Insights
The strategic role of EM equities

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Executive summary

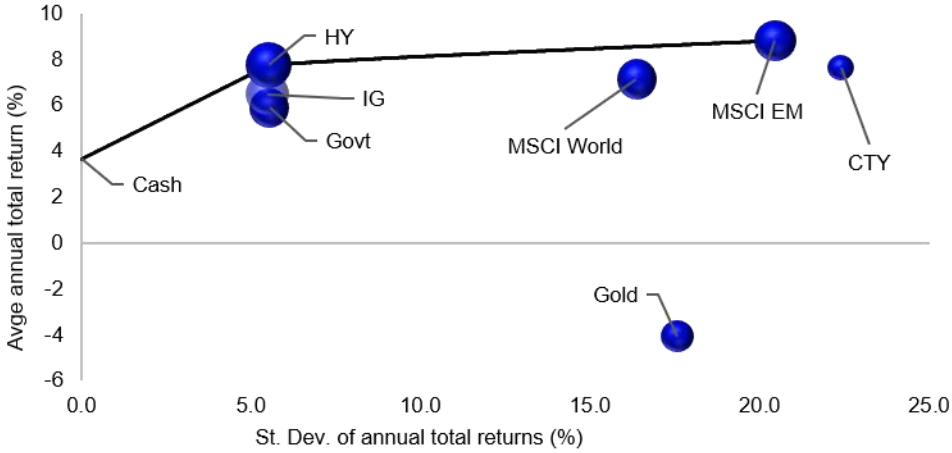
- EM equities have been a popular asset class since the 1980s, with strong performance over multiple decades.
- Performance in the last 10 years has been less impressive (though with a recent upturn), and the nature of EM indices has changed, with greater concentration, especially in technology stocks.
- However, valuation comparisons have improved. An optimisation analysis based Invesco's CMAs confirms that EM equities could play a strategic role in global multi-asset portfolios.
- If energy prices fall in 2027, we think the global cycle could strengthen. This has historically been associated with outperformance by EM equities, especially by EMEA, Lat Am and ex-China indices.

Emerging market equities have been popular since the 1980s and optimal allocations based on data since 1999 suggest an important role within global multi-asset portfolios. However, the nature of EM indices has changed, and post-Covid returns were disappointing (though with a recent upturn). Nevertheless, our forward looking analysis based on Invesco CMAs supports the conclusion that EM equities can play a strategic role. From a cyclical perspective, we think the global economy could strengthen in 2027 (if energy prices weaken), which history suggests could support EM equities.

Main conclusions:

- Emerging market (EM) equities have provided strong returns over the period since 1999 and would play an important role in optimal allocations based on that data (especially at the higher volatility end of the efficient frontier).
- However, performance in the immediate post-Covid years was disappointing. Despite the recent improvement, an optimisation analysis based on the last 10 years suggests no strategic role. Further, the nature of EM indices has changed, with greater concentration and a heavier weighting in technology.
- On the positive side, EM equities are now relatively attractive compared to US and global indices, which was not the case 10-20 years ago. Indeed, Invesco's 10-year CMA projections suggest that EM equity returns will be relatively attractive over the next decade (see Figure 1). Optimisations based on those CMAs suggest that EM equities could play an important role within global multi-asset portfolios, confirming the earlier conclusion derived from longer data histories.
- Correlation analysis suggests that EM equities have outperformed when cyclical indicators such as the US ISM Manufacturing index, the G20 leading index and commodity prices are improving (especially for EMEA, Lat Am and ex-China EM regions). On top of our strategic preference for EM equities, our view that the global economy could strengthen in 2027 also leads us to a tactical preference.

Figure 1 – Global total returns in USD based on Invesco 10-year CMAs



Notes: **Though based on the projected returns provided by Invesco Solutions, these optimal allocations do not represent their views, nor those of any other investment team at Invesco**. Based on Invesco's 10-year capital market assumptions (CMAs), as provided by Invesco Solutions, as of 30 September 2026 (see appendices for definitions, methodology and disclaimers). The chart shows the arithmetic average of total returns in US dollars, unless stated otherwise. The CMAs are based on the following indices: Citigroup 3-Month US Treasury Bill Index (Cash), Bloomberg Global Treasury Index (Govt), Bloomberg Global Aggregate Corporate Index (IG), Bloomberg Global High Yield Index (HY), S&P GSCI Precious Metals Index (Gold), S&P GSCI Index (CTY), MSCI World Index (MSCI World), MSCI Emerging Markets Index (MSCI EM). Size of bubbles is in proportion to the average pairwise correlation with other assets shown in the chart. Source: Bloomberg, Citigroup, MSCI, S&P GSCI, LSEG Datastream, Invesco Solutions and Invesco Strategy & Insights

Introduction

Emerging market (EM) equities has been a popular asset class since at least the 1980s. Common arguments in its favour are often centred on the possibility of higher returns than on other assets, including developed market equities, and diversification benefits. However, the asset class has gone through big changes over recent decades, including the emergence of China as a large part of any emerging market index and the more recent concentration in technology stocks. It also feels as though it is harder to gain diversification benefits than used to be the case. Is there still a case to be made for EM equities as a separate asset category (distinct from global equities), and, if so, how has its role evolved?

EM equities have offered higher returns than other global assets, but with higher volatility and elevated correlation

Figure 2 shows the results of a simple analysis based on data since 1999 that puts EM equities into a global multi-asset framework. A quick glance at Figure 2a suggests that EM equity returns have been higher than for the other assets in the study. That is encouraging, but those returns came with higher volatility and with elevated correlation to other assets (the size of the bubbles is in proportion to the average pairwise correlation with other assets). Hence, it is likely that EM equities would have played an important role in optimal portfolios (especially given that the asset class is on the efficient frontier), despite high volatility and correlation.

EM equities dominate optimal allocations at the more volatile end of the efficient frontier

Figure 2b confirms just that, **though the exercise was unconstrained and therefore impractical for investors that impose diversification**. EM equities dominate optimal allocations at the more volatile end of the efficient frontier but are not present in the low-to-mid volatility ranges. Cash, which is close to the other end of the efficient frontier, dominates allocations in the lower volatility areas, while gold dominates the mid-volatility segments (it is very close to the efficient frontier).

Have recent developments impacted how we should view EM equities?

