosystem to commodities and terms-of-trade winners, to domestically-driven markets with stronger policy credibility - so portfolios can choose the drivers they want and avoid the ones they don't.

So, what's changed in EM and why it matters?

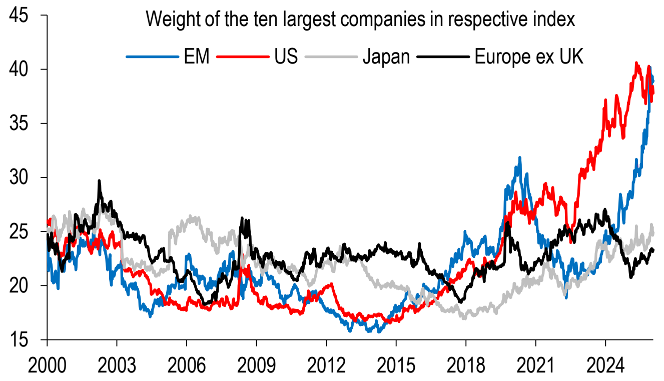
Historically, adding EM to a multi-asset portfolio often meant allocating to a broad, cap-weighted benchmark. The implicit assumption was that EM behaved as a diversified growth allocation, meaningfully distinct from the US and other developed markets.

Today, broad benchmark exposure can behave very differently:

1.) **Concentration risk is now a headline feature of MSCI EM index:** Performance has increasingly been driven by a small set of large technology names, particularly in North Asian semiconductor and memory chips producers, which together now account for close to 30% of the EM index, and only ~20% of EM constituents outperformed the benchmark over the past year*.

When leadership narrows, index outcomes become disproportionately sensitive to one theme and a handful of stocks—raising both drawdown risk and the probability of surprises versus client expectations. The old EM equities playbook is ageing. The index isn't the diversifier many investors expect.

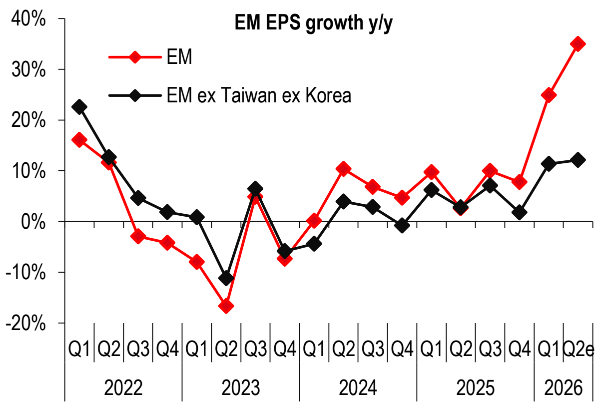
Like the US, EM index too now has a high concentration of technology companies



Source: FTSE Russell, Factset, HSBC Global Investment Research, HSBC Private Banking, August 2026.

2.) **Tech-heavy EM can correlate more closely with the global AI cycle**: As EM equity beta is increasingly shaped by semiconductors, memory and the AI capex cycle, EM can act less like a diversifier to US technology and more like a satellite expression of the same theme. As the next chart shows, just like the US, most of the YTD growth in earnings per share (EPS) in EM has been driven by a handful of tech companies in South Korea and Taiwan.

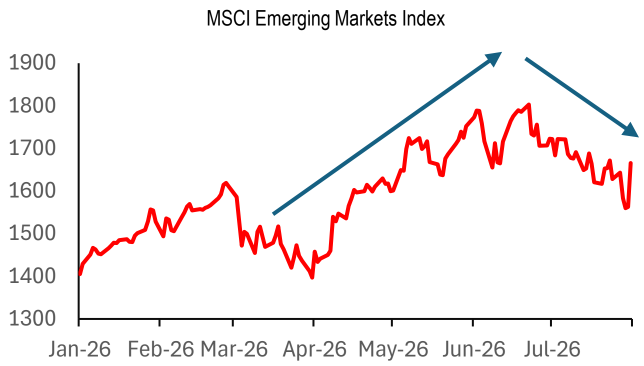
A handful of tech stocks has driven up most of the EPS growth in EM



Source: FTSE Russell, Factset, HSBC Global Investment Research, HSBC Private Banking, August 2026.

