The ‘Fab 4’ become the ‘FOMO 3’

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July 2026

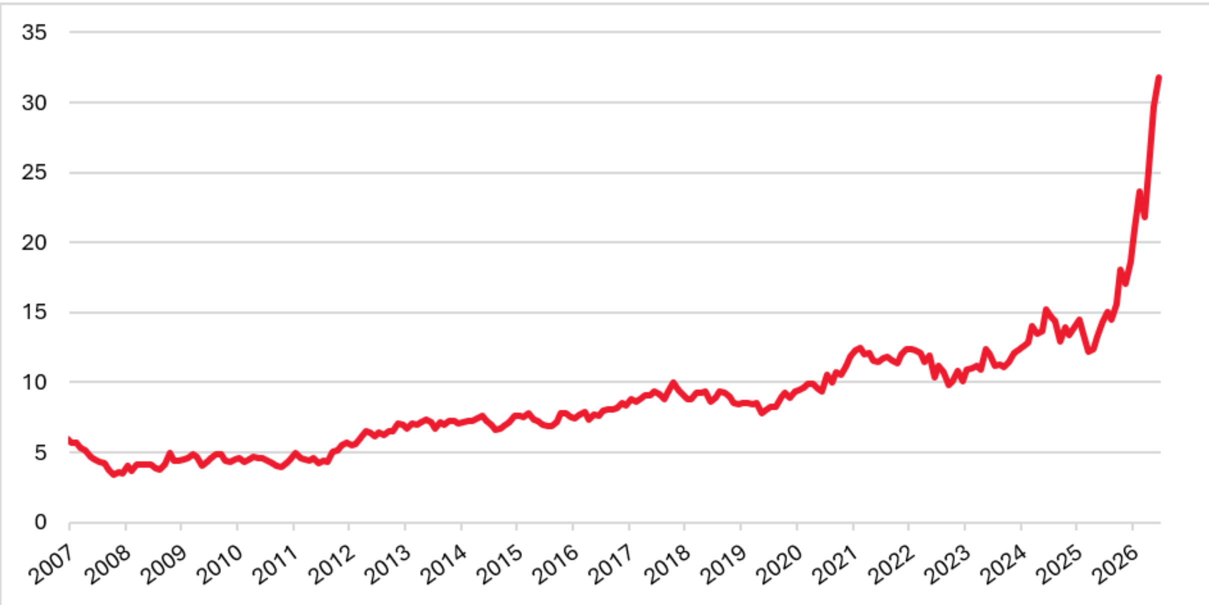
FOMO 3: Taiwan Semiconductor, Samsung Electronics & SK Hynix

The growing market capitalization of the largest companies in equity indices has become a serious problem for investors trying to construct diversified equity portfolios. The MSCI Emerging Markets Index is one of the most extreme examples of issuer concentration, with the three biggest companies accounting for over 30% of the market capitalization of an index that contains nearly 1,200 securities.

We first noted the tendency towards mega-capitalization stocks in November 2024[1], when the ‘Fab 4’ (Taiwan Semiconductor, Tencent, Samsung Electronics & Alibaba) accounted for just under 20% of the index. The problem posed by the ‘FOMO 3’ is now even more acute: Taiwan Semiconductor is now 15% of the index, while Samsung Electronics and SK Hynix are just over 8% each.[2]

However, under-represented countries, sectors and themes offer a rich seam of idiosyncratic growth and diversification opportunities for allocators willing to look beyond index heavyweights.

Chart 1: FOMO 3 as a % of the MSCI Emerging Markets Index



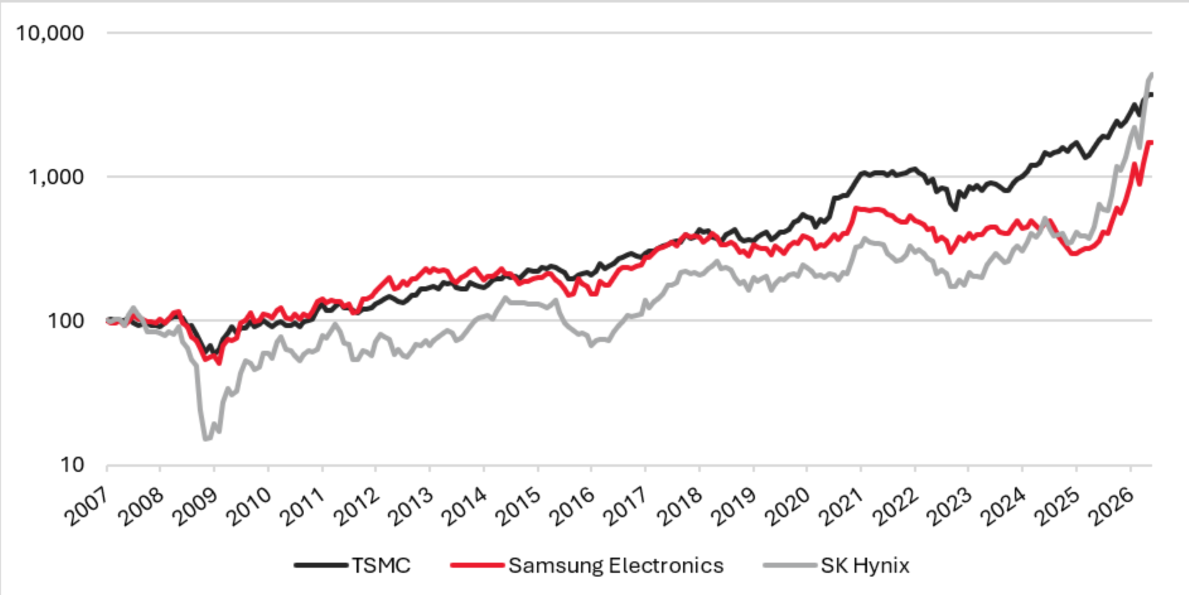
Source: Bloomberg 30 June 2026. The information shown above is for illustrative purposes.

