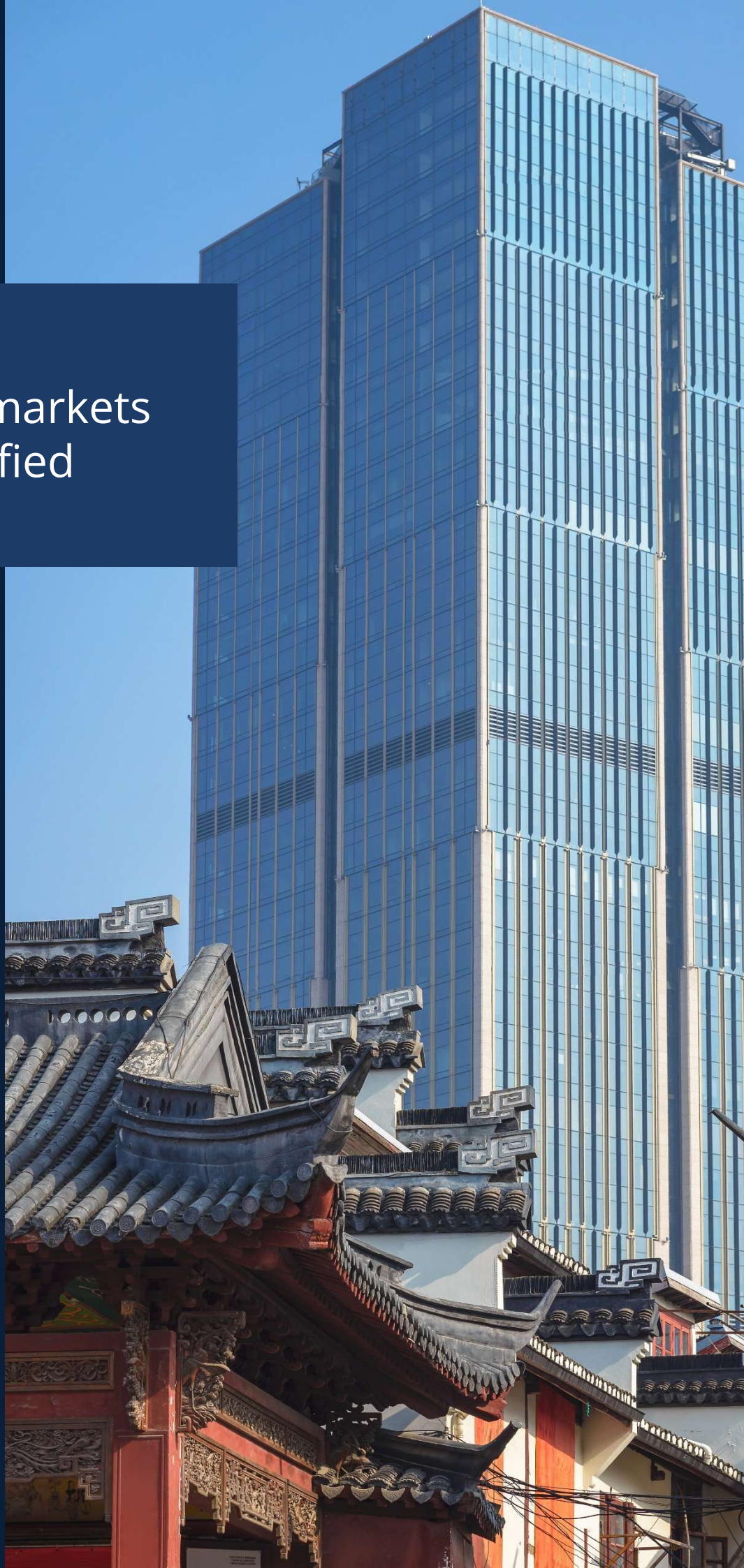


The role of
emerging markets
in a diversified
portfolio



Introduction

One of the core tenets of our investment policy is to diversify portfolios by investing across a range of asset classes, providing clients with exposure to areas such as equities, bonds and alternative assets (e.g. commodities, infrastructure and private equity).

