Emerging and frontier markets outlook 2026: Super cycle redux

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2025 marked the first year that emerging markets outperformed the US since 2017. Long-term believers in non-US markets hope this will mark a new period of outperformance to match the near decade-long streak in the first decade of the millennium, when emerging markets (EM) outperformed every year except for 2008, the year of the Global Financial Crisis.

In the 2000s, EM performance was fuelled by higher commodities' prices and a lower US dollar. Today, similar conditions prevail, reinforced by falling rates, compelling valuations, reform momentum and shifting capital flows.

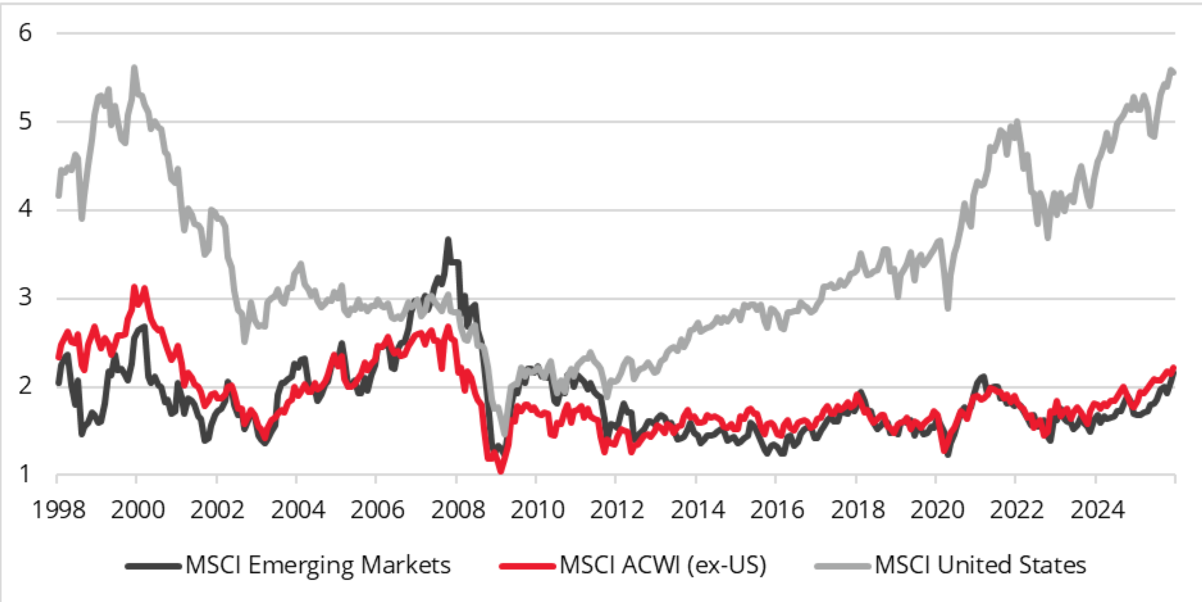
MSCI	2025	3 Years	5 Years	10 Years
ACWI ex-US	32.4%	17.3%	7.9%	8.4%
EM	33.6%	16.3%	4.2%	8.4%
US	17.3%	22.7%	13.4%	14.2%

Source: Bloomberg 31 December 2025. Past performance is not a guide to the future.

Currencies and valuations are a tailwind for international markets

Global equities all traded at similar price-to-book valuation multiples in the late 2000s, but from 2010 onwards, US valuations began to expand and now exceed 5 times book value, a level not seen since the peak of the technology-driven bull market in the late 1990s.

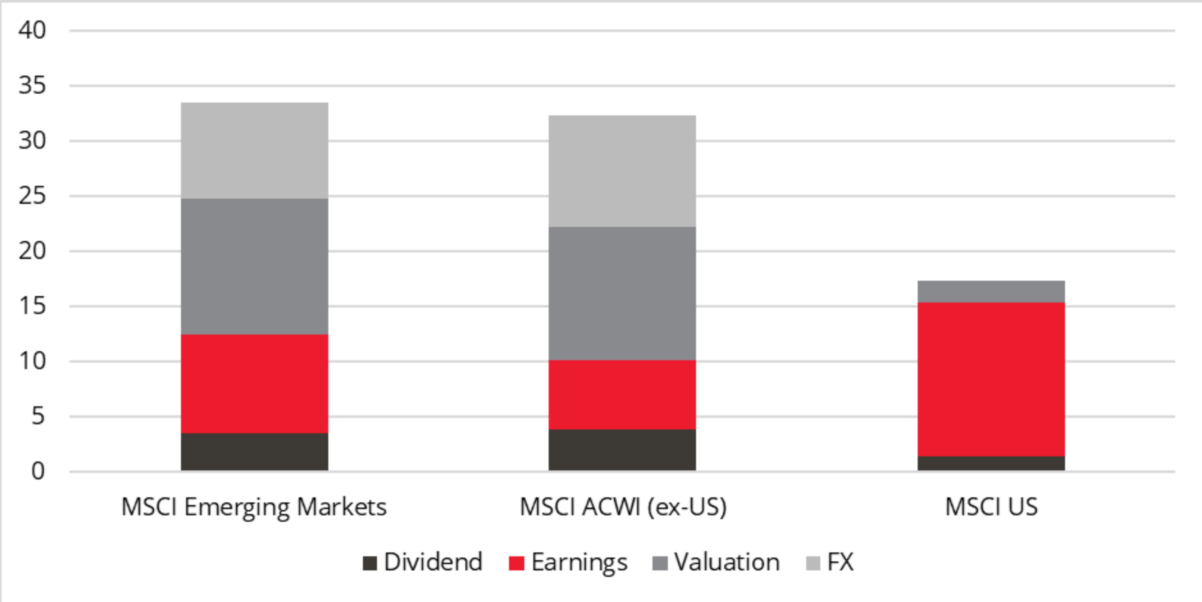
Chart 1: Price to book (x)