Taiwan Semiconductor and Samsung Electronics have been two of the biggest index constituents since the Global Financial Crisis in 2008, and they have significantly outperformed the MSCI Emerging Markets Index over a multi-year period.[3] The rise of passive investing over the past couple of decades has resulted in performance-chasing behaviour, with each stock in the index being purchased in accordance with its current index weight, reinforcing the dominance of the biggest companies

[1] See ‘The big get bigger – concentrating on the ‘Fab Four’’, Redwheel, November 2024.
[2] Portfolio holdings are subject to change at any time without notice. This information should not be construed as a recommendation to purchase or sell any security
[3] Bloomberg, June 2026

when there are inflows. The three largest companies account for over 70% of total index returns year to date[4]; we estimate that fewer than 20% of MSCI Emerging Markets Index constituents have outperformed the index so far this year.

Chart 2: Performance of the FOMO 3 (log scale)

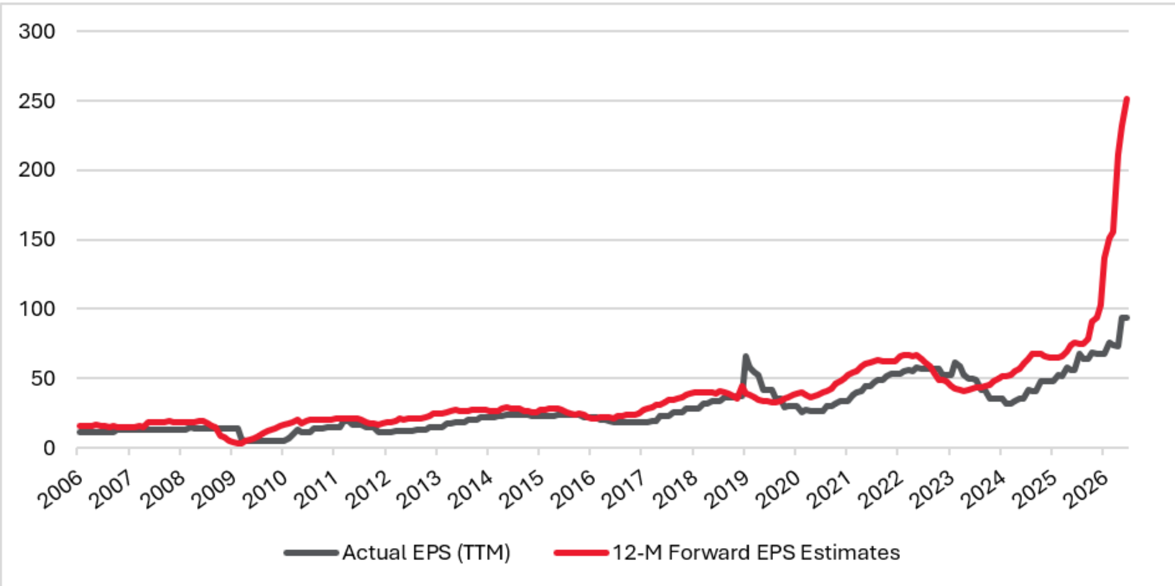


Source: Bloomberg 30 June 2026. Normalised to 100. USD. The information shown above is for illustrative purposes. Past performance is not a guide to future results. The prices of investments and income from them may fall as well as rise and an investor's investment is subject to potential loss, in whole or in part.

FOMO 3 sectors: technology, technology and technology

Technology has not always been as singularly important as it is today, but its weight began to increase after the COVID-19 pandemic in 2020 and, with the adoption of AI, now accounts for an unprecedented 45% of the MSCI Emerging Markets Index.[5] Essentially, the technology sector has risen in line with its forward earnings estimates. The recent steep climb in earnings raises questions about their long-term sustainability and increases the risk of equally sharp future corrections.

Chart 3: MSCI Emerging Markets Information Technology sector - Actual vs. 12-month forward EPS (USD)