That is all well and good, but a lot has changed 1999. Leaving aside EM equities for the moment, gold has gone from extreme lows to extreme highs (in real terms) and it will be interesting to see if it plays the same dominant role when different periods are used. China has emerged as the world's second largest economy and is now challenging the US, while India has more recently emerged as an economic force. At the same time, the world is going through a demographic deceleration, and some of the important members of EM equity indices are at the forefront of that (China and South Korea, for example). Finally, the composition of EM equity indices has changed massively, and it is not clear that the asset class still behaves the same way. All of this will be the subject matter of the coming sections.

Figure 2a – Global total returns in USD (1999-2025)

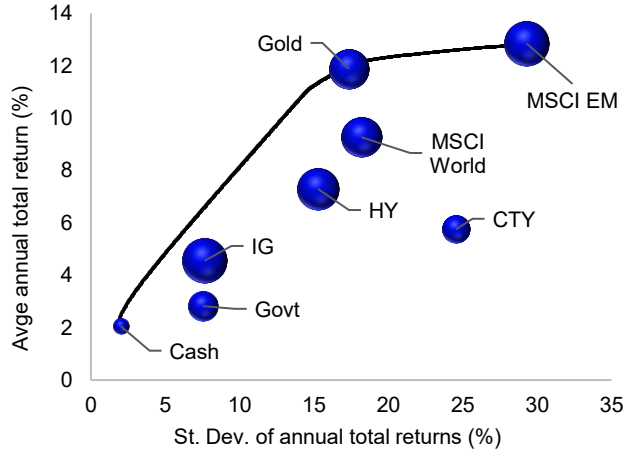
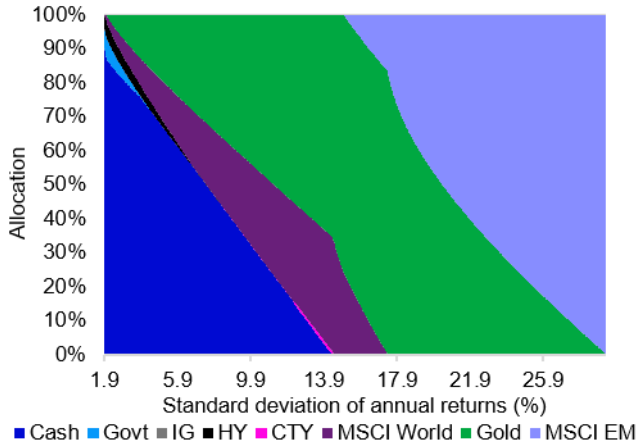


Figure 2b – Unconstrained optimal allocations along the efficient frontier (1999-2025)



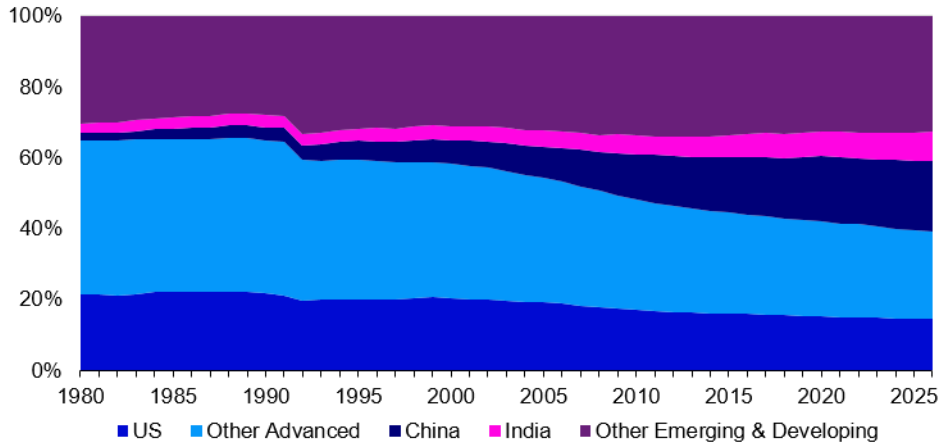
Notes: **Past performance is no guarantee of future results**. Figure 2a is based on calendar year data from 1999 to 2025 (as of 30 September 2026). It shows total returns in US dollars, unless stated otherwise. Calculated using spot price of gold, ICE BofA 0-3-month US treasury index (Cash), ICE BofA Global Government Index (Govt), ICE BofA Global Corporate Index (IG), ICE BofA Global HY Index (HY), S&P GSCI total return index for commodities (CTY), MSCI World Index (MSCI World) and MSCI Emerging Markets Index (MSCI EM). Size of bubbles is in proportion to the average pairwise correlation with the other assets. Figure 2b shows the unconstrained optimal allocations along the efficient frontier, based on the data in Figure 2a. Source: ICE BofA, MSCI, S&P GSCI, LSEG Datastream and Invesco Strategy & Insights

EM equities in a state of flux

Emerging economies are a bigger share of the world economy…

The economies of emerging countries have become more important within the global economy over recent decades (see Figure 3), with the gains due partly to a rising share of world population but mainly to a closure of GDP per capita gaps. Based on IMF data, EM economies had gone from 35% of the global economy in 1980 to 61% by 2025. The growth of the Chinese economy accounts for a large part of that, going from 2.1% to 19.6%, while India's economy went from 2.7% to 8.2%. The share of other emerging economies has been relatively stable, moving from 30.2% to 32.7%. Among developed economies, the share of the US within the global economy has fallen from 21.6% to 14.6%, while the share of other advanced economies has fallen from 43.4% to 24.8%.

Figure 3 – Share of global GDP (%)



Notes: Based on annual data from 1980 to 2026. Share of global economy is measured by the share of global GDP using purchasing power parity exchange rates to convert to US dollars. Source: IMF Global Economic Outlook October 2026, LSEG Datastream and Invesco Strategy & Insights

…as are emerging market equities within global markets

At the same time, emerging market equities have become more important within global markets (see Figure 4). Starting at 6.8% in January 1995, the share of emerging markets within global market capitalisation had risen to 22.5% by September 2026 (with a peak at 28.5% in January 2021, as the popularity of Chinese stocks peaked). That is based on MSCI indices, but our own calculations based on broader World Bank data, gives similar results, with the share of equity market capitalisation accounted for by low and middle income countries rising from 6.3% in 2003 to 23.3% by 2025 (China's share went from 1.6% to 11.0% and India's from 1.0% to 7.5%).