Source: Bloomberg, Redwheel 31 December 2025. Past performance is not a guide to the future.

While US equities depend upon earnings growth and maintaining premium valuations, international equities have strong return potential from a re-rating of valuations to close the gap with the US, and currency appreciation against the US dollar. Markets outside the US began to narrow the valuation gap in 2025.

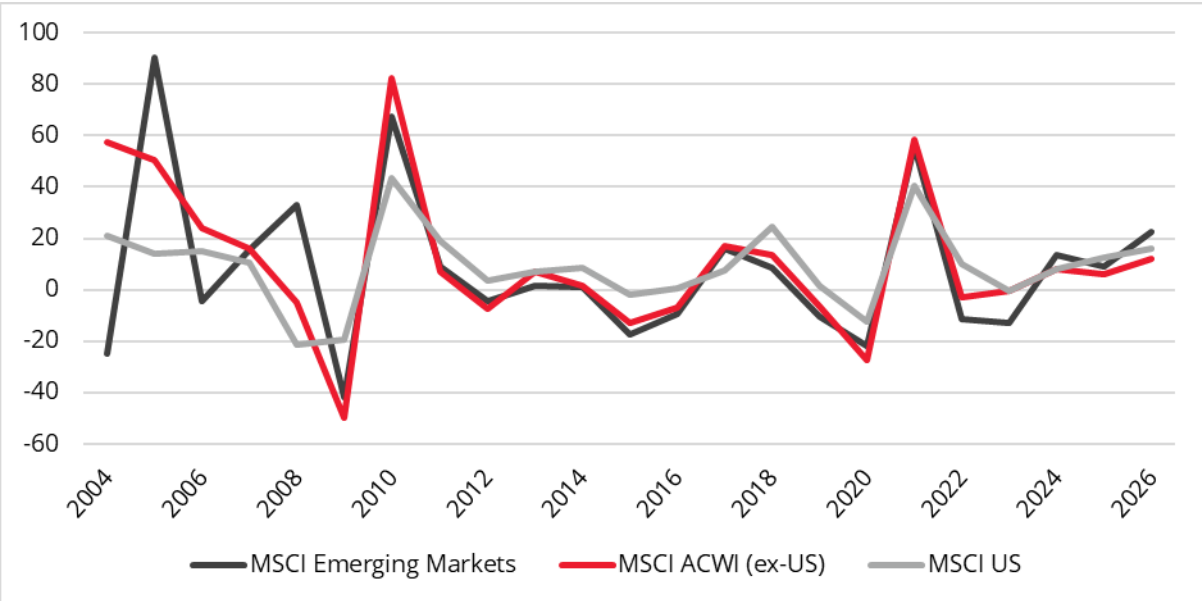
Chart 2: 2025 Decomposition of Returns (%)



Source: Bloomberg, Redwheel 31 December 2025. Past performance is not a guide to the future.

As valuations have expanded, corporate earnings must now grow to sustain higher multiples. Earnings outside the US, although more volatile, are improving and match the growth rate of the US market through 2026.

Chart 3: EPS growth (%)