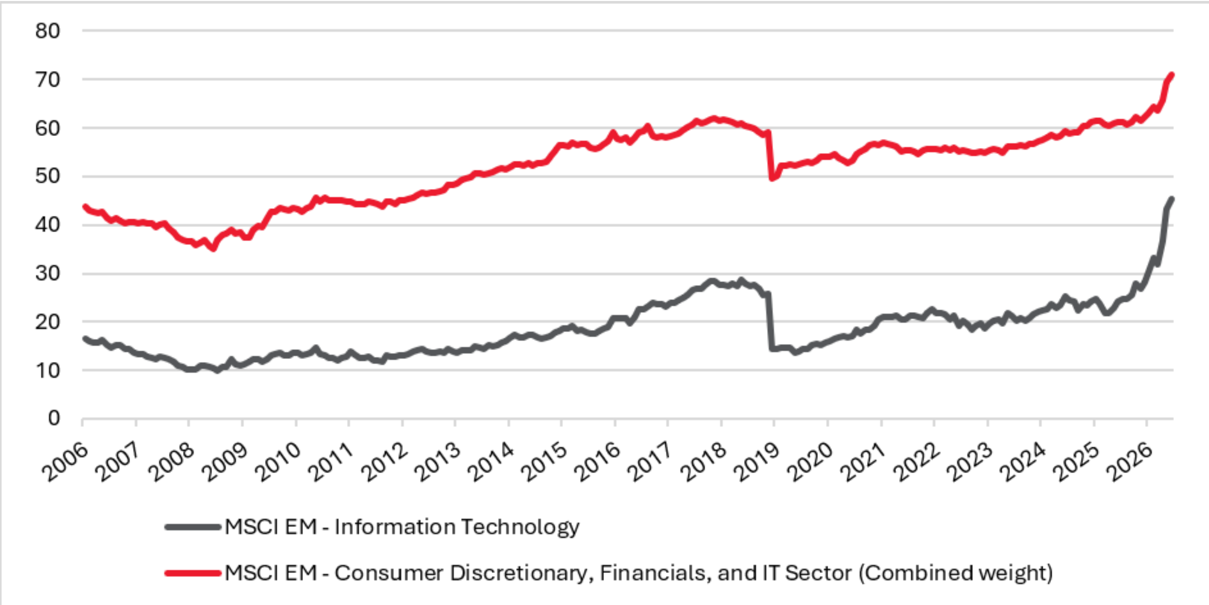


Source: Bloomberg 30 June 2026. The information shown above is for illustrative purposes. Past performance is not a guide to future results. The prices of investments and income from them may fall as well as rise and an investor's investment is subject to potential loss, in whole or in part.

[4] Bloomberg, June 2026
[5] Bloomberg, June 2026

Financials and Consumer Discretionary are the other two significant sectors, but Technology would be even bigger were it not for the reclassification of internet stocks from Information Technology to Consumer Discretionary and Communication Services at the end of 2018. The largest of these companies: Alibaba, Baidu, Tencent and Netease still account for about 5% of the MSCI Emerging Markets Index. The Information Technology sector would have been 50% of the investable universe today had the reclassification not been implemented.[6]

Chart 4: MSCI EM: Top 3 and IT sector weight (%)

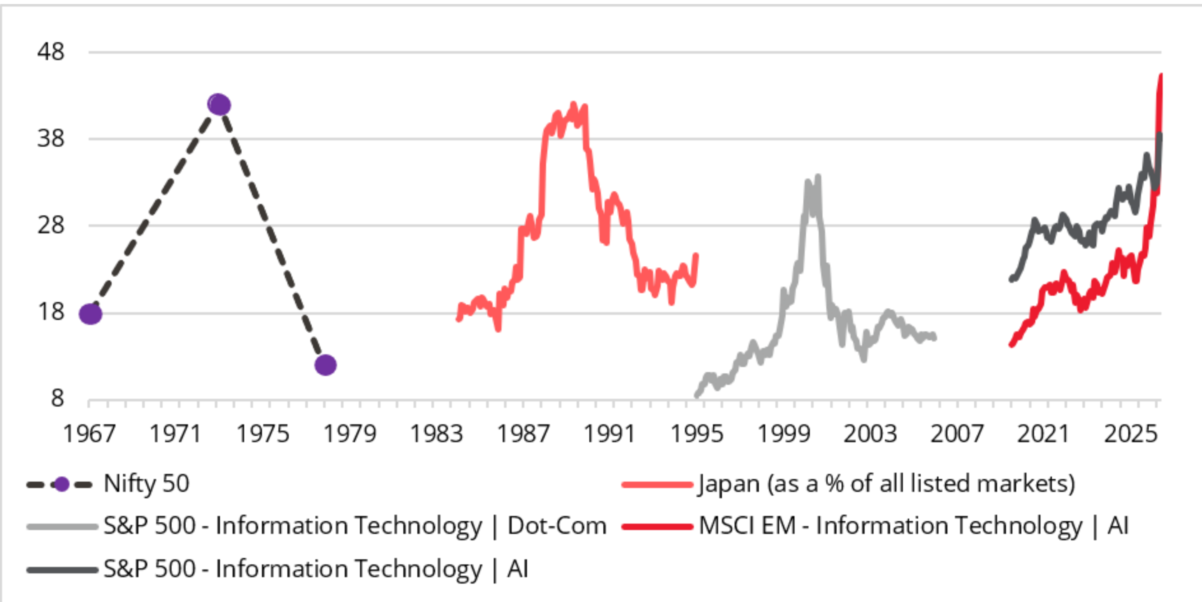


Source: Bloomberg 30 June 2026. The information shown above is for illustrative purposes.

Is 40% of total capitalization a natural sector ceiling?

By way of comparison, single countries, sectors or themes have rarely exceeded 40% of total capitalization for more than a year or two at a time. Both Japan and the 'Nifty 50' peaked at 42% of global and US market capitalization, respectively, before reverting to around 20%; even the dot-com boom peaked in the mid-30% range. The current EM technology weight of 45% is unprecedented in the 20th and 21st centuries.