3.) **Expectations and leverage can matter as much as earnings**. Even when earnings are resilient, elevated positioning and leverage (including signs of rising margin debt in parts of EM Asia) can amplify volatility. In this environment, strong fundamentals may still disappoint if expectations have been priced to perfection or crowded trades unwind quickly.

Higher volatility – Sudden swings & rotations have become a new feature of EM



Source: Bloomberg, HSBC Private Banking, August 2026.

The bottom line: Index EM now = concentrated factor exposure

A broad EM index exposure may unintentionally concentrate equity risk in "AI hardware beta" and positioning sensitivity, rather than delivering the portfolio diversification many investors still associate with EM.

Furthermore, higher US yields, the possibility of a firmer USD, contracting global liquidity and continued geopolitical uncertainty - all lift the hurdle for EM assets.

EM can therefore move from preference for one factor to another i.e. *"AI hardware leadership"* → *"broader cyclicals"* → *"domestic recovery"* → *"commodity terms-of-trade*, often quickly, and sometimes without much warning.

This is why a portfolio that is only positioned for one EM factor (i.e. tech/AI) can become vulnerable to sentiment-driven swings or crowded positioning unwinds. All this calls for being more selective and more fundamentals led.

Therefore, a more useful framework is to treat EM as a menu of exposures (Not a single asset class)

If EM is no longer a 'diversified growth' bucket – different from the US, the portfolio question shifts from "*How much EM?*" to "*Which EM exposures—and what role do they play?* A practical way to "slice and dice" EM is through factor and macro-sensitivity lens that align with how EM markets increasingly behave:

a.) Selective EM Asia markets provide exposure to the AI ecosystem and strategic tech supply chains. Markets in EM Asia are not "generic growth" anymore. Each as its own characteristic and some offer specific exposure to the AI and semiconductor capex cycle, which can be powerful but cyclical. For instance, China offers exposure to AI ecosystem, including data centres, energy and advanced manufacturing; South Korea is a memory chips hub; Taiwan is home of foundry and advanced packaging - with parts of SE Asia participating via assembly/testing.

Risk to watch: When the market narrative shifts from "AI capacity build-out" to concerns over "monetisation and returns on AI capex," sentiment can turn quickly, triggering sudden rotations.

b.) Commodities, real assets and terms-of-trade sensitivity. Another way to "slice" EM is via commodities, metals and agricultural linkages. Brazil and Mexico offer commodity sensitivity. South Africa is another resources-linked market that benefits from exposure to gold and other commodities. This matters for multi-asset portfolios because commodity exporters and importers can behave very differently, especially in inflation shocks; USD strength/weakness regimes; supply disruptions; and global growth slowdowns / recoveries. Having selective exposure to some commodity producers like those in Latin America could therefore offer diversification benefits.

LATAM: Commodity earnings offset absence of AI exposure

Latin America's Key Drivers		
Commodity Earnings Offset Lack of AI exposure	**Valuation Discount Remains Supportive**	**Election Risks Loom**
Latin America's limited exposure to AI leaves commodities as the region's primary earnings driver. Higher oil prices have supported upward earnings revisions in 2026.	Latin American equities continue to trade at a wider-than-average discount to global peers. Historically, the region's current valuation discount remains supportive of attractive long-term returns.	Brazil's presidential election is currently the region's largest market catalyst. We expect political uncertainty and asset price volatility elevated through election.

Source: Bloomberg Intelligence, HSBC Private Bank, August 2026.