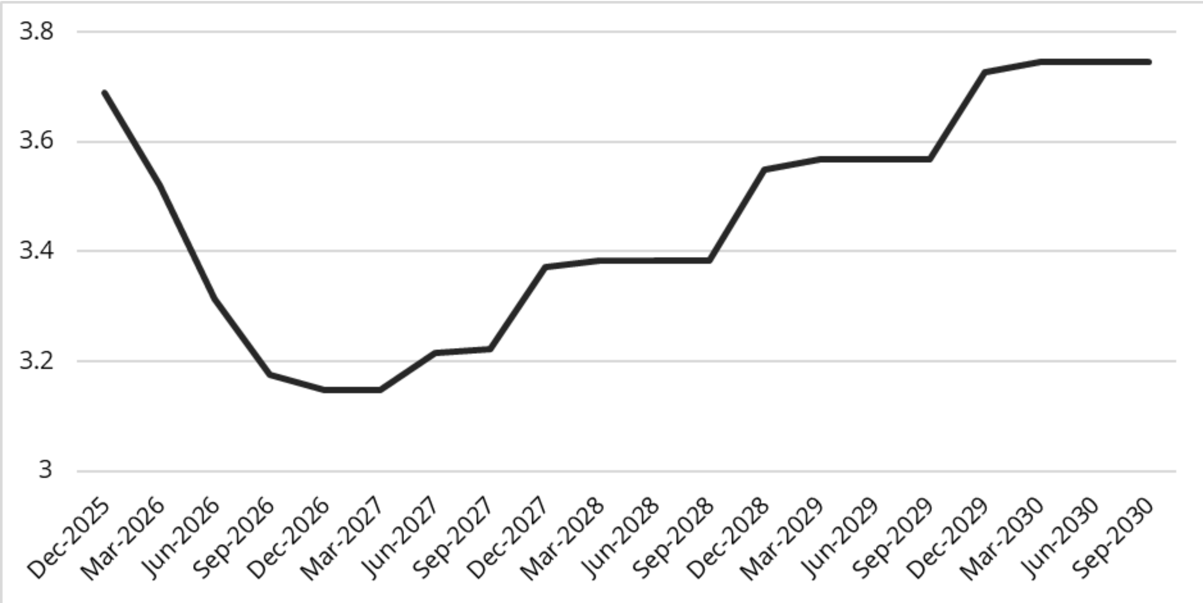


Source: Bloomberg 31 December 2025. 2026 is a Bloomberg estimation. Forecasts and estimates are based upon subjective assumptions. Past performance is not a guide to the future.

What could push international markets higher in 2026?

We believe that interest rates will be the most important economic driver of global equity performance in 2026, and the US Federal Reserve sets the pace. The easing cycle that began in late 2024 resumed in late 2025 and is expected to continue in 2026. Fed funds futures indicate that the Federal Reserve will cut the policy rate twice more in 2026, reaching a level of 3.00% - 3.25% by year end.

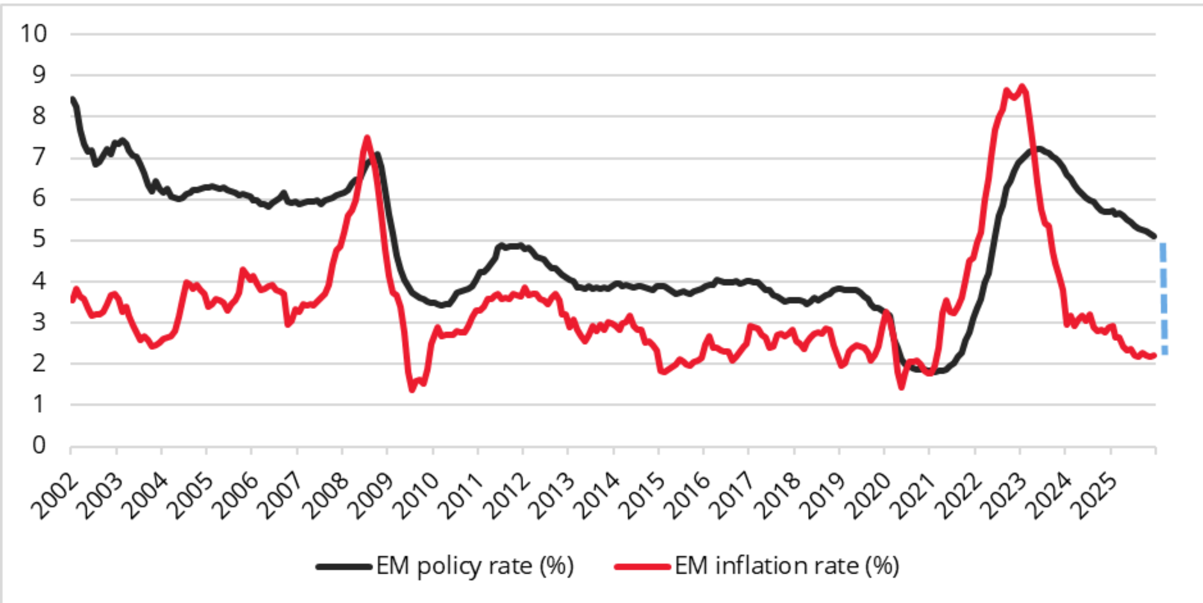
Chart 4: Fed funds futures (implied yield)



Source: Bloomberg 31 December 2025. The prices of fed funds futures contracts reflect the collective expectations and consensus of market participants regarding future actions by the Federal Open Market Committee (FOMC) on interest rates. The information shown above is for illustrative purposes.

