

## (Re)Emerging Markets: 10 Reasons for Optimism

Emerging markets are gaining momentum as global forces align, offering investors a fresh cycle of opportunity across debt, equity, and innovation.

Emerging-market (EM) equities and debt have been star performers year to date. The question is, can this continue? Investors evaluating EMs may be focused on recent weakness in the US dollar (USD) as the primary driver of outperformance vs. developed markets (DM). But we think it's important to look at a wider set of factors that may support EMs in the next 12-18 months. Drawing on insights from several of Wellington's EM specialists, including Gillian Edgeworth, Tyler Brown, and Bo Meunier, here are 10 things that we think investors should consider:

- 1. The global backdrop is (actually) good** — Global growth has, to date, been roughly consistent with its long-term trend. Inflation, while still above central-bank targets, has been steadily declining in developed countries since 2023. Recession fears have subsided, and we expect the global economy to remain resilient and potentially inflect upward in 2026 thanks to stronger fiscal stimulus. On the government-debt front, some countries have seen their balance sheets improve, but others have work to do to stabilize debt relative to GDP.
- 2. Tariffs remain a risk, but uncertainty has declined** — The US has struck trade deals with South Korea, the European Union, and Japan, among others. There are still many potential deals and deadlines to come, but the uncertainty has been reduced somewhat. As of this writing, the effective tariff rate seems likely to end up in the 15%–20% range—far higher than in the past, but below levels first discussed by the Trump administration in early April. The ultimate impact on different countries will vary greatly, depending on their specific tariff rate, volume of exports to the US, and the extent to which those exports can be directed elsewhere.
- 3. Central banks have scope to cut rates** — Weaker US employment data has increased the likelihood of rate cuts despite looming inflation. Federal Reserve rate cuts can pave the way for EM central banks to cut rates themselves, as there is less risk of capital flight or currency weakness that could spur domestic inflation. In addition, significant strengthening of EM currencies has helped curb EM inflation, giving many the room to cut rates.
- 4. There's reason for cautious optimism on China** — China remains the largest weight in the MSCI Emerging Markets Index,<sup>1</sup> at almost 30%. Since the country's real-estate bust, it has moved away from a property-centric economy to a more diversified one that embraces consumption, services, and innovation in areas such as electric vehicles, AI, robotics, high-end manufacturing, and green energy. Geopolitical tensions related to Taiwan and US trade dynamics continue to be risks, but we think practical considerations will prevail.

### Insight from sub-adviser Wellington Management



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### Key Points

- Emerging markets are benefiting from a favorable global backdrop, including easing inflation, resilient growth, and potential central-bank rate cuts.
- Structural shifts—such as China's economic pivot, India's improving outlook, and rising demand for commodities—are creating new opportunities across EMs.
- With light investor positioning, attractive valuations, and overlooked tech exposure, EMs may offer compelling potential for active managers.

5. **India's economy could be taking a turn for the better** — India is the third-largest weight in the MSCI Emerging Markets Index, and there are signs its economy is on track to improve into 2026. Inflation has declined sharply, enabling the central bank to cut rates significantly and further easing is likely. US tariffs are a concern, but the US market only accounts for roughly 2% of India's GDP, and the country may be able to soften the blow by diversifying exports to other destinations.
6. **The world needs commodities and critical minerals** — A generally positive economic backdrop could drive increased demand for commodities and critical minerals that will benefit a wide range of exporting EMs, such as Indonesia (palm oil), Peru (copper), South Africa (precious metals), and Ghana (cocoa and gold). While the ongoing reordering of global trade may be a challenge for EMs, it also provides an opportunity to diversify export markets.
7. **EMs can offer exposure to technology, too** — While investors tend to think of DMs for technology opportunities, and the US in particular, the tech sector represents 25% of the MSCI Emerging Markets Index. For those seeking more global technology exposure, there are many EM options.
8. **Politics have been moving in a more market-friendly direction** — Across many EM countries, there's been a shift toward the center (e.g., Ecuador, India, Argentina, Mexico), and upcoming elections may bring more of a shift to the right (e.g., Chile, Peru, Colombia, Brazil). This suggests the potential for more market-friendly solutions to some countries' challenges.
9. **The valuation gap is wider than usual** — EM equities typically trade at a discount relative to DM equities given the additional risks, but that gap is significantly wider than it has been over the past 20 years. Of course, valuations vary significantly by country, which creates opportunities for active investors.
10. **Investor positioning is light** — EMs have seen net outflows for several years, with investors preferring DM markets. This creates scope for rebalancing that could benefit EMs.

## And Yes, the USD Is a Consideration

The USD's primacy among reserve currencies faces several threats, including the US fiscal deficit, growth and inflation headwinds, and capital flows moving to other regions. We think we could see further weakening of the USD, which could provide an additional layer of returns for EM investors and may benefit EM economies with dollar-denominated debts.



The USD's dominance as a reserve currency is under pressure from fiscal deficits, economic headwinds, and global capital shifts.

## Investment Implications

- **EMs offer investors a potentially rich opportunity set** — Whether it's debt or equity, the EM universe includes a wide range of countries, policies, politics, industries, and styles, making it an attractive hunting ground for active managers. Moreover, Wellington's proprietary "efficiency framework" identifies EMs as among the least efficient, which implies further scope for active managers to add value. In addition, our intermediate capital-market assumptions (10-year horizon) assign EM equities the highest expected return potential within public-equity markets.<sup>2</sup>
- **High real yields and easier central-bank policies may be positives for EM debt investors** — Inflation is dropping in many countries, easing the path to rate cuts by central banks. In addition, current starting yields may be attractive from a carry<sup>3</sup> perspective. EM currencies and local debt markets could also rally in a scenario of lower oil prices and stable tariffs.
- **On the equity side, technology, domestic-oriented sectors, and Asia may be attractive** — In technology, hardware and IT companies may benefit from previous consolidation and structural demand from hyperscalers. Innovation is a theme in the healthcare sector, too, as drug discovery has often been quick and quality tends to be on par with Western companies. South Korean companies are also benefiting from improved corporate governance and more shareholder-friendly behavior. Elsewhere, worries about domestic and US politics have pushed valuations to favorable levels in Mexico and in Central and Eastern Europe, which may benefit from Europe's fiscal expansion.
- **Investors need to understand the risks** — Broadly speaking, EMs entail more risk than DMs. Key risks for EMs include higher-than-expected tariffs, a spike in oil prices, and the global impact of a stagflationary<sup>4</sup> US environment driven by trade tensions. A reversal in easy financial conditions currently supporting EMs would also pose a risk. Government spending and debt are ongoing issues for some EM countries that bear watching, particularly in Brazil.
- **Consider domestic companies/sectors that are less exposed to global challenges** — Export-oriented EMs may be affected by tariffs and trade restrictions. One way to potentially insulate investments from this risk is to focus on domestically focused EM companies that can benefit from cheaper input costs due to a weaker USD.

**To learn more about the potential benefits of investing in EMs,  
please talk to your financial professional.**

<sup>1</sup> MSCI Emerging Markets Index is a free float-adjusted market capitalization-weighted index that is designed to measure equity market performance in the global emerging markets.

<sup>2</sup> The analysis relies upon assumptions and other expectations of future outcomes, it is subject to numerous limitations and biases, including subjectivity. Assumptions do not consider transaction costs, management fees, or other expenses associated with actual investing. Actual results may differ significantly.

<sup>3</sup> Carry is the difference between the yield on a longer-maturity bond and the cost of borrowing.

<sup>4</sup> Stagflation is an economic cycle characterized by slow growth, inflation, and signs of labor market weakness.

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