Figure 4 – EM equities as a share of global market capitalisation (%)



Notes: **Past performance is no guarantee of future results**. Based on monthly data from January 1995 to September 2026 (as of 30 September 2026). The chart shows the market capitalisation of MSCI Emerging Markets Index as a percent of the sum of the market capitalisations of the MSCI World and MSCI Emerging Markets indices. Source: MSCI, Bloomberg and Invesco Strategy & Insights

EM equity indices have also evolved

Just as emerging economies and stock markets have played a more important role within the global economy and global markets, the composition of emerging market indices has changed, suggesting that what investors own when they invest in emerging markets has evolved.

Focusing on the MSCI Emerging Markets Index, even the last 20 years has seen important changes in composition. For example, on 31 August 2006, the five largest national components of the MSCI Emerging Markets Index were South Korea (19.1%), Taiwan (13.8%), Brazil (11.5%), China (9.0%) and South Africa (8.9%). That suggests a mix of manufacturing and commodities were dominant.

Indices appear more concentrated in a few countries…

By 31 August 2026, the five largest markets were Taiwan (27.5%), South Korea (20.8%), China (16.9%), India (11.2%) and Brazil (3.9%). That suggests the index has become more concentrated, with the top five markets now accounting for more than 80% of the index versus 62% in 2006. Based on those country weighting changes, commodity producers now seem less important than they were, and technology seems to have become more important.

and technology now dominates…

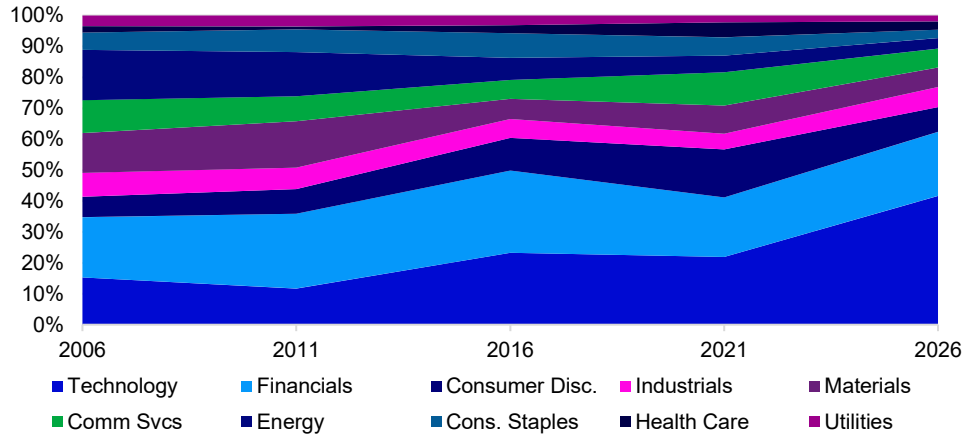
Indeed, Figure 5 shows how the technology sector has become more important, accounting for 41.6% of the index on 31 August 2026, versus less than 12% in August 2011 (a time when financials, materials and energy were the dominant sectors, with commodity related sectors benefitting from the commodity super-cycle of the first decade of this century). Financials remain important (20.7% of the index, as of 31 August 2026) but most other sectors have been squeezed by technology (commodity related sectors also suffered from the weakness of commodity prices as the super-cycle deflated).

which could reduce the diversification potential of EM indices

Hence, investing in emerging markets seems like a different proposition today than it was 20 or 30 years ago. In recent years, EM ex-China indices have become popular, ostensibly to reduce the dominance of China within portfolios (China accounted for 30% of the MSCI EM index at the end of 2020). The logic being that the Chinese market was so big, that it merited separate consideration. Perhaps the same logic could apply today to the technology sector. Although the dominance of technology stocks may render EM investing more compelling to many investors, it could also make EM indices less useful as diversifiers versus the US market, say.

Given the changing nature of emerging indices, it may be worth considering the use of data from shorter periods to test whether the conclusions shown in Figure 2 remain valid. This will be covered in the next section.

Figure 5 – The evolving sector composition of MSCI Emerging Markets Index



Notes: **Past performance is no guarantee of future results**. The chart shows the sector composition of the MSCI Emerging Markets Index at five points in time (31 August 2006, 31 August 2011, 31 August 2016, 31 August 2021 and 31 August 2026). As of 31 August 2026. "Consumer Disc." Is consumer discretionary, "Cons. Staples" is consumer staples, "Comm Svcs" is communication services.
Source: MSCI, Bloomberg, Invesco Strategy & Insights

Recent history is less supportive of EM equities

EM equity returns have been disappointing in the last 10 years

Figure 6a suggests that if we focus on the last 10 years, the performance of global assets is similar to that of the original period since 1999, in that EM equities have been more volatile than most other assets. However, despite the higher volatility, EM equity returns have been lower than for both gold and MSCI World.

Figure 6a splits the EM equity performance into MSCI China and MSCI EM ex-China, since the poor performance of Chinese equities was an important factor in depressing MSCI EM returns over 10 years (China was 21% of the MSCI EM index at end-August 2016). But, as can be seen, even MSCI EM ex-China returns were marginally lower than those of MSCI World and gold.

A repeat of those returns would suggest no role for EM equities in optimal allocations

Figure 6b shows that this translates into there being no role for either MSCI China or MSCI EM ex-China within optimal allocations along the efficient frontier. Those optimal allocations are split between MSCI World, gold, commodities and cash (**again the exercise was unconstrained and therefore impractical for investors that impose diversification)**.

It may seem odd that commodities (CTY) play a role in the optimal allocations despite generating lower returns than MSCI EM ex-China, with higher volatility. The answer to that conundrum is that commodities offered better diversification possibilities (lower correlation to other assets), as indicated by the small bubble. The same is also true for cash and gold. On the other hand, MSCI EM ex-China offered no particular advantage as a diversifier. MSCI China appears to have been a better diversifier, but the low returns count against it.

But there are reasons to doubt the last 10 years will provide a template for the future

So, does that imply we should ignore EM equities within global multi-asset portfolios? If we expect the last 10 years to be a guide to future asset returns, the answer would be yes. However, we think there are reasons to doubt the returns shown in Figure 6a will be repeated: first, the low fixed income returns were the result of a normalisation of yields that we think were artificially depressed 10 years ago (by central bank QE policies); second, we doubt that gold returns will continue to be so impressive (starting at a very low point in real terms at the turn of the century, gold's recent performance has exceeded long term returns); finally, just as Chinese equity returns have been depressed over the last 10 years, US equity returns have been exceptional and we expect a reversal of that comparison (based on valuations). Indeed, EM equity relative returns have improved since early 2025.