Looser US monetary policy will also permit EM central banks to lower interest rates, which are currently very tight given how rapidly inflation has decreased. Less restrictive monetary policy not only boosts growth but also helps equity valuations to continue their upwards re-rating.

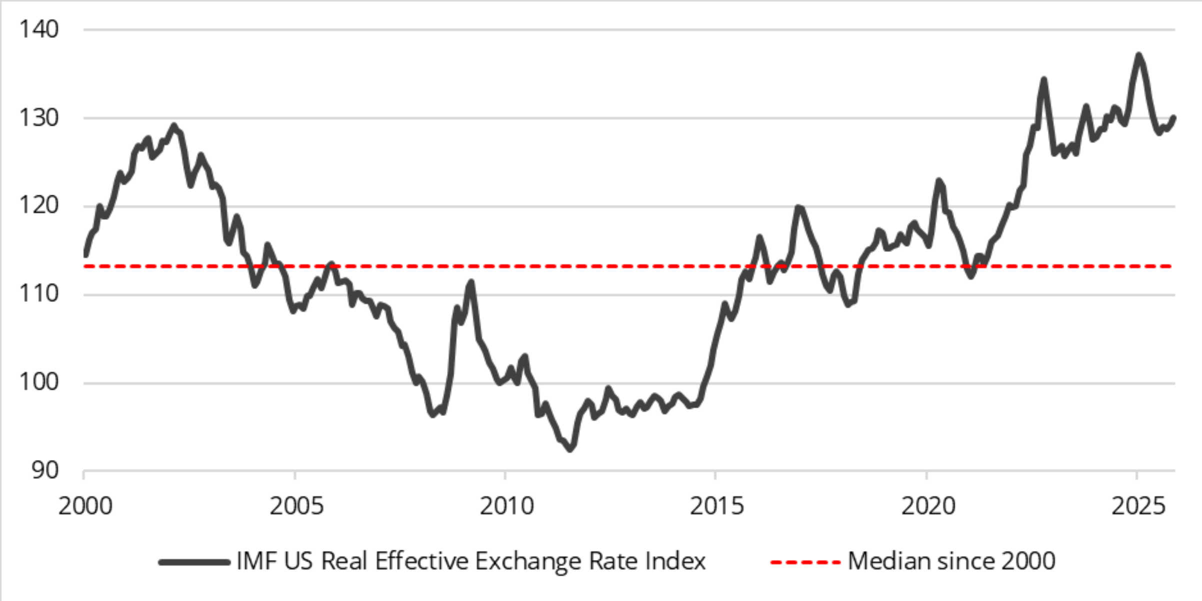
Chart 5: EM policy rates v. inflation (%)



Source: HSBC, Redwheel 31 December 2025. The information shown above is for illustrative purposes.

The same factors that pushed the US dollar lower in 2025 should still be present in 2026. The main cause of dollar weakness has been larger US fiscal deficits and government indebtedness without a plan for fiscal consolidation, which caused Moody's to downgrade the US credit rating in 2025, following Fitch in 2023 and S&P in 2011. Markets have also shown concern over erratic US economic and trade policy, as well as the potential to weaken the independence of key institutions such as the Federal Reserve that have been viewed as guardians of American financial stability. International currencies have started to strengthen, but the US dollar still looks expensive in real terms.

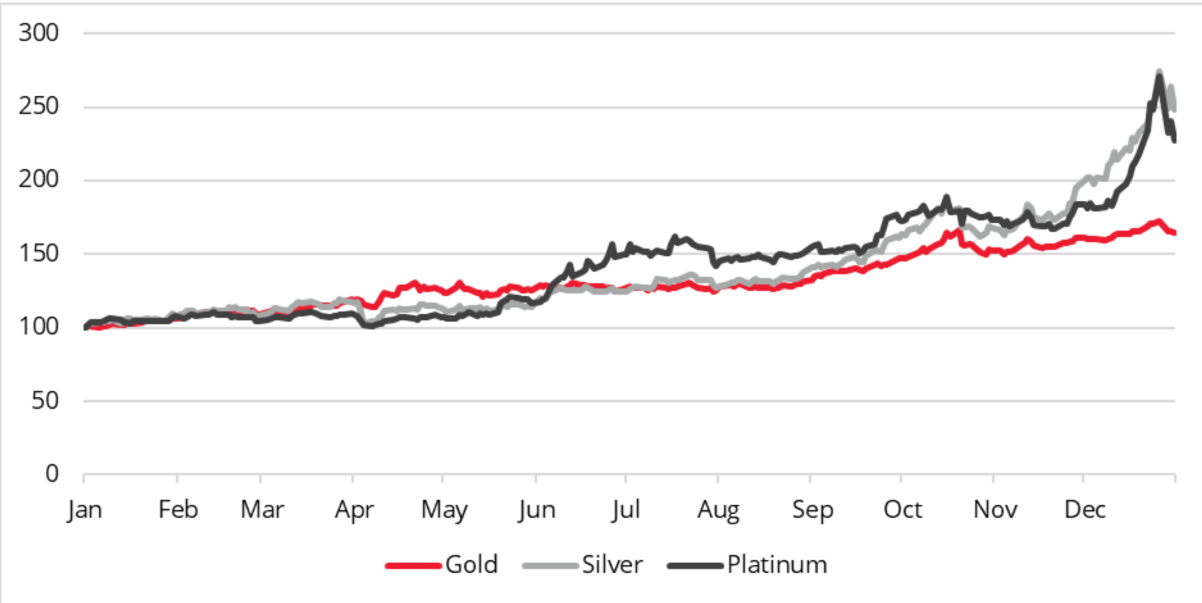
Chart 6: US dollar looks expensive to the median real exchange rate