While the first two 'sleeves' look at EMs through the factor lens, the next two sleeves (decoded below) look at EMs through the macro sensitivity/thematic exposure lens that different emerging markets may or may not offer.

c.) Preference for energy exporters vs importers (from an Energy & Resource Resilience lens)

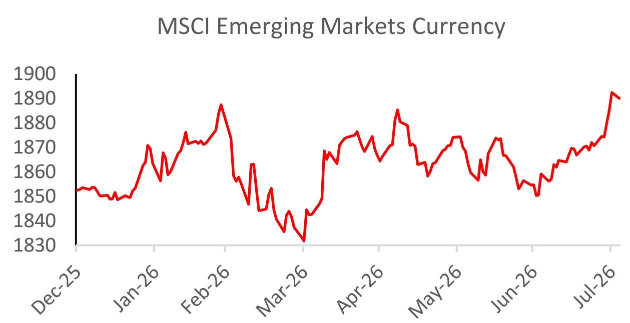
- Energy exporters are resilient to geopolitics induced energy shocks**:** They generally benefit from stronger terms of trade when energy prices rise, potentially supporting external balances and fiscal dynamics.

- Energy importers: on the other hand, generally, face inflation pressure and tighter policy constraints when energy prices rise.

d.) The macro hurdle has risen in 2026: Domestic fundamentals and global geopolitics are becoming increasingly important, especially for EM FX and capital flows. Low-yielding EM currencies and countries with weaker external balances tend to be more vulnerable when the USD strengthens. Furthermore, recent developments have shown how geopolitical developments can impact oil prices and put oil importers under pressure. As the below chart shows, a fall in oil prices normally boosts the EM currency complex, and vice versa.

India aptly illustrates this dynamic. It imports around 90% of its crude oil and is therefore exposed to geopolitical supply shocks and swings in oil prices. In the wake of the Middle East conflict and its impact on crude prices, in June 2026, India's CPI edged higher on rising food and fuel costs, while the trade deficit widened as the import bill increased. The rupee has also come under pressure amid weaker external balances and recent foreign investor outflows. Although the rupee has rebounded somewhat from its record low in May 2026 (after the RBI and Indian government introduced new measures to attract foreign capital), persistent oil volatility, rupee pressure, cautious external inflows, and higher domestic inflation are keeping investors cautious on Indian equities in the near term, even if their long-term prospects remain bright.

EM currency gauge rebounds amid oil drop



Source: Bloomberg, HSBC Global Private Bank, August 2026.

Portfolio implications: How to be more discerning about EM exposure

1.) **Don't outsource portfolio construction to the index**:

- **Know what you own**: Given the concentration risk, EM benchmarks can embed unintended bets. The goal is not to avoid EM—it is to own EM intentionally.
- **Understand the key drivers of your EM holdings**: how much is tech/AI hardware; how much is exposed to commodities; financials, domestic demand, etc.
- **Stress-test exposures** to all key parts of the current EM macro backdrop: a.) USD strength, b.) higher US yields, c.) global liquidity tightening, and d.) AI volatility

2.) **Diversify within EM by factor and macro regimes**:

Instead of one EM fund, consider a diversified EM blend that combines:

- **AI ecosystem exposure** - selectively sized, mindful of valuation/positioning/leverage.
- **Real asset / commodity sensitivity** - where it fits the portfolio's inflation/energy-resilience objectives.
- **Adopt fundamentals-led selectivity**: Prefer markets with stronger policy credibility and external buffers.

3.) Separate "growth" from "value traps": EM equities fundamentals should distinguish genuine earnings growth from value traps.

Emerging markets with credible policy frameworks, resilient external balances and stronger domestic fundamentals should fare well as global financial conditions tighten.

Where do we see opportunities in EM?

EM Asia's AI and tech trade: Notwithstanding the recent volatility, EM Asia's AI and tech trade remains a core opportunity and we stay constructive on the region's AI upcycle. We see the most compelling exposure in China's AI infrastructure and high-tech manufacturing, alongside selective opportunities in Chinese internet platforms.

South Korea looks more like a reset than a reversal. The recent sell-off appears to be the market working off excess froth after a rally that ran too far, too fast—amplified by a heavy build-up in retail leverage, particularly in 2x/3x leveraged single-stock ETFs. That said, the underlying drivers remain intact - semiconductor demand is holding up and memory supply remains tight, which should keep the chip-led momentum in place. The strong AI capex should provide a floor to memory and semiconductor stocks, just as excess retail leverage gets washed out.

Overall, we prefer a balanced, full stack AI exposure as the underlying demand drivers across AI models, compute, data, platforms and applications remains intact.