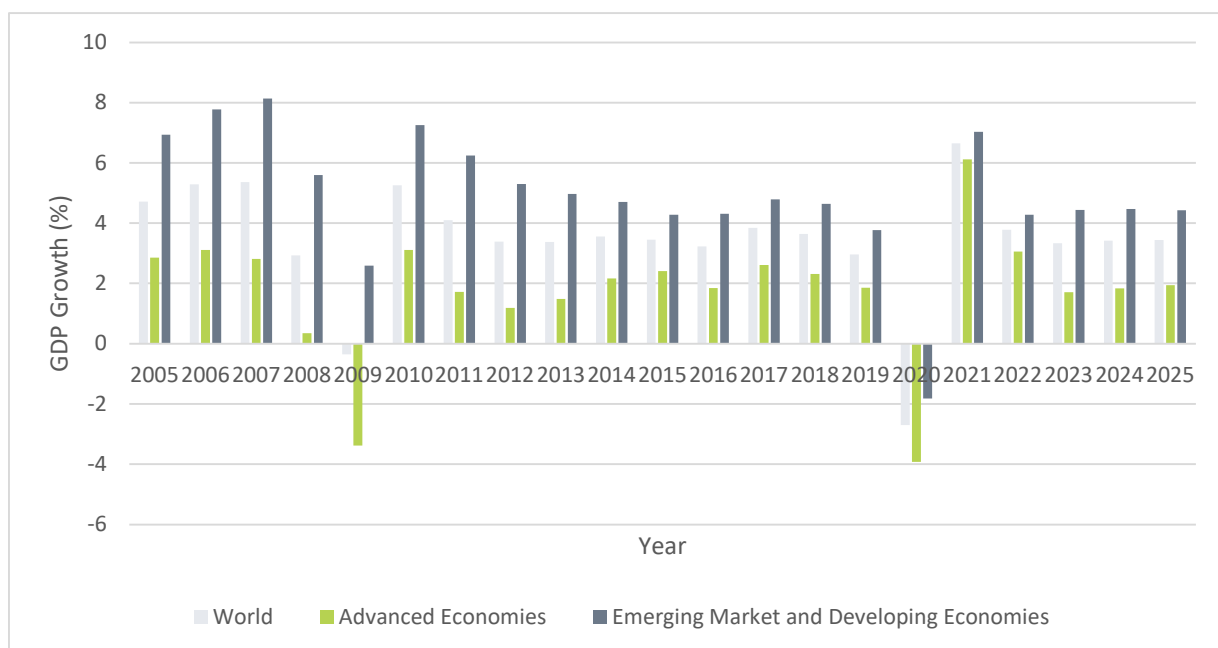
In this report, we focus on one particular area of the equity market – ‘Emerging Markets’ – and discuss the potential benefits and risks associated with investing in this asset class, along with some rationale for the inclusion of this exposure in Barratt & Cooke portfolios.

What are emerging markets?

While there are a number of definitions for the term ‘emerging markets’, an emerging market economy is often defined as an economy that is in the process of moving towards becoming a developed economy with higher standards of living. This is a broad definition that includes an array of economies, ranging from larger nations such as China and South Korea, to comparatively much smaller economies in regions such as Latin America and sub-Saharan Africa.

In practice, these economies are often characterised by:

- **High Gross Domestic Product (GDP) growth:** Because emerging market economies are typically smaller, their annual GDP growth is usually higher than larger economies. This is illustrated in the chart below, where we see that over the last twenty years, year-on-year GDP growth in emerging market and developing economies has consistently exceeded that of advanced economies:



Source: International Monetary Fund

While it is important to acknowledge that in the past, there have been concerns around the accuracy of GDP data from China (a key emerging market), we do also see this trend reflected across other key metrics, such as shipping data.

- **Higher volumes of international trade:** Emerging market economies typically conduct a higher volume of international trade than larger peers, which in turn leads to...
- **Export-led growth:** Compared to their developed market counterparts, emerging market economies typically see more of their economic growth derived from exporting goods and services to foreign trading partners.

To help illustrate this, we can refer to the below table showing the export-to-GDP ratios (i.e. how much of a country's GDP is attributable to its exports) for a handful of major emerging market economies:

Exports of goods and services (% of GDP) (2024)	
Brazil	17.9%
China	20.4%
India	22.1%
Indonesia	22.3%
Mexico	37.3%
Singapore	174.7%