Chart 5: Periods of concentration as a % of market capitalization



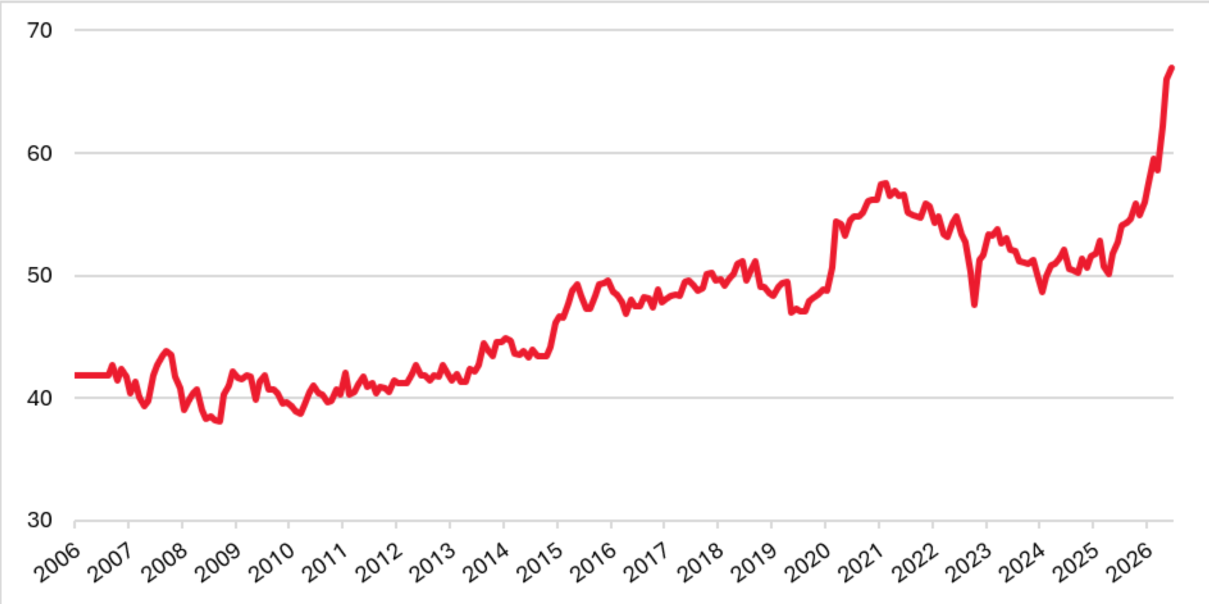
Source: Bloomberg, World Bank, Redwheel 30 June 2026. Timeline abridged between 2007 and 2019. The information shown above is for illustrative purposes.

[6] Bloomberg, Redwheel, June 2026

FOMO 3 countries: China, Korea & Taiwan

China, Korea and Taiwan have consistently been three of the largest and most important markets in the MSCI Emerging Markets universe.

Chart 6: Top three countries as a % of the MSCI Emerging Markets Index



Source: Bloomberg 30 June 2026. The information shown above is for illustrative purposes.

Evidence of ever-increasing concentration is apparent at the country level, with the top three countries now comprising two thirds of the entire index; Korea and Taiwan – the home of many of the world's most important technology companies – amount to over half the weight of MSCI's index. With two dozen country constituents, other countries' average weight is just over 2% each, and 15 countries weigh in below the 1% threshold.[7] It has become more difficult to achieve a diversified emerging markets portfolio given the index skew.

Diversification, not indexation, is the point

The purpose of investing in EM is to achieve diversification and take advantage of superior idiosyncratic growth opportunities at lower valuations than are usually available in developed markets. The dominance of three gigantic technology companies, whose market capitalization exceeds $1tn each in Korea and Taiwan,[8] means that index-following EM equity investors are more dependent on a single global AI theme than they are to individual country, sector and stock opportunities. The sheer size of the companies in question makes it almost impossible for any other than passive EM investors to achieve overweight positions without breaching concentration limits, even if they wish to. Taking advantage of potential growth opportunities that are unique to EM investors means deviating significantly from benchmark index weights.

FOMO reduces diversification

MSCI EM correlations with the US have usually been lower than MSCI DM correlations with the US, indicating the value of emerging markets in diversifying global equity portfolios.

However, the increase in the weight of the technology sector, which is dominated by AI-related companies, has resulted in higher correlation of EM equities to the US, depriving equity investors of the important element of diversification. As the technology sector began to dominate in 2025 and continued to rise in 2026, emerging market equities have started to mirror the performance of the US, which is also dominated by mega-capitalization technology companies. The monthly correlation of the MSCI Emerging Markets Index with the MSCI USA Index is now nearly 70% and higher even than developed markets