Figure 6a – Risk versus reward for global assets and the efficient frontier (2016-2026)

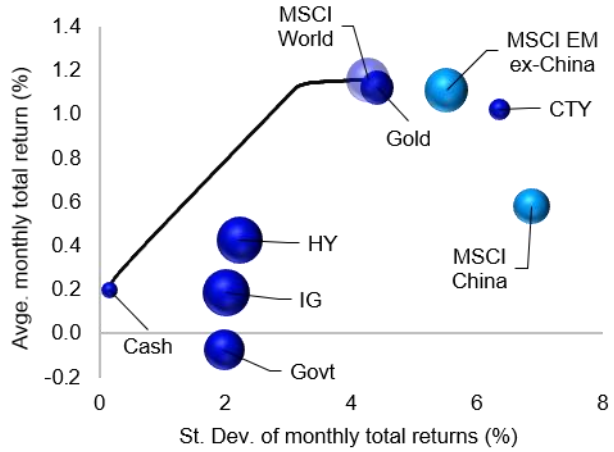
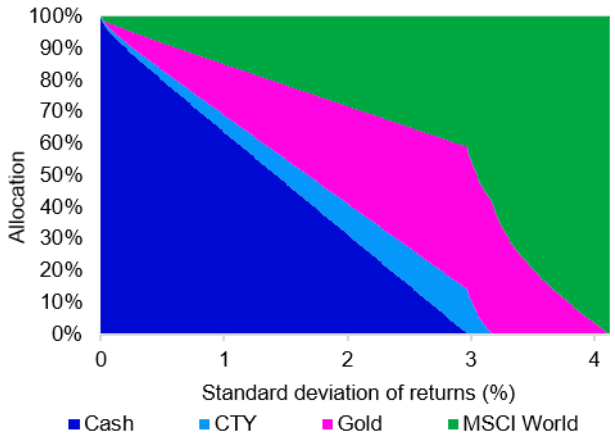


Figure 6b – Optimal allocations along the efficient frontier for global assets (2016-2026)



Notes: **Past performance is no guarantee of future results**. Figure 6a is based on monthly data from September 2016 to August 2026 (as of 31 August 2026). It shows total returns in US dollars, unless stated otherwise. Calculated using spot price of gold, ICE BofA 0-3-month US treasury index (Cash), ICE BofA Global Government Index (Govt), ICE BofA Global Corporate Index (IG), ICE BofA Global HY Index (HY), S&P GSCI total return index for commodities (CTY), MSCI World Index (MSCI World), MSCI China index (MSCI China) and MSCI Emerging Markets ex-China Index (MSCI EM ex-China). Size of bubbles is in proportion to average pairwise correlation with other assets in the chart. Figure 6b shows the unconstrained optimal allocations along the efficient frontier, based on the data in Figure 6a. It shows only those assets for which the allocations are non-zero. Source: ICE BofA, MSCI, S&P GSCI, Bloomberg, LSEG Datastream, Invesco Strategy & Insights

But valuations could favour EM equities over the medium-to-long term

Changes in valuations may have been an important factor in the underperformance of EM equities versus US and global indices over the last 10-15 years. Figure 7 shows that the cyclically adjusted PE ratios of China A share and emerging market indices have barely changed in the period since early 2013, based on Datastream indices (we use cyclically adjusted ratios to dampen the distorting effect of earnings cycles). Over that same period, the CAPE of the US market has more than doubled, which has also pulled up the global CAPE.

The underperformance of EM equities in recent decades was due in part to the divergence of valuations

In fact, an even bigger contrast is given if we go back to October 2007, when the China A CAPE was 91.4. That had fallen to 15.8 by the end of September 2026, and the Datastream China A index has fallen by 39% over the intervening period. Over the same period, the EM CAPE halved (from 38.1 to 19.1), and the Datastream Emerging Market index rose by only 12%. On the other hand, the US CAPE had risen from 29.9 in October 2007 to 45.2 in September 2026, and the Datastream US index had risen by 368%. Clearly, the difference in performance also reflects the divergence in earnings growth but valuations played a role.

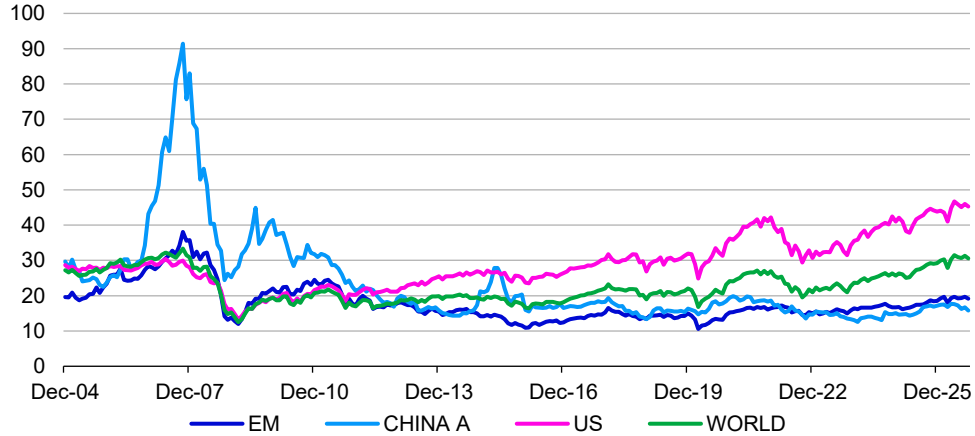
It is difficult to imagine that the Chinese market was ever so expensive or indeed that the EM CAPE was higher than that of the US (China accounted for about 16.2% of the MSCI EM index at that time). In fact, when the long period of US market outperformance started in early 2008 (based on MSCI USA versus MSCI World ex-USA), the US CAPE was lower than those of China, emerging markets, Japan and Europe ex-UK.

We doubt that will be repeated over the next 10 years, which encourages a more positive view on EM equities

Clearly, the valuation comparisons are no longer the same, which is one reason why we believe the last 10-15 years may be misleading when it comes to the future relative performance of emerging market equities. We doubt the US market will be as expensive in 10 years as it is today, which we think will dampen its performance (and that of global indices). Hence, we suspect the full data history shown in Figure 2 provides a better guide to future returns than just the last 10 years. This also applies to the fixed income returns that we think were distorted downward in the most recent period. This thought is developed in the section that uses Invesco's 10-year CMAs as a way of forecasting future returns.