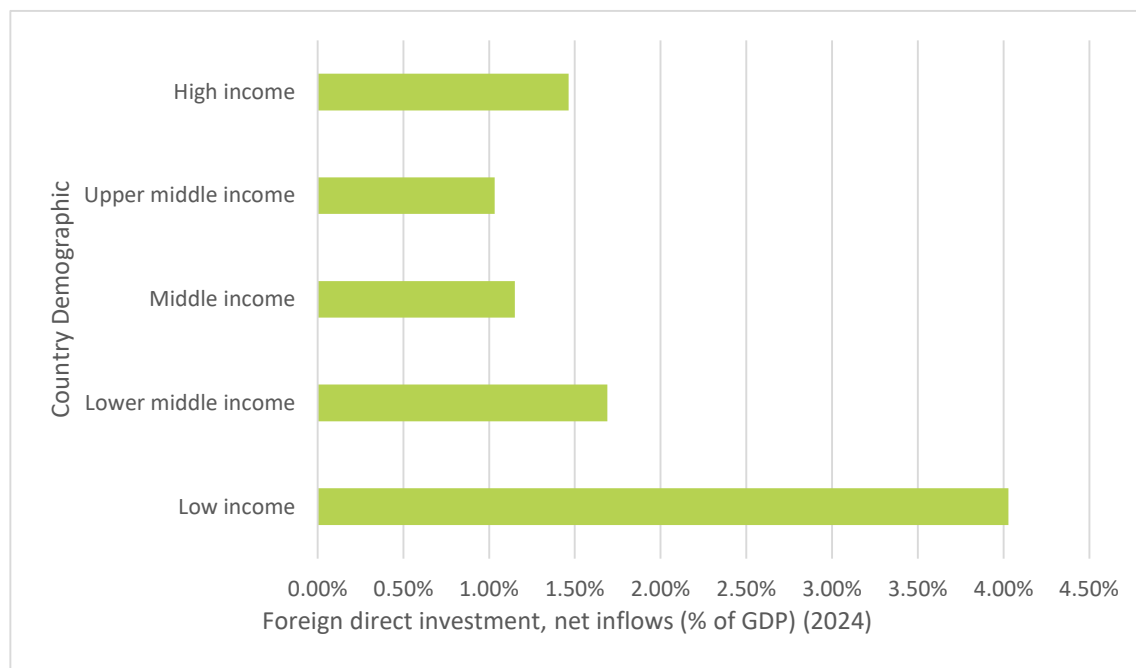
Source: World Bank Group

Singapore acts as an interesting case in point from the list above, as here, sales revenues generated through exports exceed the value of domestic production captured by GDP, resulting in exports accounting for over 100% of GDP. This is reflective of factors such as Singapore's geographic positioning as an international shipping hub and its small domestic consumer base, features which are common across many smaller developing nations.

When we compare the above with data for more developed countries (such as the USA, with exports accounting for approximately 11.0% of GDP), we find that emerging market economies typically see a higher percentage of their GDP accounted for by exports.

- **Higher foreign direct investment:** Emerging market economies typically benefit from a higher volume of capital from foreign investors being injected into domestic businesses.

This is illustrated in the chart below, where we see that lower income countries received a higher proportion of foreign direct investment than wealthier counterparts in 2024:



Source: World Bank Group

Benefits of investing in emerging markets

Diversification

When investing for the long-term, one of our core areas of focus is ensuring that portfolios are sufficiently diversified across asset classes, sectors and geographies. This provides clients with exposure to a range of attractive opportunities for generating returns, while mitigating specific risks associated with certain areas of the market.

With this in mind, a core advantage of investing in emerging markets is that it acts as an effective diversifier within the equity sphere. To help illustrate this, the matrix below shows the correlation coefficient (ranging from 0, indicating no correlation, to 1, indicating a perfect correlation) on 1-year returns (up to 28th August 2026) across the FTSE Emerging Markets Index and other global equity market indices:

	FTSE 100	FTSE 250	S&P 500	EuroStoxx 50
FTSE Emerging Markets	0.30	0.46	0.42	0.51
FTSE 100	1.00	0.72	0.37	0.73
FTSE 250	0.72	1.00	0.52	0.78
S&P 500	0.37	0.52	1.00	0.58
EuroStoxx 50	0.73	0.78	0.58	1.00

Source: Iress

If we look down this matrix column by column, we generally see that the return on the FTSE Emerging Markets Index exhibits a relatively low correlation with large-cap indices, compared to the correlation between the large-cap indices (for example, the FTSE 100 and EuroStoxx 50, with a correlation coefficient of 0.73). As the returns on the emerging markets index demonstrate little correlation with the returns on large-cap equity indices, we would expect returns not to be closely aligned over the long term and emerging markets to therefore act as a 'ballast' in more volatile periods for large cap indices (i.e. a sharp fall in the FTSE 100 would not necessarily translate to a sharp fall in the FTSE Emerging Markets Index, meaning exposure to the latter could be positive for portfolio returns in a negative environment for more developed markets).