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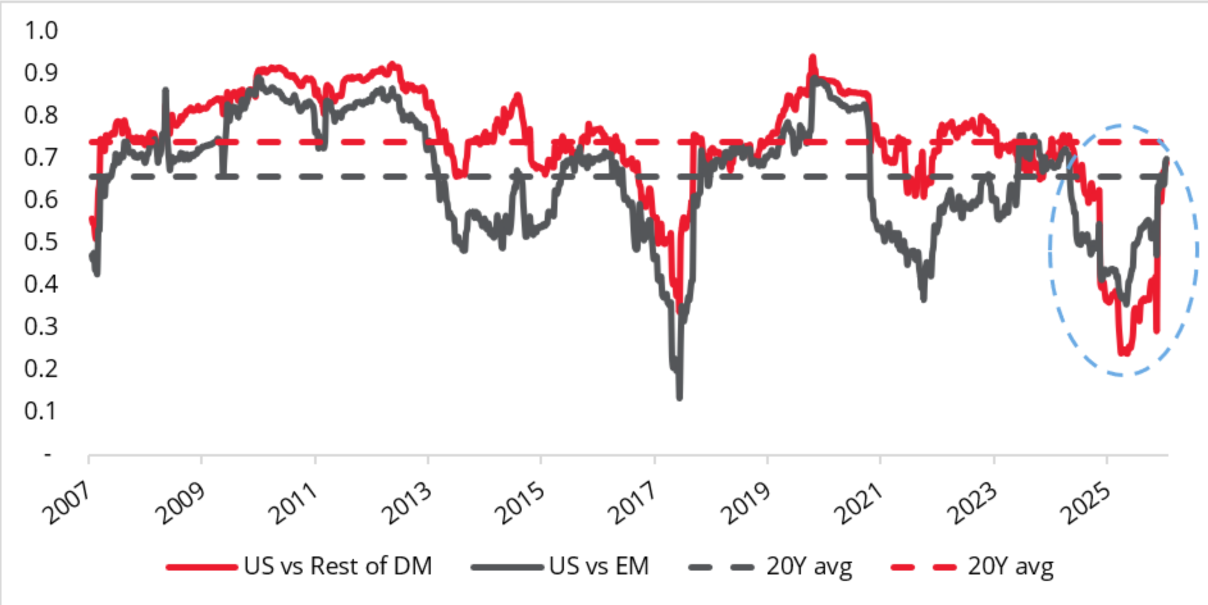
[7] Bloomberg, 30 June 2026

[8] Bloomberg, 30 June 2026

to the US; this means that EM investors ought to look outside the technology sector for diversification and idiosyncratic emerging market growth opportunities.

Chart 7: Rolling 12-Month return correlation

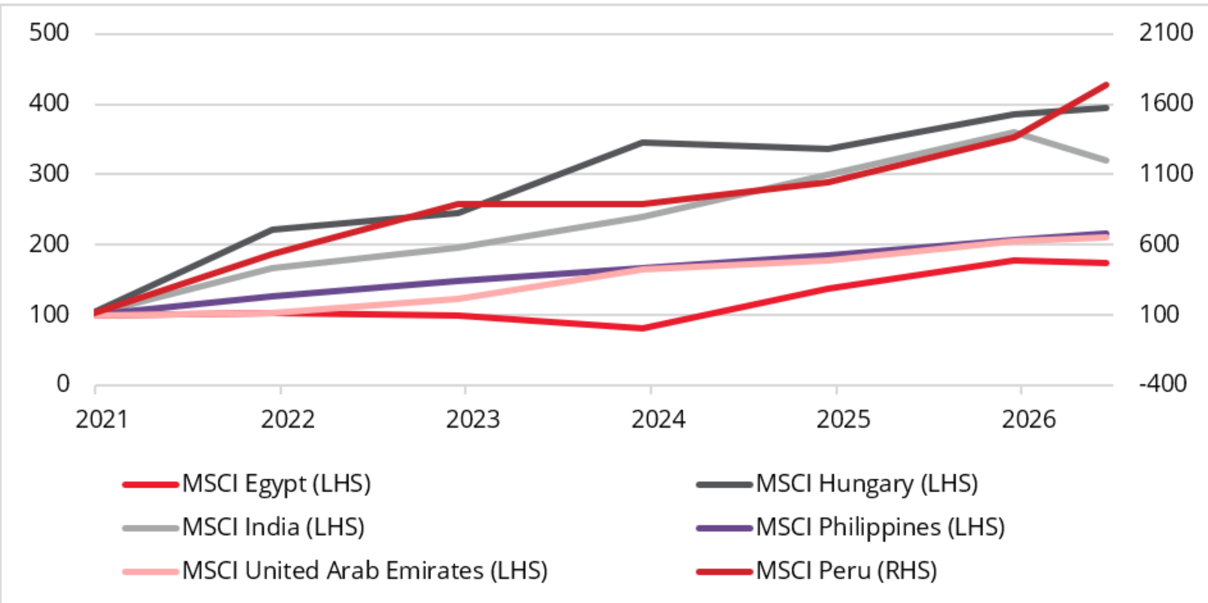


Source: UBS 30 June 2026. The information shown above is for illustrative purposes.

What opportunities are there other than Asian technology?

Investors allocate to emerging markets because of the general combination of growth and value. Outside Asian technology, much of the best growth potential is to be found in smaller countries. Many smaller emerging markets including Egypt, Hungary, India, Peru, Philippines and UAE have all exhibited impressive USD earnings growth since the COVID-19 pandemic in 2020. This is important considering the tendency for the USD to have strengthened against EM currencies over the long run.