From here on, we see scope for broader EM earnings upgrades beyond the most crowded winners.

Beyond tech, we see three clear avenues for alpha:

- **Cyclical recovery plays:** If oil prices ease and growth concerns fade, performance could broaden into more cyclical parts of EM. While a hawkish Fed and a firmer USD limit EM central banks' ability to cut rates, the backdrop doesn't necessarily derail EM equities given still-supportive earnings momentum. Softer inflation prints could also reduce expectations for further rate hikes and provide additional support.

- **Deep value in laggards**: Select markets such as Brazil screen as deep value, having underperformed by more than fundamentals justify and trading at valuations that look excessively cheap. But domestic elections and the ensuing uncertainty led us to keep a neutral view on Brazil for now.

- **Energy exporters vs energy importers**: Energy exporters should benefit from stronger terms of trade when energy prices rise, potentially supporting external balances and fiscal dynamics. At the opposite end, energy importers face inflation pressures and tighter policy constraints when energy prices rise. Our high conviction theme on *Energy and Resource Resilience* aligns well with this approach and also works as a Tech hedge.

In essence - Selectivity over 'broad EM equities beta' is the new core message

Emerging markets still matter in multi-asset portfolios—but how you access them matters more than it did when EM could be treated as one broad beta trade.

Today, EM is best viewed as a "set of distinct building blocks": AI supply-chain exposure; commodity and terms-of-trade exposure; domestic reform stories; and markets differentiated by policy credibility and external resilience; and those which are more resilient to energy price shocks than others.

A portfolio that is only positioned for one EM factor (e.g., tech/AI) can become vulnerable to sudden sentiment-driven swings or crowded positioning unwinds.

Well informed, discerning investors will take cognisance of the new backdrop and move away from having an "*indiscriminate EM beta*" that worked in the past and lean towards a "*more selective EM playbook*"—especially in a world of tighter liquidity, a higher risk-free hurdle rate, a firmer USD regime, and elevated geopolitical uncertainty.

For investors, the objective is not to predict every rotation, but to build an EM allocation that is diversified across drivers - so the portfolio can participate in long-term growth while remaining resilient when one crowded theme goes out of favour.

We end this note with a simple "EM due diligence" checklist for investors (to consider when reviewing an EM allocation or their existing EM holdings):

1) How concentrated is my EM exposure? Remember, three stocks are ~30% of the EM index - so check your concentration.

2) What's the hidden factor exposure? Is this mostly AI hardware/tech momentum or is it broader?

3) How will it behave in a stronger USD / higher US yields regime? Stronger USD and higher US yields raise the hurdle; domestic fundamentals matter more.

4) Is positioning crowded or leveraged? As displayed by the rising margin debt in Korea recently, excessive retail leverage build-up leads to volatility and air pockets.

5) Is the "cheap" story real—or a value trap? Look for evidence of durable earnings drivers, not just low multiples.

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Sources Used:

* HSBC Global Investment Research reports, July 2026

Risk Disclosures

Risks of investment in fixed income

There are several key issues that one should consider before making an investment into fixed income. The risk specific to this type of investment may include, but are not limited to:

Credit risk

Investor is subject to the credit risk of the issuer. Investor is also subject to the credit risk of the government and/or the appointed trustee for debts that are guaranteed by the government.

Risks associated with high yield fixed income instruments

High yield fixed income instruments are typically rated below investment grade or are unrated and as such are often subject to a higher risk of issuer default. The net asset value of a high-yield bond fund may decline or be negatively affected if there is a default of any of the high yield bonds that it invests in or if interest rates change. The special features and risks of high-yield bond funds may also include the following:

- Capital growth risk - some high-yield bond funds may have fees and/ or dividends paid out of capital. As a result, the capital that the fund has available for investment in the future and capital growth may be reduced; and
- Dividend distributions - some high-yield bond funds may not distribute dividends, but instead reinvest the dividends into the fund or alternatively, the investment manager may have discretion on whether or not to make any distribution out of income and/ or capital of the fund. Also, a high distribution yield does not imply a positive or high return on the total investment.
- Vulnerability to economic cycles - during economic downturns such instruments may typically fall more in value than investment grade bonds as (i) investors become more risk averse and (ii) default risk rises.