Across EM regions, there is also an interesting divergence of valuations. The region with the lowest CAPE is Emerging Europe (12.6), followed by Latin America (14.6). Like China, those CAPEs are below historical norms (measured since December 2004), while that for Asia ex-Japan (22.0) is above its historical norm.

Figure 7 – Cyclically adjusted PE ratios



Notes: **Past performance is no guarantee of future results**. Based on monthly data from December 2004 to September 2026 (as of 30 September 2026). Cyclically adjusted PE ratios compare price to a 10-year moving average of earnings per share. They are based on Datastream Market indices. "EM" is emerging markets. Source: LSEG Datastream and Invesco Strategy & Insights

EM equities feature in optimal allocations based on Invesco CMAs

One way to allow for the above factors is to use Invesco's forward looking capital market assumptions to forecast returns over the next 10 years. These CMAs are based partly on current valuations and therefore allow for the sort of valuation discrepancies mentioned above, along with consideration of other factors including potential currency returns and future earnings growth (in the case of equity assets). Figure 8a shows the resultant returns (Appendix 4 shows the data for a more complete set of assets, along with the indices upon which these returns are based).

Invesco's 10-year CMAs suggest EM equities will produce the highest returns among the assets we consider

Importantly, those CMAs suggest that EM equities will produce the highest returns among the assets shown in Figure 8a, though it is also presumed it will be among the most volatile (and most correlated to other assets). Compared to Figure 2a, the most notable difference is the negative return expected on gold (we have used the CMA projections for precious metals as a proxy for gold). After a long period of strong returns, the presumption is that gold/precious metals are now expensive. The other notable change is the higher returns now expected on cash, government bonds and investment grade credit (now that yields have normalised upward).

Not surprisingly, they also play an important role within optimal allocations (at the more volatile end of efficient frontier)

The resultant efficient frontier runs from cash to the MSCI EM asset class, passing near to HY. The optimal allocations along that efficient frontier are shown in Figure 8b. EM equities now play an important role in optimal allocations at the upper end of the volatility spectrum (**accepting that the exercise was unconstrained and therefore impractical for investors that impose diversification**). That is a similar outcome to when the full set of historical returns from 1999 were used (Figure 2b) but is different to the outcome based on more recent data (Figure 6b).

Cash dominates the allocations at the low-volatility end of the efficient frontier, while HY dominates the mid-volatility section. Both IG and government bonds appear fleetingly (at the low-volatility end) but not enough to be visible. Not surprisingly, gold no longer features in the optimal allocations, whereas it was very important when using historical returns. Finally, the low correlation of commodities with other assets is not enough to overcome the assumed high volatility.

In conclusion, though recent history suggests that EM equities should play no role in optimal allocations, Invesco's 10-year CMAs give a more constructive outcome.

Figure 8a – Global total returns in USD based on Invesco 10-year CMAs

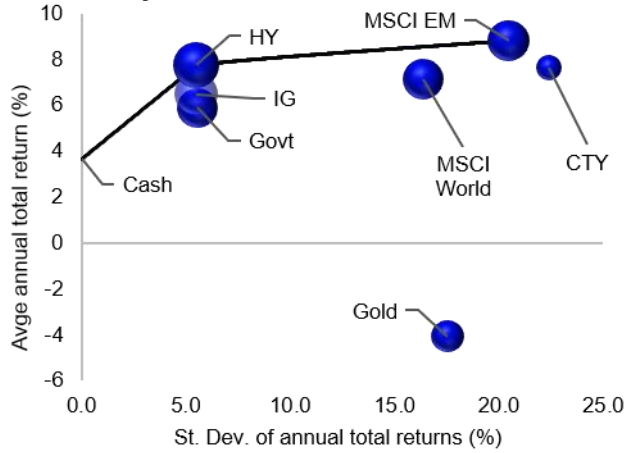
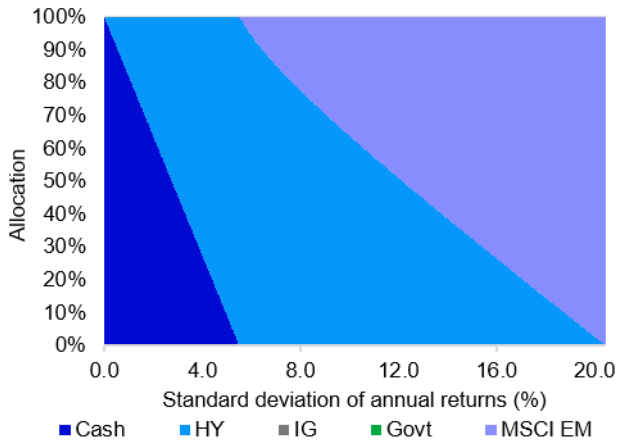


Figure 8b – Unconstrained optimal allocations along the efficient frontier using Invesco CMAs



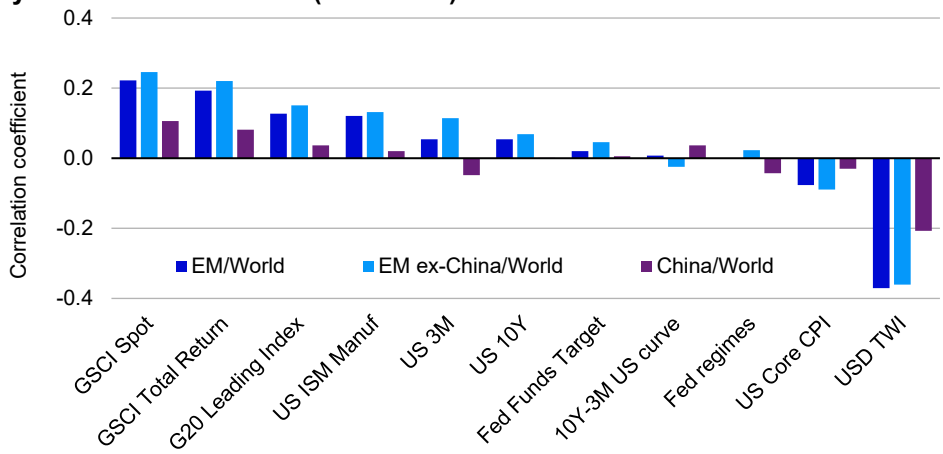
Notes: **Though based on the projected returns provided by Invesco Solutions, these optimal allocations do not represent their views, nor those of any other investment team at Invesco**. Figure 8a is based on Invesco's 10-year capital market assumptions CMAs), as provided by Invesco Solutions, as of 30 September 2026 (see appendices for definitions, methodology and disclaimers). The chart shows the arithmetic average of total returns in US dollars, unless stated otherwise. The CMAs are based on the following indices: Citigroup 3-Month US Treasury Bill Index (Cash), Bloomberg Global Treasury Index (Govt), Bloomberg Global Aggregate Corporate Index (IG), Bloomberg Global High Yield Index (HY), S&P GSCI Precious Metals Index (Gold), S&P GSCI Index (CTY), MSCI World Index (MSCI World), MSCI Emerging Markets Index (MSCI EM). Size of bubbles is in proportion to the average pairwise correlation with other assets shown in the chart. Figure 8b shows the unconstrained optimal allocations along the efficient frontier, based on the data shown in Figure 8a (only assets with non-zero weightings are shown). Source: Bloomberg, Citigroup, MSCI, S&P GSCI, LSEG Datastream, Invesco Solutions and Invesco Strategy & Insights