Source: IMF, Bloomberg, Redwheel 30 November 2025. Past performance is not a guide to the future.

Precious and base metals have also been part of the dollar debasement trend and higher prices have benefited countries such as South Africa[1] and sectors such as materials. Although gold might have captured most of the headlines, platinum and silver have performed even more strongly. Other industrial metals including copper and aluminium should also benefit from growing demand for renewable energy and data centres, as well as demand from the defence industry[2] as NATO members increase their military spending.

Chart 7: 2025 Precious metal performance (normalized to 100)



Source: Bloomberg 31 December 2025. Past performance is not a guide to the future.

Although gold and precious metals have surged in 2025, their price performance is not unique by historical standards. From the termination of convertibility of the USD into gold in August 1971 at $41 per ounce to the peak of $850 in January 1980, gold rose 20-fold over 8 ½ years, a return of over 40% per annum. Similarly, gold climbed nearly 8 times from its 1999 low of $253 per ounce in the 'dot.com' boom to the cycle high of $1,900 in 2011, a compound annual return of about 20%.

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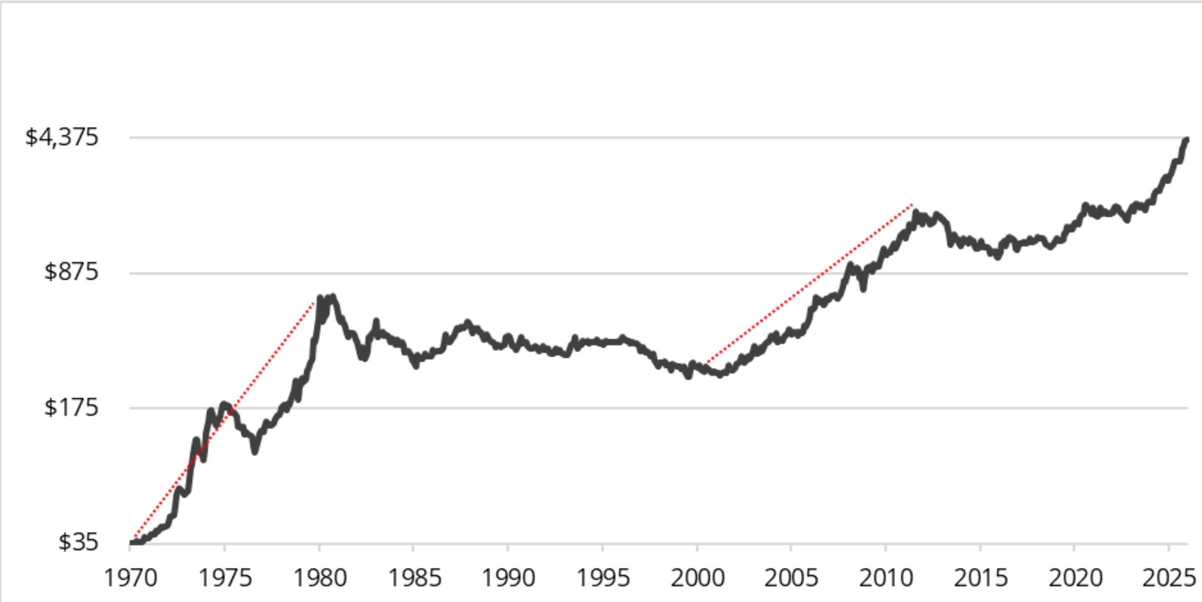
[1] See '[Harnessing reform as a catalyst for growth: South Korea and South Africa]', Redwheel, August 2025

[2] See '[Europe's defence resurgence: Mapping the opportunities']', Redwheel, October 2025

Therefore, the annualized increase of 45% since the start of 2024 is not extraordinary by historical standards and could keep going for several years, albeit at a less dramatic rate.

Chart 8: Price of gold (log scale, USD, monthly close)



Source: Bloomberg 31 December 2025. Past performance is not a guide to the future.