Risks associated with subordinated debentures, perpetual debentures, and contingent convertible or bail-in debentures

- Subordinated debentures - subordinated debentures will bear higher risks than holders of senior debentures of the issuer due to a lower priority of claim in the event of the issuer's liquidation.
- Perpetual debentures - perpetual debentures often are callable, do not have maturity dates and are subordinated. Investors may incur reinvestment and subordination risks. Investors may lose all their invested principal in certain circumstances. Interest payments may be variable, deferred or cancelled. Investors may face uncertainties over when and how much they can receive such payments.
- Contingent convertible or bail-in debentures - Contingent convertible and bail-in debentures are hybrid debt-equity instruments that may be written off or converted to common stock on the occurrence of a trigger event. Contingent convertible debentures refer to debentures that contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event. These debentures generally absorb losses while the issuer remains a going concern (i.e. in advance of the point of non-viability). "Bail-in" generally refers to (a) contractual mechanisms (i.e. cotractual bail-in) under which debentures contain a clause requiring them to be written off or converted to common stock on the occurrence of a trigger event, or (b) statutory mechanisms (i.e. statutory bail-in) whereby a national resolution authority writes down or converts debentures under specified conditions to common stock. Bail-in debentures generally absorb losses at the point of non viability. These features can introduce notable risks to investors who may lose all their invested principal.

Contingent convertible securities (CoCos) or bail-in debentures are highly complex, high risk hybrid capital instruments with unusual loss-absorbency features written into their contractual terms.

Investors should note that their capital is at risk and they may lose some or all of their capital.

Changes in legislation and/or regulation

Changes in legislation and/or regulation could affect the performance, prices and mark-to-market valuation on the investment.

Nationalisation risk

The uncertainty as to the coupons and principal will be paid on schedule and/or that the risk on the ranking of the bond seniority would be compromised following nationalisation.

Reinvestment risk

A decline in interest rate would affect investors as coupons received and any return of principal may be reinvested at a lower rate. Changes in interest rate, volatility, credit spread, rating agencies actions, liquidity and market conditions may have a negative effect on the prices, mark-to-market valuations and your overall investment.

Risk disclosure on Dim Sum Bonds

Although sovereign bonds may be guaranteed by the China Central Government, investors should note that unless otherwise specified, other renminbi bonds will not be guaranteed by the China Central Government.

Renminbi bonds are settled in renminbi, changes in exchange rates may have an adverse effect on the value of that investment. You may not get back the same amount of Hong Kong Dollars upon maturity of the bond.

There may not be active secondary market available even if a renminbi bond is listed. Therefore, you need to face a certain degree of liquidity risk.

Renminbi is subject to foreign exchange control. Renminbi is not freely convertible in Hong Kong. Should the China Central Government tighten the control, the liquidity of renminbi or even renminbi bonds in Hong Kong will be affected and you may be exposed to higher liquidity risks. Investors should be prepared that you may need to hold a renminbi bond until maturity.

Alternative Investments

Hedge Fund - Please note Hedge Funds often engage in leveraging and other speculative investment practices that may increase the risk of investment loss. They can also be highly illiquid, are not required to provide periodic pricing or valuation information to investors, and may involve complex tax structures and delays in distributing important information. Alternative investments are often not subject to the same regulatory requirements as, say, mutual funds, and often charge high fees that may potentially offset trading profits when they occur.

Private Equity - Please note Private Equity is generally illiquid, involving long term investments that do not display the liquid or transparency characteristics often found in other investments (e.g.

Listed securities). It can take time for money to be invested (cash drag) and for investments to produce returns after initial losses.

Risks of investing in private markets

The value of investments and any income from them can go down as well as up and investors may not get back the

amount originally invested. Past performance information presented is not indicative of future performance. The return and costs may increase or decrease as a result of currency fluctuations.

