Zuger Kantonalbank

Asset Spotlight

Equities

22 July 2026

Forgotten giants: the potential of emerging markets

Emerging markets stocks tend to be a sideline for many Swiss investors. This investment segment's performance has also been underwhelming in the past. In the 2010s, equities from developed markets generated significantly better returns than equities from emerging markets, which had moved more or less sideways. Even during and after the COVID pandemic, emerging markets performed rather poorly compared to other stock markets. The tide turned in mid-2025, however. Since then, emerging markets stocks have been outperforming even US technology stocks, which are ubiquitous in the media and can be found topping the rankings alongside the winners of the AI boom.

What is meant by "emerging markets"?

In a stock market context, the term emerging markets refers to countries whose economies and financial markets are not (yet) at the level of developed countries such as Switzerland or the USA. The classification and precise criteria used for grading stock markets are determined individually by index providers such as MSCI or FTSE Russell. Market participants generally follow these definitions. At MSCI, some factors considered in this classification include the degree of economic development, market capitalisation and liquidity on domestic stock exchanges as well as market access for international investors.

Although around half of the world's population lives in emerging markets and these nations account for around 40% of global economic output (measured in terms of nominal gross domestic product), emerging markets only account for roughly 12% of the global stock market.

Did you know?

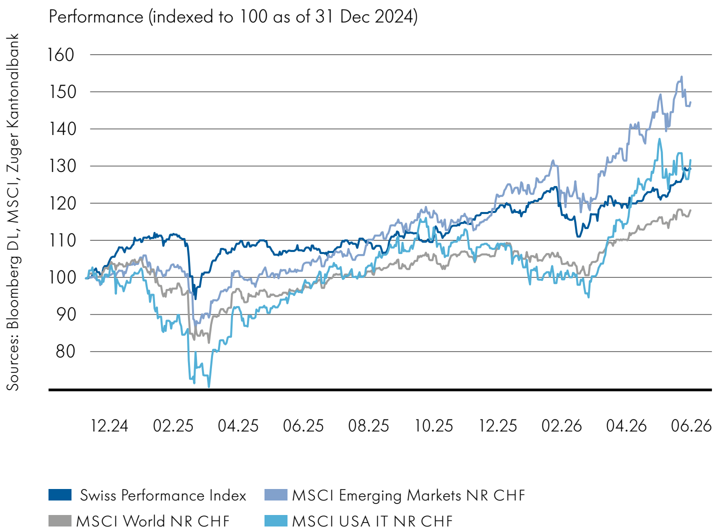
The term "emerging markets" was coined by the Dutch economist Antoine van Agtmael and originated from a marketing idea. The International Finance Corporation (IFC), a member of the World Bank, began to track performance in several local stock markets such as China, India, and Zimbabwe in the early 1980s. The IFC found that there were good reasons to invest in these stock markets, and planned to launch a "Third World Equity Fund". The name was cause for hesitation among potential investors, however: "Third World" sounded like poverty and despair. Van Agtmael suggested the term "Emerging Markets" instead, which stands for progress, uplift and dynamism. In the end, van Agtmael prevailed, and the term has become widely established.

In geographic terms, the weighting within the MSCI Emerging Markets Index is quite heavily concentrated in Asia. At the end of June 2026, Taiwan (27%) and South Korea (24%) accounted for around half of the index, followed by China (19%) and India (11%). In terms of sectors, information technology (45%) dominates and is followed by financials (18%) and consumer discretionary (7%). The high weighting of the information technology sector has caused the performance of emerging markets stocks to gain significant momentum in recent months. Companies such as semiconductor manufacturers TSMC and SK Hynix as well as the Samsung Electronics Corporation have benefited from an artificial intelligence investment boom, giving their profits a considerable boost. This trend is also reflected in their stock prices.

Favourable valuations despite skyrocketing prices

In Swiss francs, the MSCI Emerging Markets Index's performance (Chart 1) was at around 47% between the start of last year and the end of June 2026. By comparison, Swiss stocks (Swiss Performance Index) posted a return of 29% over the same period, while global stocks from industrialised nations (MSCI World) posted a return of 18%. US technology stocks (MSCI USA IT), which dominate media coverage, delivered a return of 32%.

Equity Index Performance Comparison



The fundamentals tell an interesting story: While stocks from developed nations had a price/earnings ratio (P/E) of 19.2 for the next 12 months as at the end of June, the P/E ratio for emerging markets was merely 11.7, despite the fact that stock prices in emerging markets have risen significantly in the past few months. From a valuation perspective, this speaks in favour of emerging markets – provided that the earnings growth expected by analysts actually materialises. For South Korea, the largest market in the index, analysts expect year-on-year earnings to increase by 300% in the current year; earnings growth is expected to reach 36% next year. The low P/E ratios are attributable to astronomically high growth rates.