Idiosyncratic opportunities abound

International markets are not a homogenous asset class, and there are many investment opportunities that arise independently of global themes, especially around reform and restructuring. The intention of economic reform is to lower the cost of capital, improve the return, attract investment, boost growth and raise equity valuations.

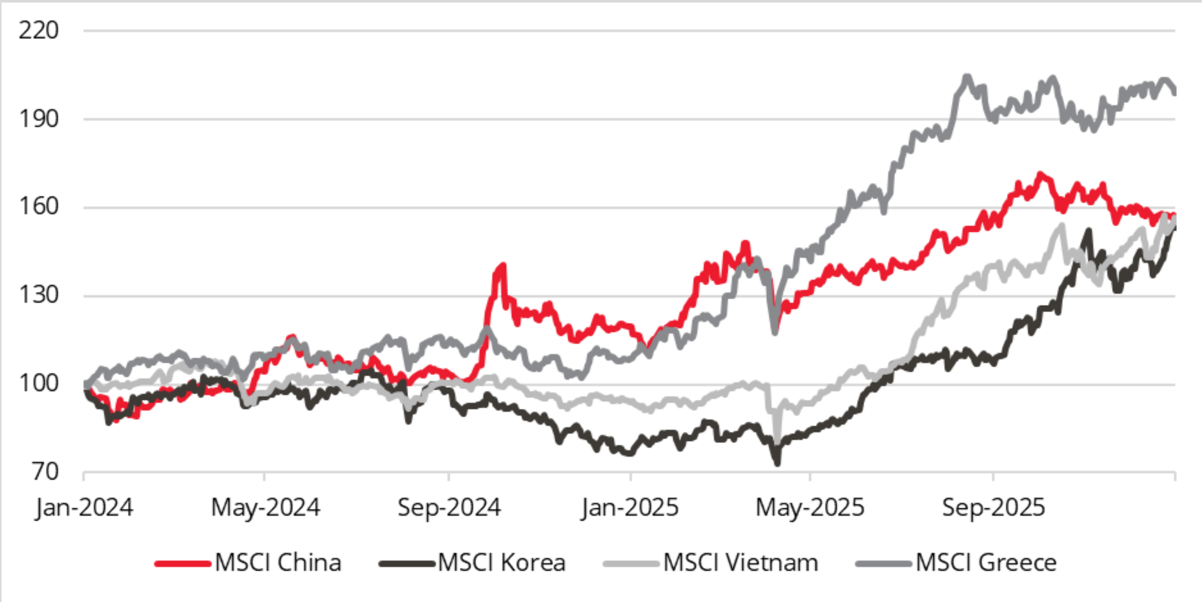
Country	Reform	12-Month Forward P/E (x)	EPS Growth '26e	ROEe
China	Anti-involution[3]	12.1	12.1%	11.1%
Greece	Balanced budget	8.8	25.1%	13.8%
Korea	Value-up	9.5	69.4%	15.3%
Vietnam	FTSE inclusion	16.5	49.3%	13.5%
MSCI EM	-	13.3	22.5%	14.2%

Source: Bloomberg, Redwheel 7 January 2026. Consensus estimates. Forecasts and estimates are based upon subjective assumptions. Past performance is not a guide to the future.

When reform and restructuring programmes work, they often lead to strong returns.

[3] See 'Ending the race to the bottom: China's anti-involution reforms explained', Redwheel, November 2025

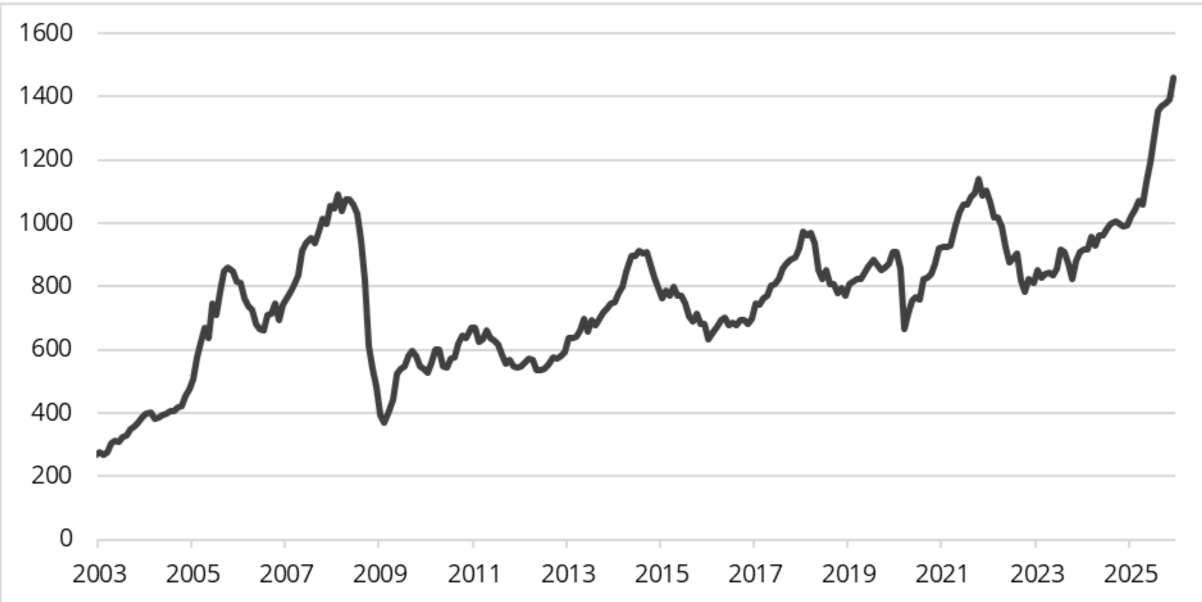
Chart 9: Reform & restructuring: Return by country (normalized to 100)