- **Liquidity Risk -** Investors may be unable to dispose of an investment quickly and at a price that's closely related to recent similar transactions. There is no guarantee of distributions and no established secondary market.
- **Event Risk -** A significant event may cause a substantial decline in the market value of all securities.
- **Long-term Horizon -** Investors should expect to be locked-in for the full term of the investment, which is subject to extensions.
- **No Capital Protection -** Investors may lose the entirety of invested capital.
- **Unpredictable Cashflows -** Capital may be called and distributed at short notice.
- **Economic Conditions -** Ability to realise/divest from existing investments depends on market conditions and the regulatory environment.
- **Risk of Forfeiture -** Failure to make call payments could result in forfeiture of commitment, including invested capital, without compensation.
- **Default Risk -** in the event of default investors risk losing their entire remaining interest in the vehicle and may be subject to legal proceedings to recover unfunded commitments.
- **Reliance on Third-party Management Teams -** Underlying investments will be managed by various third-party management teams that will in aggregate determine the eventual returns for the investor.

The risk factors listed above are not exhaustive, always refer to product specific documentation for full details and risk disclosures.

Risk disclosure on Emerging Markets

Investment in emerging markets may involve certain, additional risks which may not be typically associated with investing in more established economies and/or securities markets. Such risks include (a) the risk of nationalisation or expropriation of assets; (b) economic and political uncertainty; (c) less liquidity in so far of securities markets; (d) fluctuations in currency exchange rate; (c) higher rates of inflation; (f) less oversight by a regulator of local securities market; (g) longer settlement periods in so far as securities transactions and (h) less stringent laws in so far the duties of company officers and protection of Investors.

Risk disclosure on FX Margin

The price fluctuation of FX could be substantial under certain market conditions and/or occurrence of certain events, news or developments and this could pose significant risk to the Customer.

Leveraged FX trading carry a high degree of risk and the Customer may suffer losses exceeding their initial margin funds. Market conditions may make it impossible to square/close-out FX contracts/options. Customers could face substantial margin calls and therefore liquidity problems if the relevant price of the currency goes against them.

The leverage of a product can work against you and losses can exceed those of a direct investment. If the market value of a portfolio falls by a certain amount, this could result in a situation where the value of collateral no longer covers all outstanding loan amounts. This means that investors might have to respond promptly to margin calls. If a portfolio's return is lower than its financing cost then leverage would reduce a portfolio's overall performance and even generate a negative return.

Currency risk – where product relates to other currencies

When an investment is denominated in a currency other than your local or reporting currency, changes in exchange rates may have a negative effect on your investment.

Chinese Yuan ("CNY") risks

There is a liquidity risk associated with CNY products, especially if such investments do not have an active secondary market and their prices have large bid/offer spreads.

CNY is currently not freely convertible and conversion of CNY through banks in Hong Kong and Singapore is subject to certain restrictions. CNY products are denominated and settled in CNY deliverable in Hong Kong and Singapore, which represents a market which is different from that of CNY deliverable in Mainland China.

There is a possibility of not receiving the full amount in CNY upon settlement, if the Bank is not able to obtain sufficient amount of CNY in a timely manner due to the exchange controls and restrictions applicable to the currency.

Illiquid markets/products

In the case of investments for which there is no recognised market,

it may be difficult for investors to sell their investments or to obtain reliable information about their value or the extent of the risk to which they are exposed.

Environmental, Social and Governance ("ESG") Customer Disclosure

In broad terms "ESG and sustainable investing" products include investment approaches or instruments which consider environmental, social, governance and/or other sustainability factors to varying degrees. Certain instruments we classify as ESG or sustainable investing products may be in the process of changing to deliver sustainability outcomes. There is no guarantee that ESG and Sustainable investing products will produce returns similar to those which don't have any ESG or sustainable characteristics. ESG and Sustainable investing products may diverge from traditional market benchmarks. In addition, there is no standard definition of, or measurement criteria for, ESG and Sustainable investing or the effect of ESG and Sustainable investing products. ESG and Sustainable investing and related measurement criteria are (a) highly subjective and (b) may vary significantly across and within sectors.

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An investment which is considered to fulfil sustainable criteria today may not meet those criteria at some point in the future. When we allocate an HSBC ESG and Sustainable Investing (SI) classification:

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