High growth potential

While emerging market and developing economies clearly come in different 'shapes and sizes' as we have highlighted above, companies operating in emerging markets are typically characterised as being smaller than their large-cap counterparts. Because these companies are at more of an infant stage of their growth, we would expect the growth opportunities associated with these companies to be greater.

To help illustrate this, consider the table on the following page showing the largest three constituents in the equity indices highlighted above (as at 31st August 2026):

This table shows the 5-year average reported 'Return on Equity' for these companies, a key growth metric showing the net income generated by a company as a proportion of its net value, providing an indication of how effectively a company uses equity to generate profits. Of course, these numbers are somewhat skewed by the outperformance of the Artificial Intelligence (AI)-exposed names in recent years (for example, Nvidia and Apple). However, when comparing the return on equity over the last year of the names in the FTSE Emerging Index with larger-cap, non-AI focused names such as Shell, HSBC and SAP, these numbers suggest that the younger, more growth-focused names in the FTSE Emerging Index are more effective in using shareholders' capital to generate growing profits than their larger, 'steadier' peers.

	Largest 3 constituents	5-year average return on equity
FTSE E/M	TSMC	32.3%
	Tencent Holdings	22.5%
	Alibaba Group Holding	9.1%
FTSE 100	HSBC Holdings	11.1%
	Shell	13.0%
	AstraZeneca	13.0%
FTSE 250	Balfour Beatty	-0.2%
	easyJet	17.0%
	WPP	9.2%
S&P 500	Nvidia	75.0%
	Apple	164.7%
	Microsoft	38.1%
EuroStoxx 50	ASML	55.3%
	Siemens	14.7%
	SAP	11.8%

Source: Iress

Access to underrepresented sectors

Investing in companies based in emerging market and developing economies also allows investors to gain exposure to sectors that are less well represented in larger-cap indices.

Indeed, as Wim-Hein Pals and Jan de Bruijn outline in their Robeco article '*Three emerging markets trends for the next decade*', asset-light areas of the market such as fintech, digital payments processing and e-commerce are arguably easier to access in emerging markets. This is because dynamics such as younger populations, support from governments and less established existing infrastructure act as a tailwind for emerging market economies to outperform in such areas of technological enterprise.

This access to underrepresented sectors is clearly positive for investors from a diversification perspective, allowing investors to potentially benefit from outperforming areas of the market that they may not be able to access by only investing in larger global equity markets.

Risks of investing in emerging markets

Geopolitical risk

When we talk about geopolitical risk, we are turning away from market-specific indicators and focusing on how factors such as international relations, conflicts and trade policy affect companies based in emerging markets via channels such as:

- **Tariffs**, where increased levies on exports from emerging market and developing countries affect company profits as demand for domestically produced goods and services falls
- **Supply chains**, where political factors impact the ease with which factors of production can move between countries, thus impacting global supply chains (most recently demonstrated by the closure of the Strait of Hormuz as a result of the conflict in the Middle East)
- **Fiscal policy**, where changes to government spending and taxation, along with behavioural factors such as corruption within government regimes, impact companies' net profits and/or operations

Interestingly, in a 2026 Bank for International Settlements working paper titled '*Geopolitical risk and emerging market sovereign risk premia*', Fredy Gamboa and José Vicente Romero found that anticipated events, as opposed to actual events, had a more significant impact on sovereign risk premia in emerging markets, and that these effects are amplified by wider macroeconomic and financial factors (such as financial stress and terms of trade metrics). It is therefore important for investors not just to be cognisant of existing geopolitical factors and how these could impact companies within emerging economies, but also factors that could, and may be likely to, come into effect in the near term. That said, in recent times, perhaps with geopolitical instability across the globe, irrespective of country 'wealth', maybe this gap is narrowing.

Regulatory risk

A further risk of investing in emerging markets surrounds regulation. Developed economies typically (though not always) benefit from higher standards of regulation across areas such as corporate governance and financial reporting, making it easier for investors to have conviction over the quality of the companies in which they invest.

In certain (especially smaller) emerging market and developing economies, such regulatory standards are not always as high, potentially leading to misleading reporting, unfavourable corporate practices and, in extreme circumstances, higher levels of corruption. From an investment perspective, there is therefore increased risk in emerging markets of returns being impacted by businesses suffering from poor practices as a result of lack of sufficient oversight from regulatory bodies.