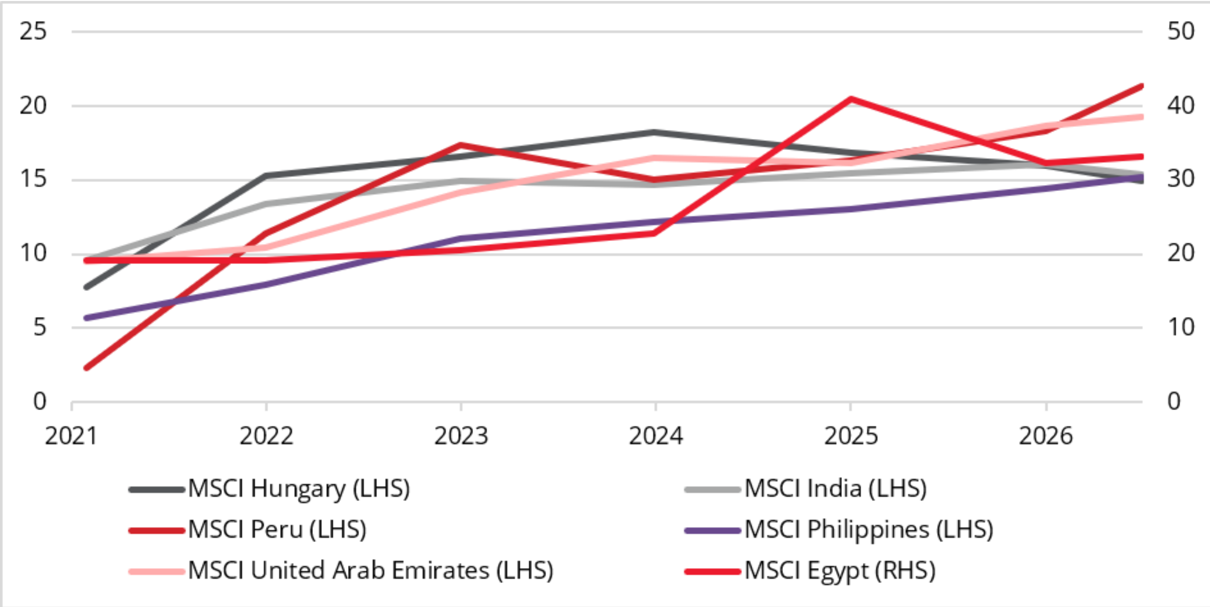
Chart 8: Earnings growth (%) of smaller emerging markets



Source: Bloomberg 30 June 2026. Normalised to 100. USD. The information shown above is for illustrative purposes. MSCI Peru uses right hand scale.

As USD earnings have improved, return on equity (ROE) has also increased, supporting a long-term re-rating of valuations.

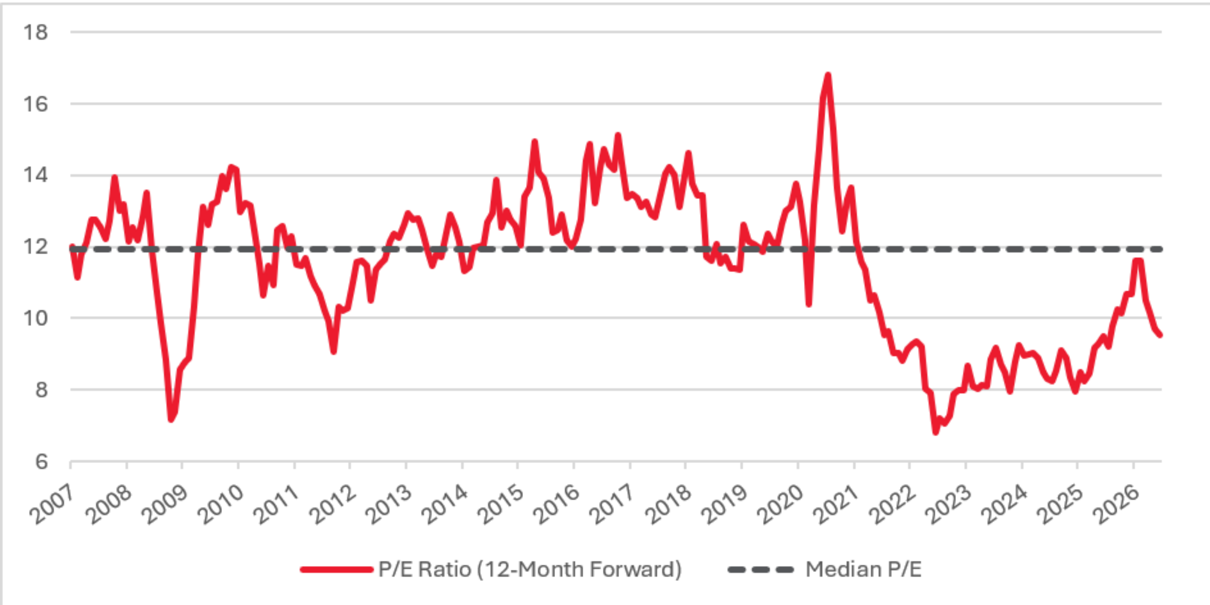
Chart 9: Return on equity (%) of smaller emerging markets



Source: Bloomberg 30 June 2026. The information shown above is for illustrative purposes. Past performance is not a guide to the future. MSCI Egypt uses right hand scale.