Relative EM equity performance has been negatively correlated to USD, but that may be a feature of the index construction

Tactical considerations: cyclical and financial drivers of EM equities

It is tempting to believe that the performance of emerging market equities is driven by global economic and financial cycles (in particular those of the US). Figure 9 shows the correlation between the relative performance of EM stocks and a range of economic and financial indicators. The clearest correlation appears to be with the US dollar (USD TWI), though that negative correlation may be biased by the fact that the US market dominates MSCI World, so that when the dollar weakens it benefits emerging market indices relative to MSCI World.

Figure 9 – Correlation between relative performance of MSCI EM indices and cyclical/financial drivers (1999-2026)



Notes: **Past performance is no guarantee of future results**. Based on correlations between monthly changes from January 1999 to August 2026, using total return MSCI indices in US dollars (MSCI EM indices are divided by the MSCI World index to give a measure of relative performance). "EM" is emerging markets. The drivers are ranked by the "EM/World" correlation coefficient. See appendices for definitions, methodology and disclaimers. As of 30 September 2026.
Source: MSCI, Bloomberg, LSEG Datastream and Invesco Strategy & Insights

Otherwise, the clearest correlations appear to be with commodity prices, the G20 leading index and the US ISM Manufacturing index (all with positive correlations). Figure 10 shows the correlations for a broader range of EM indices and indicates their statistical significance (blue is statistically significant, pink is not).

Figure 10 – Correlation between relative performance of MSCI EM indices and cyclical/financial drivers

	MSCI EM/ World	MSCI EM Asia/World	MSCI EM EMEA/World	MSCI EM Lat Am/World	MSCI EM ex-China/World	MSCI China/World
GSCI Total Return	0.19	0.07	0.33	0.32	0.22	0.08
GSCI Spot	0.22	0.09	0.35	0.33	0.25	0.11
USD TWI	-0.37	-0.29	-0.32	-0.30	-0.36	-0.21
US 3M	0.05	0.00	0.13	0.14	0.11	-0.05
US 10Y	0.05	0.03	0.08	0.11	0.07	0.00
US ISM Manuf	0.12	0.09	0.11	0.14	0.13	0.02
US Core CPI	-0.08	-0.08	-0.05	0.07	-0.09	-0.03
G20 Leading Index	0.13	0.09	0.13	0.18	0.15	0.04
Fed Funds Target	0.02	-0.04	0.09	0.12	0.05	0.01
10Y-3M US curve	0.01	0.02	-0.02	-0.01	-0.02	0.04
Fed regimes	0.00	-0.04	0.04	0.08	0.02	-0.04

Note: **Past performance is no guarantee of future results**. Based on correlations between monthly changes from January 1999 to August 2026, using total return MSCI indices in US dollars (MSCI EM indices are divided by the MSCI World index to give a measure of relative performance). "EM" is emerging markets. The colour coding relates to the statistical significance of the correlation coefficients (blue suggests significantly different from zero, pink suggests not significantly different from zero, assuming a two-tailed distribution, at the 95% confidence level). See appendices for definitions, methodology and disclaimers. As of 30 September 2026.
Source: MSCI, Bloomberg, LSEG Datastream and Invesco Strategy & Insights

Cyclical indicators such as the US ISM, G20 leading index and commodity prices seem to be positively correlated with EM relative performance (especially in the EMEA, Lat Am and ex-China regions)

Figure 10 suggests that commodity prices have an important relationship with EM equities. Not surprisingly (given the commodity endowments involved), MSCI EMEA and Lat Am appear to be the biggest EM beneficiaries of rising commodity prices (the three largest markets in the EMEA index are South Africa, Saudi Arabia and the United Arab Emirates, as of 30 September 2026). Though the correlations are not as strong, the same conclusions apply to the G20 leading index and US ISM Manufacturing index (they are positive for all regions but statistically insignificant for Asia and China). The EMEA, Lat Am and ex-China regions seem to be most correlated to the global cycle. On the other hand, apart from the dollar, the financial drivers appear to lack statistical significance in the majority of cases.

Financial drivers are not significantly correlated to ongoing EM performance, but elevated US interest rates and USD have been associated with future strong relative returns

However, when we look at predictive power, rather than contemporaneous correlations, there appears to be more of a role for financial variables. Figure 11 shows the correlation between the level of cyclical and financial drivers and the relative return on EM equity indices over the following 24 months. Some results may seem counterintuitive. For example, future EM equity performance appears to be positively correlated with the US 10-year yield, the Fed Funds Target rate, the US 3-month yield and the US dollar. One explanation could be that when rates, yields and the dollar are high, the future direction is more likely to be downward, which may benefit EM assets.

Elevated cyclical drivers have tended to be associated with poor future EM returns

Cyclical drivers (spot commodity prices, US ISM Manufacturing, G20 leading index), appear to be negatively correlated with future relative EM equity returns. Perhaps the stronger the global economy (and the more mature the cycle), the greater the risk of future downturn.

Across regions, it seems the most consistent relationships (judging by the statistical significance of correlations) are found in the EMEA region, while the least reliable correlations are found in Latin America (except commodities) and China.

In summary, EM equity indices have tended to outperform when USD weakens, and when commodity prices, leading indicators and US ISMs are strengthening. However, absolute strength in those cyclical indicators or a weak USD/low US interest rates have been signs of future underperformance.