South Korea as the driving force

While various emerging markets delivered positive market returns, the South Korean stock market outperformed all of them. South Korea's market boom began with one of the Republic's most dramatic political episodes of the past few decades. Then-President Yoon Suk-yeol imposed martial law at the end of 2024 in order to "eradicate pro-North Korean forces" and accused the country's largest opposition party of "anti-state activities". The manoeuvre failed, however, and Yoon was removed from office and impeached. This created a power vacuum that initially destabilised the Republic. The presidential elections of June 2025 proved to be a turning point, however: Lee Jae-myung, Chairman of the Democratic Party, won on a clear election platform that included pledges to reform corporate governance and alleviate the "Korea discount". The term "Korea discount" refers to the historical valuation gap between Korean stocks and their global counterparts, which was caused in part by weak corporate governance guidelines and latent tensions between North and South Korea, among other things.

Once in office, the new government made rapid progress. One of the changes was a new law restricting large shareholders' voting rights in elections of audit committee members as a means of weakening the structures giving disproportionate control to founding families in Korea. Another law eliminated a mechanism that had previously allowed owners of conglomerates to consolidate their control with minimal capital investment.

The measures have borne fruit. Many analysts then changed their view of Korea and gave the entire market a rating of "overweight". At the same time, large companies such as SK Hynix and Samsung Electronics also benefited from the AI and semiconductor supercycle. Yet despite all the positive facts and conditions, the risks posed by the South Korean stock market cannot be ignored: Its high stock concentration makes it highly volatile. The aforementioned technology giants – Samsung Electronics and SK Hynix – account for roughly half of the index. This duo is highly sensitive to the newsflow from overseas. On several occasions in recent weeks, the Korean equity index experienced daily declines in the high single digits whenever news or fears emerged in the US market that the AI boom might be losing steam.

"The winners in the AI supercycle are not just found in the US but also in emerging markets."

Mario Christen, Investment Advisor

Why Indian and Chinese stocks are currently lagging behind

Indian and Chinese stocks, which together with South Korea and Taiwan make up a large part of the Emerging Markets Index, have not posted any impressive returns in recent months, even despite the fact that Indian stocks delivered solid performance figures at the start of the decade. Historically, China equities have behaved quite similar to the broad Emerging Markets Index. This year, however, Index heavyweights, such as Tencent and Alibaba, are struggling with poor performance.

In the case of India, this is partly due to the US tariff policy announced by US President Donald Trump last year. Indian imports were among the hardest hit by those tariffs, which punished India for the country's continued purchases of sanctioned Russian oil exports. This weighed on the profit expectations of export-oriented companies and dampened investor sentiment. The Indian rupee is also undergoing a downward trend that is squeezing the returns of international investors. Added to that is the fact that real economic growth is slowing down, albeit at a significantly higher level than in industrialised nations. The outbreak of the war in Iran and the subsequent closure of the Strait of Hormuz exacerbated the growth problem and triggered short-term inflationary pressures. This put additional pressure on companies' margins. What's more, the valuation levels (both forward-looking and retrospective) of India's stock market were significantly higher than those of other emerging markets in the past. This discrepancy has lessened in recent months. Reducing the structural uncertainties should pave the way for India's stock market to regain momentum.

The Chinese stock market recovered relatively well from the initial Liberation Day shock, but lost momentum towards the end of the second half of the year. This was due, among other things, to declining investment and lending volumes. Households and private companies tended to pay off debt rather than take out new loans, resulting in a self-perpetuating cycle of economic weakness and the longest period of deflation since the 1990s. Domestic consumption continues to show signs of weakness. The stock market rally at the start of the second half of 2025 was largely driven by fiscal stimulus rather than fundamentals. Chinese companies are also seeing declining margins due to higher energy prices triggered by the closure of the Strait of Hormuz. The Chinese real estate sector, which has been a problem child for many years, also continues to be a source of investor concern. Chinese tech companies seem unable to benefit from the AI supercycle to the same extent as US companies or the Taiwanese and Korean stock markets. China's stock market is walking the line between a resilient export sector and a deteriorating domestic economy. If the demand side recovers, the Chinese stock market could pick up momentum again.

Emerging markets as a diversifier

As mentioned, the MSCI Emerging Markets Index's exposure to the technology sector is relatively high. Nevertheless, there is a positive diversification effect for investors when compared with stocks from developed markets. This speaks in favour of including emerging markets stocks in personal asset allocation. Over the last five years, the correlation between the performance of emerging markets stocks and stocks from developed nations (on a weekly basis) was only 0.6.

But diversification is not the only factor that speaks in favour of investing in emerging markets: Valuations are low and the expected earnings growth rates are high. While emerging markets have historically been highly dependent on various commodity prices, primary industry exposure has shifted towards other sectors, such as technology, in recent years. As a result, the winners of technological megatrends are no longer just to be found in the US stock markets, but also in emerging markets. And with all the hype surrounding the AI boom, investors should not forget that the emerging markets still have potential to expand more broadly if India and China regain their momentum. This should boost emerging markets stocks, even if the winners of the AI boom stagnate.