Many countries also exhibit good value characteristics; there are several markets on single-digit earnings multiples. In Latin America, both Brazil and Colombia are valued below 10 times forward earnings and await the catalyst of lower interest rates to re-rate upwards.

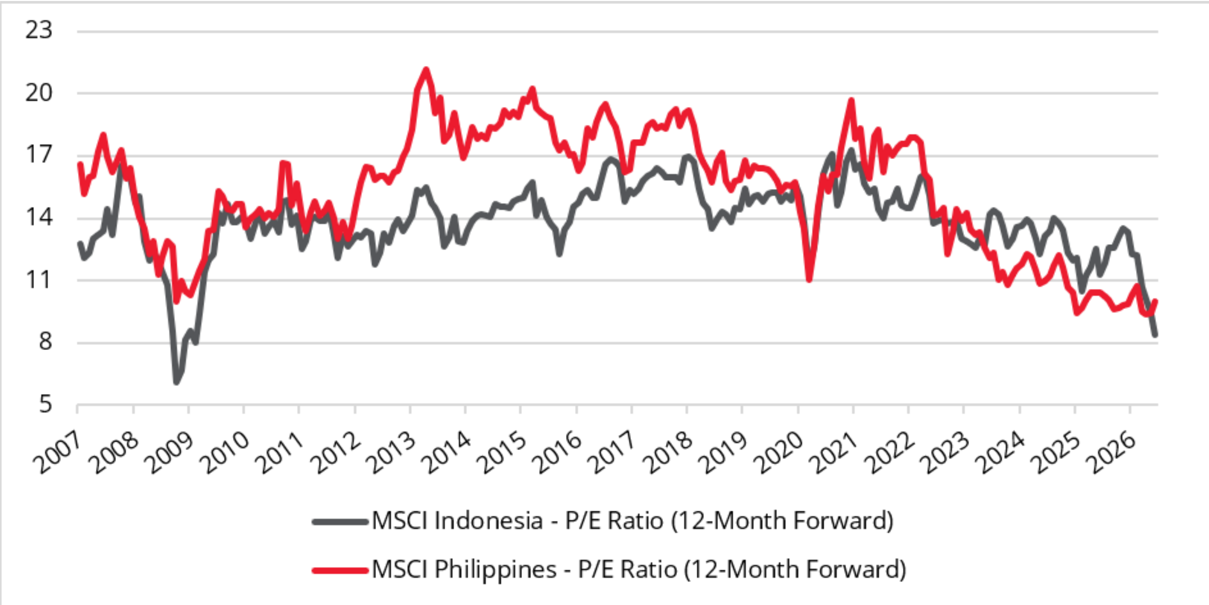
Chart 10: MSCI Emerging Markets Latin America Index - 12-month forward P/E



Source: Bloomberg 30 June 2026. The information shown above is for illustrative purposes. Past performance is not a guide to future results. The prices of investments and income from them may fall as well as rise and an investor's investment is subject to potential loss, in whole or in part.

In Asia, Indonesia and Philippines have been similarly de-rated and, if US / Iran hostilities cease, should have the benefit of lower oil prices to aid economic growth.

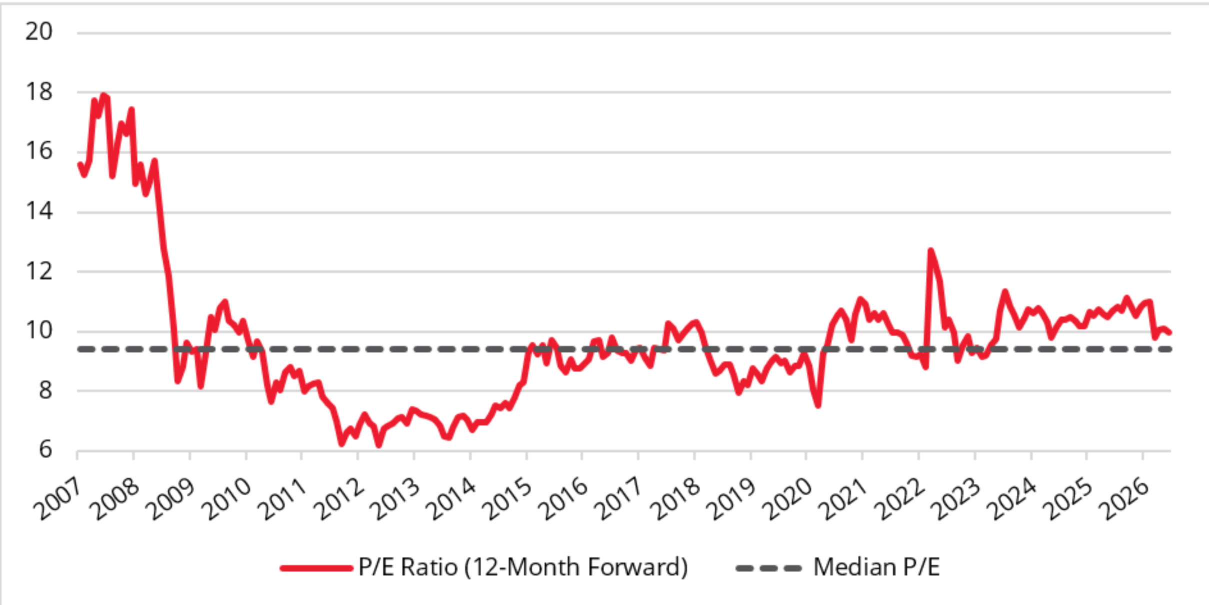
Chart 11: MSCI Indonesia & Philippines - 12-month forward P/E



Source: Bloomberg 30 June 2026. The information shown above is for illustrative purposes. Past performance is not a guide to future results. The prices of investments and income from them may fall as well as rise and an investor's investment is subject to potential loss, in whole or in part.