Liquidity risk

As we have touched on already, companies and the exchanges on which they trade tend to be smaller for emerging market and developing economies compared to developed peers. Because of this, emerging markets exchanges are often said to be less 'liquid', meaning that there are less buyers and sellers trading in companies' shares. The result for an investor is that, in a less liquid market, it can become difficult to buy or sell shares quickly and such trades can have a more significant impact on share prices.

Why invest in emerging markets now?

Artificial Intelligence (AI) and Tech Leadership

A core theme across global stockmarkets over the past couple of years has been AI and the rally that we have seen in the technology sector as the buildout of AI models has taken fold.

While much of the commentary around AI has focused on large cap names (for example, the 'Magnificent 7' technology stocks in the US, which account for approximately a third of the S&P 500 index), there are a number of examples of companies based in emerging markets and developing economies that have benefitted from the AI narrative, including:

- **SK Hynix** (+1,323% over last 3 years), a South Korean company who are the leading manufacturer of Random Access Memory chips, a faster and more efficient chip that is key to allowing more complex AI models to function
- **Taiwan Semiconductor Manufacturing Company (TSMC)** (+343% over last 3 years), the world's largest manufacturer of semiconductor chips, accounting for approximately 70% of global chip manufacturing
- **Samsung Electronics** (+282% over last 3 years), a South Korean technology corporation, manufacturing semiconductor products such as Dynamic Random Access Memory (DRAM), a core type of semiconductor chip that holds application data

Data source: Iress

In previous publications, we have written on the topic of 'picks and shovels' in the AI space; this refers to companies that have benefited from being indirectly connected to the AI theme via their operations across areas such as chip manufacturing, construction of cooling systems and servicing of data centre clients. While some exposure to the technology sector is of course appropriate in a balanced equity-focused portfolio, we typically favour these 'picks and shovels' names as a means of gaining exposure to the AI theme. Such names are prevalent in emerging market economies as we have highlighted above, and indeed, we have already seen Taiwan and Korea in particular benefiting from recent scarcity in AI hardware. With the buildout of AI infrastructure set to continue, companies in this space look well-positioned to benefit from the higher projected levels of capital expenditure being committed to the AI buildout going forward.

Positive earnings outlook

As outlined in the 2026 article '*Why Now Emerging Markets*' published by Franklin Templeton, emerging market equities are expected to deliver earnings growth of 50% in 2026, almost double the estimate for the US. As Franklin Templeton outline, much of this is due to a renewed focus among many emerging market companies on delivering attractive returns for shareholders and a move by these governments towards policy that supports this increasing return for shareholders.

We view corporate earnings as a key indicator of quality and a core driver of long-term returns and we are therefore encouraged to see increased company earnings as a potential tailwind for emerging markets going forward.

Consumer aspirations

A further driver of growth in emerging markets is changing consumer aspirations. As the world has become more interconnected through innovations such as the Internet and mobile communications, we have seen emerging market and developing economies benefit from increased access to information.

A result of this is that, over time, there has been increased demand for a broader array of goods and services among consumers based in emerging markets. We see this increase in spending among consumers based in emerging markets as a tailwind for this area of the market going forward.

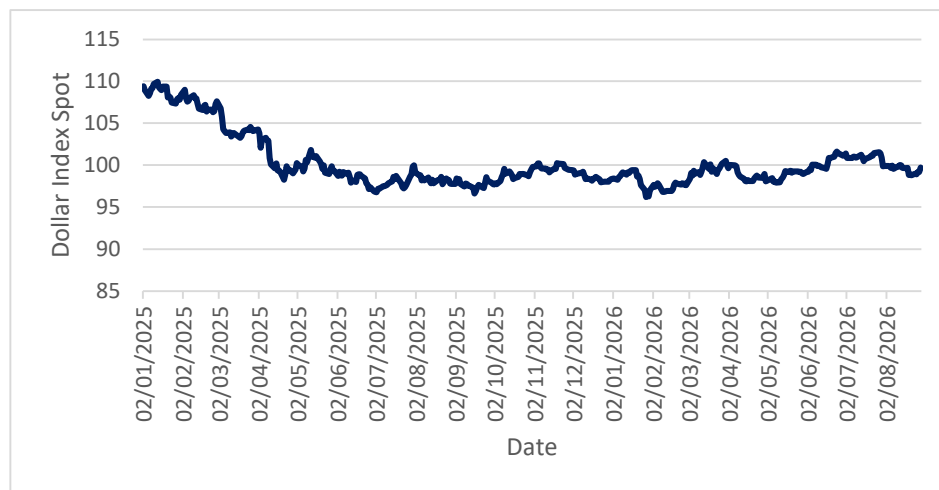
Potential headwinds

Concentration risk – what goes up...