Geopolitical risks

Unlike investments in developed markets, investments in emerging markets stocks are usually associated with greater geopolitical uncertainty. Russia's attack on Ukraine in 2022 demonstrated this in exemplary fashion. Following the invasion of Ukraine in February 2022, the Russian equity index posted a loss of 33% in a single day. The Moscow Stock Exchange was temporarily closed. Russian stocks listed abroad also plummeted. For example, Russia's largest financial institution, Sberbank, lost almost 80% (in US dollars) of its market value at the end of February 2022, while the natural gas producer Gazprom dropped by over 60% (in US dollars). Index providers such as MSCI and FTSE Russell promptly excluded Russian stocks from their indexes on the grounds that the vast majority of stocks were no longer investable. In some cases, the stocks were traded as part of an illiquid side pocket spun off from existing investment vehicles, but in some cases also written off as worthless. For broadly diversified investors, the direct impact of these price collapses was manageable since the weighting of Russian stocks on the emerging markets index was only around 4% at the start of 2022. Nonetheless, this illustrates how quickly geopolitical risks can materialise and how important it is to keep a close eye on potential risk scenarios.

One theme that investors should keep on their radar is the tense situation between China and Taiwan. Tensions between the two countries have grown steadily in recent years. Ongoing military activities, debates on the development of Taiwan's defence capability and unresolved geopolitical differences are heightening uncertainty in the region.

Tensions between North Korea and the surrounding countries are also an omnipresent issue. North Korea conducts regular missile tests, which is cause for concern among its neighbours. The steady military buildup and hardened political fronts increase the potential for escalation on the Korean Peninsula.

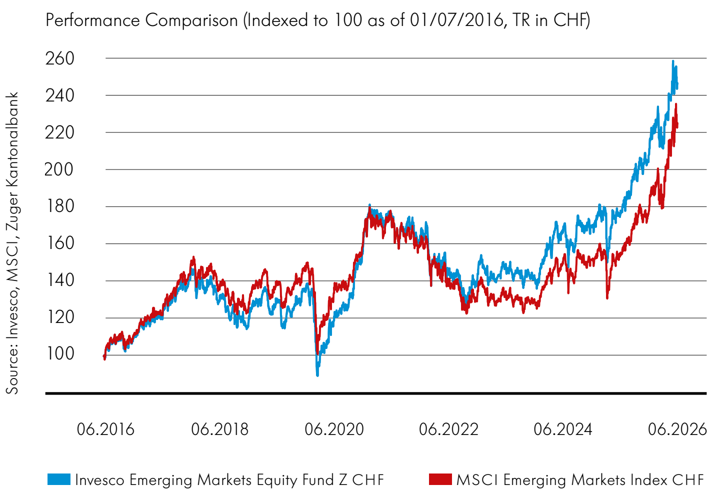
> “Active management can generate significant added value in less efficient markets, such as emerging markets.”
>
> Mario Christen, Investment Advisor

Our preference: active management in the emerging markets

The risks associated with investing in emerging market equities, as outlined in the previous sections, must be taken into account. These include the increased concentration of stocks and the resulting industry concentration as well as the prevailing political risks.

Coverage of the asset class with an active fund can help mitigate these risks. Through a reduced concentration of index heavyweights and continuous monitoring of geopolitical risks, an active manager can add value on a cost basis beyond a market cycle. While it is true that reduced concentration risks in individual stocks and sectors can cause an active fund to underperform the benchmark in a strongly sentiment-driven upward market, risk management generally pays off in a negative market phase – ideally resulting in long-term added value.

Performance Comparison: Invesco Emerging Markets Equity Fund Z vs. Benchmark



Our preferred solution, Invesco Emerging Markets Equity Fund, has significantly outperformed its benchmark index (net of fees) in the past (see Chart 2). The fund invests in undervalued companies with conservative, stable balance sheets. The portfolio manager’s goal is to monetise the discrepancy between the lower price and the higher value of a stock over a period of three to five years. With 50 to 70 stocks, the fund portfolio is relatively concentrated. Nevertheless, restrictions are defined as part of risk management to ensure that the active risk does not become too large relative to the benchmark index. For example, a stock may not be overweight or underweight by more than 4% relative to the benchmark index. The fund is significantly underweight in the two index heavyweights TSMC and SK Hynix, which reduces idiosyncratic risks at the portfolio level. While this can be detrimental to relative performance in phases of extreme upward trends, it should pay off over the market cycle. Invesco’s investment approach has proven its worth in the past: The fund outperformed its benchmark.

Our preferred active solution

Fund name	Invesco Emerging Markets Equity Fund Z
ISIN	LU3121069143
Fund assets	USD 3.5 billion
Total expense ratio	0.91% p.a.

Our preferred passive solution

Fund name	UBS Core MSCI EM ETF USD dis
ISIN	LU0480132876
Fund assets	USD 11.2 billion
Total expense ratio	0.15% p.a.

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