Source: Bloomberg 31 December 2025. Past performance is not a guide to the future.

This theme has also produced strong returns in frontier markets, where Kenya, Nigeria, Pakistan and Sri Lanka have all pursued economic orthodoxy after crises, and the MSCI Frontier Markets Index hit new highs throughout the second half of 2025.

Chart 10: MSCI Frontier Markets Index

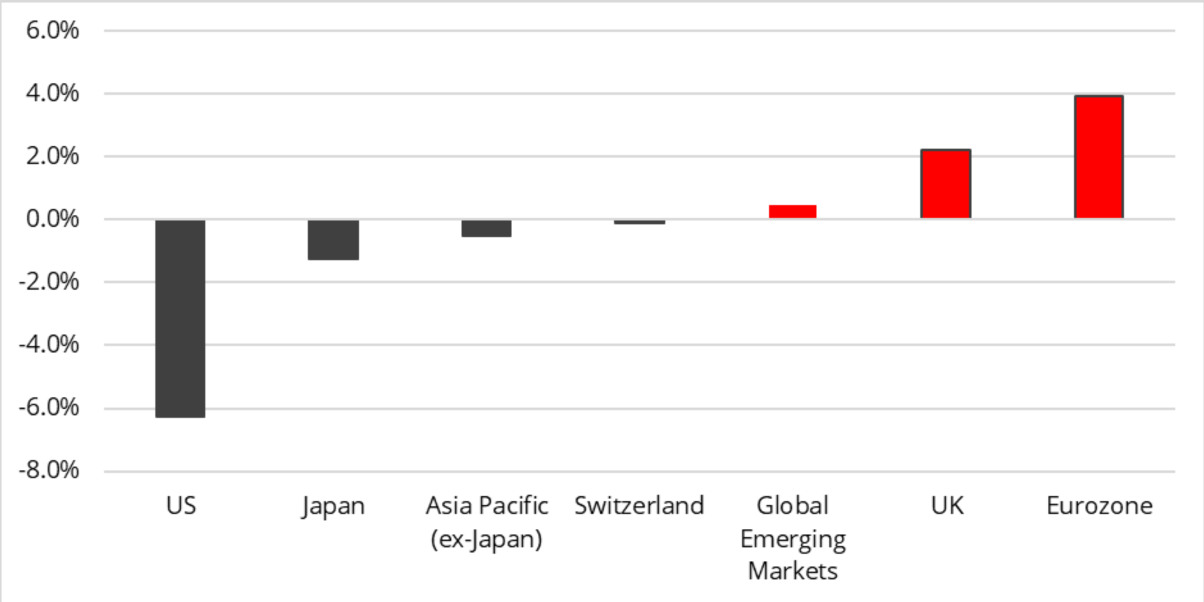


Source: Bloomberg 31 December 2025. Past performance is not a guide to the future.

Investors are increasing exposure to emerging markets at the expense of the US

We estimate that investors committed approximately $45bn to passive ETFs in 2025, but have raised their allocations to emerging markets very slightly.