Almost every country constituent in EMEA is comparably valued, with Egypt, Greece, Hungary, Poland, Qatar, South Africa and Turkey all trading on less than 10 times forward earnings and well placed to re-rate if growth expectations are delivered.

Chart 12: MSCI Emerging Markets Europe, Middle East, and Africa Index - 12-month forward P/E



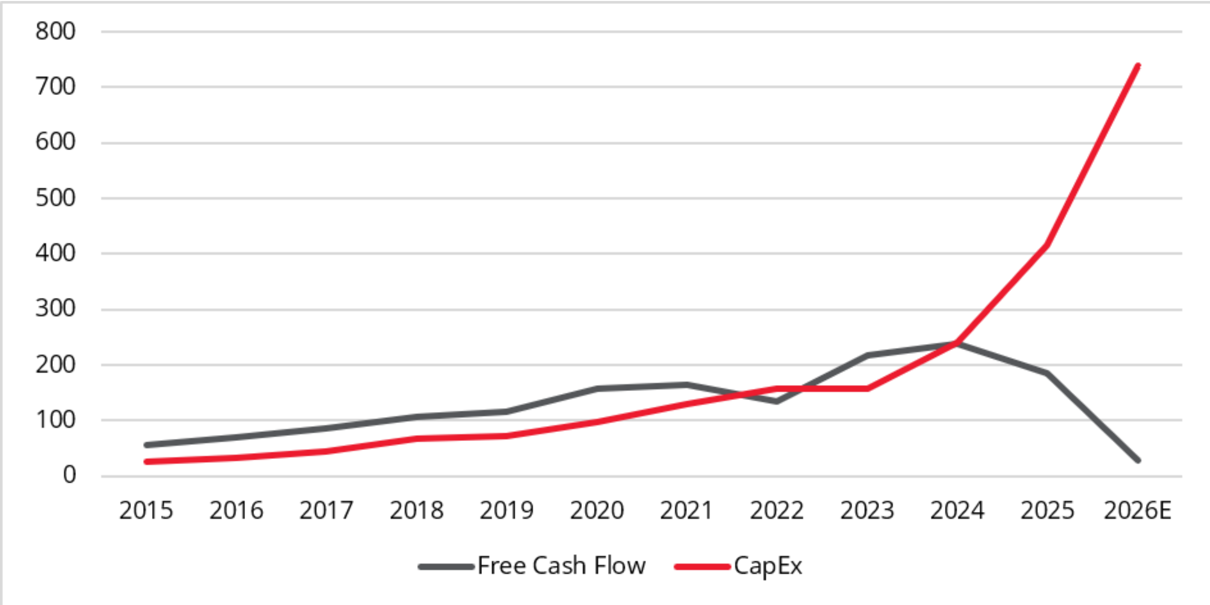
Source: Bloomberg 30 June 2026. The information shown above is for illustrative purposes. Past performance is not a guide to the future.

Questioning the durability of growth

The AI buildout is transferring capital from hyperscalers to semiconductor and hardware companies at an unsustainable pace. Surging compute demand, rising memory intensity, and component shortages are pushing the free cash flow of the 'Big-5' US hyperscalers[9] significantly lower in year-end 2026 forecasts[10] as CapEx overwhelms cash generation. At the same time, many logic and memory semiconductor producers are reporting record sales, profitability, and cash generation.

This dynamic has set the backdrop for the rise of the FOMO 3; however, we ultimately believe that many of these technology products are commodities, and that cyclical dynamics will re-emerge, pushing prices lower and reducing the earnings and cash generation potential of many technology producers.[11]

Chart 13: Big-5 US hyperscaler free cash flow and capex ($bn)



Source: Bloomberg, Redwheel as of 30 June 2026. Big-5 US hyperscalers are Amazon, Google, Meta, Microsoft and Oracle. The information shown above is for illustrative purposes. Forecasts and estimates are based upon subjective assumptions.

Looking past index heavyweights

As emerging markets have become dominated by three mega-capitalization companies, the Technology sector now comprises an unprecedented 45% of the overall index; relative performance therefore depends upon exposure to these constituents. The risks are that active EM portfolios all own the same securities to keep pace with the index, and that returns could reverse if capital expenditure on AI-related projects slows. EM correlations with the US market have risen, implying that the asset class offers less diversification and fewer idiosyncratic opportunities because of the dominance of technology.

Yet investors can still find superior growth at discounted valuations by looking for investment ideas in many smaller emerging markets, and by investing in other themes besides AI that stand to benefit from a resurgence in capital expenditures; examples include defence, the energy transition and energy security.

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[9] Big-5 US hyperscalers are Amazon, Google, Meta, Microsoft and Oracle.

[10] Bloomberg, June 2026

[11] No investment strategy or risk management technique can guarantee returns or eliminate risks in any market environment.

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