Figure 11 – Correlation between two-year ahead relative performance of MSCI EM indices and cyclical/financial drivers

	MSCI EM/ World	MSCI EM Asia/World	MSCI EM EMEA/World	MSCI EM Lat Am/World	MSCI EM ex-China/World	MSCI China/World
GSCI Total Return	0.31	0.37	0.15	0.27	0.23	0.50
GSCI Spot	-0.54	-0.36	-0.67	-0.53	-0.58	-0.16
USD TWI	0.15	0.09	0.21	0.10	0.23	-0.09
US 3M	0.35	0.34	0.24	0.24	0.32	0.24
US 10Y	0.60	0.50	0.58	0.47	0.55	0.35
US ISM Manuf	-0.35	-0.43	-0.33	-0.03	-0.37	-0.13
US Core CPI	-0.12	-0.09	-0.15	-0.09	-0.08	-0.13
G20 Leading Index	-0.14	-0.15	-0.20	0.01	-0.21	0.04
Fed Funds Target	0.36	0.35	0.24	0.24	0.33	0.23
10Y-3M US curve	0.08	0.00	0.24	0.13	0.08	0.00
Fed regimes	-0.18	-0.21	-0.25	-0.04	-0.23	0.01

Note: **Past performance is no guarantee of future results**. Based on correlations between the level of cyclical and financial drivers and the returns over the following 24 months on MSCI EM indices relative to MSCI World, from December 1998 to August 2026, using total return MSCI indices in US dollars (MSCI EM indices are divided by the MSCI World index to give a measure of relative performance). "EM" is emerging markets. The colour coding relates to the statistical significance of the correlation coefficients (blue suggests significantly different from zero, pink suggests not significantly different from zero, assuming a two-tailed distribution, at the 95% confidence level). See appendices for definitions, methodology and disclaimers. As of 30 September 2026.
Source: MSCI, Bloomberg, LSEG Datastream and Invesco Strategy & Insights

The above analysis, and our view that energy prices could fall in 2027, leads us to continue favouring emerging market equities within a global multi-asset framework

Conclusions

Using data since the start of this century suggests that EM equities have outperformed other global assets and would feature among optimal allocations along the efficient frontier based on those historical returns.

But EM investing has changed in recent decades. EM equity indices have become more concentrated in a limited number of markets, with China at one stage accounting for 30% of the MSCI EM index, while Taiwan is now approaching that level (the five biggest markets now account for more than 80% of the index).

The sector composition has also changed, with technology now accounting for more than 40% of the MSCI EM index. That may be viewed positively, but it also suggests that EM indices offer less diversification versus a tech-heavy US market.

Even worse, data from the last 10 years shows that poor Chinese market performance has dampened EM returns (despite the upturn in recent years). Even if we focus on EM ex-China markets, there would be no role for EM equities within a diversified global framework, based on optimal allocations along the efficient frontier generated from those 10 years of data.

However, we have reason to believe that the last 10 years will not be repeated, largely because of valuation considerations (with China less expensive than usual and the US close to historical peaks, when using cyclically adjusted PE ratios). Indeed, Invesco's 10-year CMAs support that notion, with EM equity returns predicted to be the highest among the global assets considered in this document. This brings us full circle to the conclusion that EM equities could play a strategic role in global multi-asset portfolios.

Considering shorter term cyclical influences, EM equities seem to outperform global equities when indicators such as the US ISM Manufacturing index, the G20 leading index and commodity prices are rising (the EMEA, Lat Am and ex-China regions appear to be more cyclical than Asia). However, there can be too much of a good thing: when those cyclical indicators reach elevated levels, future EM relative performance has tended to be negative (presumably because the cyclical indicators then decline).

Interestingly, though financial drivers are not significantly correlated to ongoing EM equity performance, elevated levels of US interest rates and the US dollar have been associated with future outperformance by EM equities, with statistical significance (we presume because those interest rates and the dollar fall from those elevated levels).

We believe the global economy remains in expansion mode, despite the challenges presented during 2025 and 2026. We also expect energy prices to decline during 2027, as energy flows improve and shipping costs fall (as Middle East tensions eventually ease). That leads us to believe that cyclical indicators could actually improve in 2027, which is why we continue to favour EM equities within a global multi-asset framework (though energy producers outside the Middle East may suffer).

Appendices: Definitions, methodology and disclaimers

Appendix 1: Correlation with cyclical/financial drivers' analysis

Correlations are calculated between the performance of several emerging market indices (relative to MSCI World) and various potential cyclical and financial drivers.

The emerging market indices are based on MSCI total return indices in US dollars and are as follows:

- MSCI EM/World (or EM/World) is the MSCI Emerging Markets Index divided by the MSCI World Index.
- MSCI EM Asia/World is the MSCI Emerging Markets Asia Index divided by the MSCI World Index.
- MSCI EM EMEA/World is the MSCI Emerging Markets EMEA Index divided by the MSCI World Index.
- MSCI EM Lat Am/World is the MSCI Emerging Markets Latin American Index divided by the MSCI World Index.
- MSCI EM ex-China/World (or EM ex-China/World) is the MSCI Emerging Markets ex China Index divided by the MSCI World Index.
- MSCI China/World (or China/World) is the MSCI China Index divided by the MSCI World Index.

The cyclical and financial drivers are:

- GSCI Total Return is the S&P GSCI Commodity Total Return Index.
- GSCI Spot is the S&P GSCI Commodity Index (using the price of futures contracts but not rolling returns or collateral yield).
- US ISM Manuf. is the US ISM Manufacturing Index.
- G20 Leading Index or G20 Leading Indicator is the amplitude adjusted leading indicator provided by the OECD.
- US 3M and US 10Y and are the 3-month and 10-year US treasury yields.
- 10Y-3M US curve is the difference between the 10-year and 3-month US treasury yields.
- Fed Funds Target is the upper end of the target range set by the US Federal Reserve Bank for its policy interest rate (the Federal Funds rate).
- Fed regimes is a variable designed to indicate whether the Fed is tightening or easing (the score is +1 in periods when the Fed is raising its policy rate, -1 when it is cutting interest rates and 0 in the periods between tightening and easing cycles).
- USD TWI is the Trade Weighted Index of the US dollar (calculated by Goldman Sachs).

The monthly changes used are in percent form, except for interest rates, yields and spreads, which are in the form of basis point changes.

Appendix 2: Efficient frontier

The efficient frontier is the set of optimal portfolios that offer the highest expected return for a defined level of risk or the lowest risk for a given level of expected return.