We have discussed how exposure to the AI theme has been a tailwind for performance in emerging market indices as the demand for AI-related technologies produced in a number of emerging market and developing countries has increased. However, with approximately 35% of the FTSE Emerging Index now made up of companies operating in the Technology space, the concern going forward is that these companies (and thus, the wider index) will be adversely impacted should there be a rotation away from AI-focused names.

We will come on to how we use collective investments to access emerging markets later in this report. However, a key consideration here is that we favour actively managed funds (where managers seek excess returns above the benchmark by selecting stocks that they believe will outperform peers) over passive vehicles (where managers seek to simply mirror the benchmark). We believe that this approach provides a degree of protection from a wider fall in emerging market indices should they be impacted by a change in sentiment away from the AI-focused names, as well as the ability to outperform markets in these times by taking a more diversified and quality-driven approach to stock selection, though there will always be a degree of 'beta' (market risk).

Weaker dollar – for now...



Source: Iress

Dollar weakness has been another core theme for global equity markets in recent months as shown in the chart above, where softness in the US labour market has weighed heavily on the currency.

Generally, a weaker dollar is considered to be positive for companies based in emerging markets for a number of reasons, including:

- **Softer inflation** as the relative cost of importing goods and services from the US falls
- **Reduced cost of debt** as interest rates on US dollar denominated credit falls
- **Higher investment** as global investors look to alternative investment opportunities as returns on US credit fall

A key risk going forward, therefore, lies in a more cautious approach by the Federal Reserve (the Fed) towards interest rates, which we would expect to result in a stronger dollar. Indeed, in recent months, US inflation has remained persistently above the Fed's target of 2%, largely as a result of higher commodity prices off the back of the ongoing conflict in the Middle East and the associated supply chain bottlenecks. The result has been a more restrictive monetary policy stance from the Federal Reserve, with Fed chair Kevin Warsh recently implementing an interest rate hike of 0.25% at the September meeting.

We would typically expect such a 'hawkish' tilt in monetary policy to be associated with a stronger dollar as demand for US-denominated credit rises off the back of higher interest rates, which could negatively impact emerging market economies in the near term via the channels outlined above. However, while this could be a temporary headwind to emerging market performance, these short-term factors do not, in our view, hinder the investment case for investing in emerging markets on a long-term basis.

Emerging markets exposure within Barratt & Cooke portfolios

At Barratt & Cooke, we view a modest exposure to companies based in emerging markets as a key component of diversified equity-focused portfolios. Of course, some of the exposure in portfolios will come from companies not based in emerging market economies, but who generate a significant proportion of their earnings in the emerging markets. A key example of this is UK consumer goods manufacturer Unilever, who, in 2025, generated approximately 59% of turnover from emerging markets. In their 2025 full-year results, Unilever saw better performance in key emerging markets such as Indonesia and China, and management outlined plans to invest in enhanced production in emerging markets such as Brazil and India.

In terms of more direct exposure to emerging markets, we typically seek to ensure a long-term asset allocation of circa 5% to this asset class where appropriate (depending, of course, on factors such as a client's investment

objective and risk profile). Our preferred means of gaining exposure to emerging markets is via listed collective investment vehicles that are invested across different companies in both emerging markets and developing countries. This allows us to manage the 'liquidity risk' that we outlined earlier in this report, while also benefiting from the expertise of specialist fund managers, many of whom have offices in numerous countries and are able to actively engage with (and indeed challenge) the management of companies in various emerging markets economies.

If you would like to discuss your exposure to emerging markets within your portfolio, please contact your investment manager at Barratt & Cooke.

Conclusion

For the reasons summarised in this report, we feel that a degree of exposure to companies based in emerging markets remains an appropriate component of a balanced, long-term, equity-focused portfolio. Indeed, we feel that investing in this area of the market helps to diversify equity market risk by providing exposure to an area of the market that exhibits a relatively low correlation with larger-cap equities, while allowing investors to benefit from attractive growth opportunities in more niche markets.

Of course, if you have any questions regarding the information contained in this report, please contact your investment manager at Barratt & Cooke.

Authored by Nicholas Burrows



Important information

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- Has been prepared for use by Retail Clients (as defined by the FCA).
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