Chart 11: Active weight by region

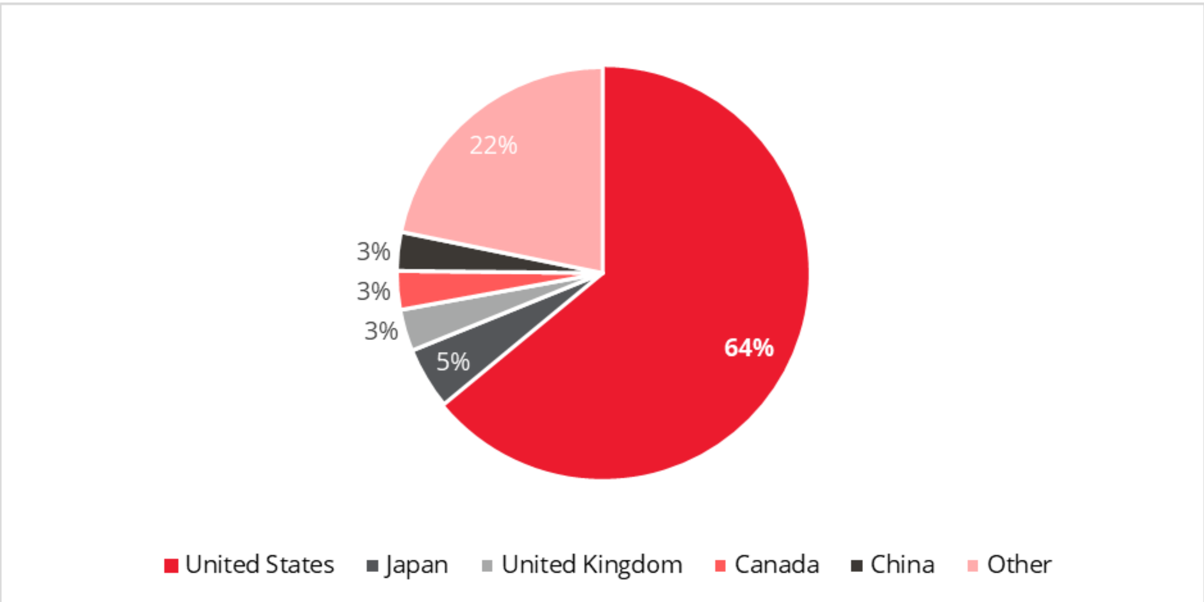


Source: HSBC, Redwheel 30 November 2025. The information shown above is for illustrative purposes.

The trend of allocating away from US equities is likely to continue, not only because of its high valuation but also because of its over-representation in global equity indices.

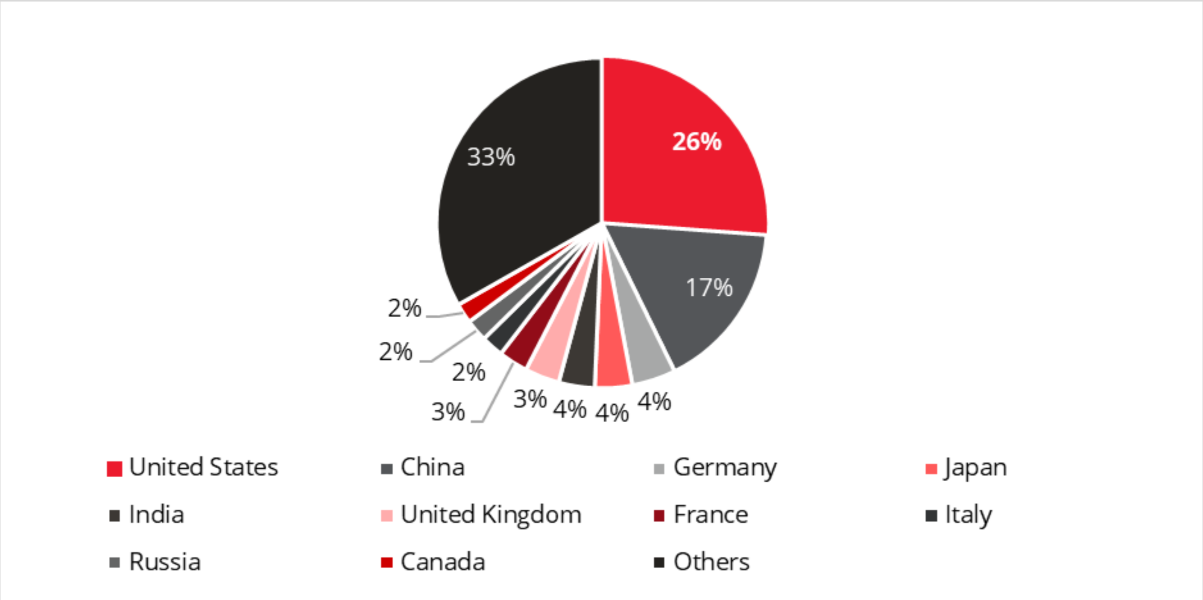
The correction of the imbalances in equity indices, in favour of emerging and international markets at the expense of the US, is a long-term structural feature that is likely to be corrected gradually.

Chart 12: Top 5 MSCI ACWI Index country weights (%)



Source: Bloomberg, Redwheel 31 December 2025. The information shown above is for illustrative purposes.

Chart 13: Top 10 countries by global GDP contribution (%)



Source: IMF WEO, Redwheel October 2025. The information shown above is for illustrative purposes.

The next chapter

The conditions that powered the last emerging market super cycle – cheaper currencies, firmer commodities and a relative growth advantage – are re-emerging. We expect long-term allocators to look increasingly beyond the US towards markets that offer diversification, lower valuations and increased exposure to manufacturing industries underpinned by structural growth tailwinds. In our view, 2026 could prove to be the next chapter in a longer cycle of international equity leadership.

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