Appendix 3: Invesco Solutions Capital Market Assumptions methodology and proxy indices (Figures1, 8a, 8b and Appendix 4)

We show a summary of the Capital Market Assumptions produced by Invesco's Solutions team (Solutions) and this is a summary of their methodology.

Invesco Solutions employ a fundamentally based "building block" approach to estimating asset class returns. Estimates for income and capital gain components of returns for each asset class are informed by fundamental and historical data. Components are then combined to establish estimated returns. This is a summary of key elements of the methodology used to produce long-term (10-year) estimates.

Fixed income returns are composed of the average of the starting (initial) yield and expected yield for bonds, estimated changes in valuation given changes in the Treasury yield curve, roll return which reflects the impact on the price of bonds that are held over time, and a credit adjustment which estimates the potential impact on returns from credit rating downgrades and defaults.

Equity returns are composed of: a dividend yield, calculated using dividend per share divided by price per share, buyback yield, calculated as the percentage change in shares outstanding resulting from companies buying back or issuing shares, valuation change, the expected change in value given the current Price/Earnings (P/E) ratio and the assumption of reversion to the long-term average P/E ratio, and the estimated growth of earnings based on the long-term average real GDP per capita and inflation.

Alternative returns are composed of a variety of public versus private assets with heterogenous drivers of return given their distinct nature. They range from a beta driven proxy to public markets or a bottom up, building block methodology like that of fixed income or equities, depending on whether they are more bond like or stock like.

Risk estimates, including individual volatilities, cross-asset correlations, and the covariance matrix, for the different asset classes displayed are derived using the MSCI Barra Multi-Asset Class (MAC) factor model. Please refer to the MSCI MAC methodology for more information about the model.

For the full Capital Market Assumptions methodology, please contact the Solutions team.

The Capital Market Assumptions returns shown in Figures 1 and 8a are based on the following indices:

- Cash: Citigroup 3-Month US Treasury Bill Index
- Global Government Bonds: Bloomberg Global Treasury Index
- Global Investment Grade: Bloomberg Global Aggregate Corporate Index
- Global High Yield: Bloomberg Global High Yield Index
- Gold: S&P GSCI Precious Metals Index
- Commodities: S&P GSCI Index
- Global Equities: MSCI World Index
- Emerging Market Equities: MSCI Emerging Markets Index

Appendix 4: Invesco 10-year Capital Market Assumptions (USD version)

	Asset Class	Index	Expected geometric return %	Expected arithmetic return %	Expected Risk %	Arithmetic return to risk ratio
Fixed income	US cash	Citi 3 Month Tbill	3.6	3.6	0.0	36378.69
	US tsy	Bloomberg US Treasury	5.6	5.8	5.9	0.99
	US Treasury Long	BBG US Treasury Long	6.7	7.4	12.1	0.61
	US TIPS	BBG US TIPS	5.7	5.8	5.7	1.02
	US Bank Loans	Credit Suisse Leverage Loan Index	7.2	7.5	7.6	0.98
	US Aggregate	BBG US Aggregate	5.9	6.1	6.1	1.00
	US Inv Grd Corps	BBG US Investment Grade	6.4	6.6	7.7	0.86
	US MBS	BBG US MBS	6.5	6.7	6.6	1.00
	US High-Yield Corps	BBG US High Yield	7.2	7.6	9.4	0.81
	US Muni	BOA ML US Muni	5.6	5.8	6.9	0.84
	US HY Muni	BBG US Muni Bond HY	6.4	6.8	8.3	0.81
	Global Aggregate	BBG Global Aggregate	5.4	5.7	7.5	0.76
	Global Treasury	BBG Global Treasuries	5.5	5.9	9.0	0.66
	Global Inv Grd	BBG Global Corporate Inv Grd	6.1	6.5	8.4	0.77
	Eurozone Corporate	BBG Euro Aggregate Credit - Corporate	5.9	6.8	13.8	0.49
	Eurozone Treasury	BBG Euro Aggregate Government - Treasury	6.5	7.3	13.2	0.55
	EM Aggregate	BBG EM Aggregate	6.6	7.3	13.0	0.56
	China RMB Credit	BBG China Corporate	5.7	5.8	3.3	1.76
Equities	World Equity	MSCI World	5.9	7.1	16.3	0.44
	World Ex-US Equity	MSCI World Ex-US	7.9	9.5	18.4	0.51
	US Broad	S&P 1500	5.2	6.6	17.3	0.38
	US Large Cap	S&P 500	5.1	6.3	16.6	0.38
	US Mid Cap	S&P 400	8.3	9.9	19.2	0.52
	US Small Cap	S&P 600	5.2	7.5	22.6	0.33
	MSCI Europe	MSCI Europe	8.2	9.8	18.6	0.53
	Eurozone	MSCI Euro X UK	8.1	9.8	19.6	0.50
	Canada	S&P TSX	6.4	8.2	19.9	0.41
	Japan	MSCI JP	8.5	10.6	22.0	0.48
	Emerging Market	MSCI EM	6.2	8.8	24.3	0.36
	Asia Pacific Ex JP	MSCI APXJ	7.1	9.7	24.4	0.40
	China equity	MSCI China	8.5	10.9	23.6	0.46
Alternatives	Hedge Funds	HFRI HF Index	5.4	5.8	8.4	0.69
	Commodities	S&P GSCI	5.1	7.6	23.9	0.32
	Agriculture	S&P GSCI Agriculture	4.3	6.3	20.8	0.30
	Energy	S&P GSCI Energy	7.4	13.1	37.5	0.35
	Industrial Metals	S&P GSCI Industrial Metals	2.3	4.9	23.5	0.21
	Precious Metals	S&P GSCI Precious Metals	-5.8	-4.1	18.5	-0.22

Notes: Estimates as of 30 September 2026, as published in Long-Term Capital Market Assumptions (October 2025). These estimates reflect the views of Invesco Solutions; the views of other investment teams at Invesco may differ from those presented here. Please note that as of March 31, 2025, Invesco Solutions have changed the methodology of their risk model for estimating volatility and correlations, now utilizing the MSCI Barra Multi-Asset Class (MAC) factor model. **There is no guarantee that these views will come to pass.** TIPS = treasury inflation protected securities, MBS = mortgage-backed securities.
Source: Invesco Solutions

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Important information

Data as of 30 September 2026 unless stated otherwise.

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