

Emerging markets: The answer to more than one question

Investing often begins with a question. Precisely what that question is, however, will be determined by a range of factors – your appetite for risk, your investment philosophy or, perhaps most importantly, your time horizon. For example, if you're comfortable making short-term calls on asset allocation and believe you possess the gift of timing the market, you might start by asking:

- Where are valuations most attractive?
- If interest rates fall, which markets would benefit?
- If the dollar continues to weaken, where might US asset owners redeploy their capital?

Alternatively, if you prefer to take a longer-term view, you might ask:

- Where do demographic trends support corporate profits?
- Where do long-term human development trends give companies a runway for growth?
- Where are debt-to-GDP dynamics supportive rather than restrictive?

At Stewart Investors, we don't claim to have any edge in timing the market. And although we incorporate analysis of long-term trends into our thinking, we believe our advantage lies in identifying high-quality companies and being sufficiently patient to allow them to compound wealth on behalf of our clients. Because we focus on finding and backing high-quality companies, we tend to ask:

- Which are the world's highest-quality, most innovative companies? And where are they most attractively valued?
- Where can we find business owners and leaders who take a multi-decadal view and who have the experience of leading companies through tough times?

At this point, we would suggest that the answers to all of these questions point in the same direction: towards emerging markets.

The tactical case for emerging markets

We are long-term investors: ideally, we want to own a company's shares for a decade or longer. Equally, we acknowledge that there are points in time when shorter-term considerations neatly align with our longer-term, strategic approach to investing. We may be at one of those points.

- Interest rates are moving lower.** Rate cuts in the US have historically been associated with rotations into emerging markets as investors have sought higher returns overseas.
- Lower interest rates in emerging markets should support consumer demand.** As rates around the world follow the US down, mortgage costs and car loan should fall, underpinning consumer spending.

–**By lowering the discount rate applied to long-term earnings, lower rates could prompt a revaluation of emerging-market equities.** At 15%, Brazil currently has among the highest interest rates in the world. To this point that has suppressed consumer demand and held down the valuation multiples awarded to the shares of some of its high-quality companies. Lower rates should change that.

–**A weaker dollar helps emerging markets by reducing their borrowing costs.** The underperformance of emerging markets for most of the past decade has been a mirror of the dollar's strength. And as the dollar weakened through the first seven months of 2025, emerging markets began to outperform.

–**Valuations favour emerging markets.** At the end of July, the MSCI Emerging Markets index traded on a historic price-to-earnings (p/e) multiple of 15x; the MSCI US index was almost twice as expensive, trading on a p/e of 28x.

The strategic case for emerging markets

Irrespective of the short-term arguments for increasing your exposure to emerging-market equities, the long-term case is much the same as it was when Stewart Investors began investing in them, nearly four decades ago.

- Favourable demographics.** Many emerging-market economies have younger populations than developed economies, and those populations are growing. The average Filipino, for example, is 25 years old – 19 years younger than the average European¹.
- GDP growth is increasingly being led by investor-friendly economies.** One valid criticism of emerging markets is that, over the past decade, their superior GDP growth hasn't translated into stronger returns from equities. In part, that reflected the structure of the Chinese market, whose largest listed companies can be obliged to put the interests of the state before those of their shareholders. Looking forward, however, growth is expected to be led by countries such as India, whose listed companies have demonstrated an impressive ability to convert economic growth into earnings per share. The IMF expects emerging market and developing economies to grow at an average rate of 4.0% through to 2030, versus 1.7% for advanced economies. Within that, however, it anticipates India – whose listed sector is rich, broad and adept at capturing economic growth – to grow by 6.5%.²

Why Stewart Investors' focus is on quality.

Irrespective of whether we are investing in developed or emerging markets, our focus is on making long-term investments in 'high-quality' companies. These are companies that generate sustainably high returns on capital and show

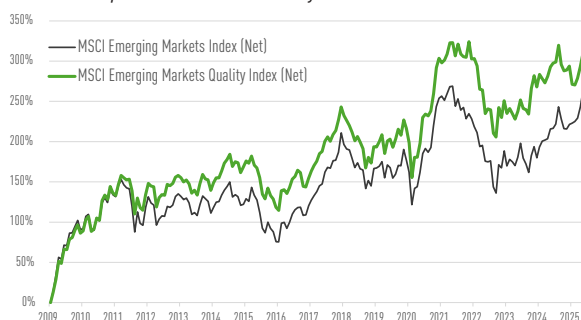


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predictable patterns of cash-flow generation. They are companies who take a conservative approach to managing their balance sheets (we prefer businesses that don't rely on debt and that can weather the storms when they come). And they are companies whose stewards continually pursue long-term growth rather than short-term payouts. Our experience suggests this focus on quality helps to protect our clients in times of crisis and to grow their wealth over the long term.

Some – but by no means all – of the characteristics we look for are, albeit imperfectly, captured by the 'quality' factor measured by index providers. And, while the MSCI Emerging Markets Quality index has endured an unusually weak run of performance over the last 18 months or so, do not lose sight of the fact that it has handily outperformed the broader, 'plain vanilla' MSCI Emerging Markets Index over the longer term.

Quality outperforms over the long term cumulative performance to 31 July 2025 (%)³



¹https://en.wikipedia.org/wiki/List_of_countries_by_median_age.
²Source: IMF World Economic Outlook April 2025.

Which are the world's most innovative companies? And where are they most attractively valued?

If you were to compile a list of the world's most innovative companies, where would you look first? Consider that:

- The world's most advanced (2-nanometer) semiconductors are made by TSMC in Taiwan.
- China leads the world in fast-charging EV battery technologies.
- Asian companies, particularly in India, are global pioneers in quick commerce ('Q-Commerce'), a turbocharged variant of e-commerce in which food, gifts or even medicines are delivered in less than an hour.
- Fintech companies across emerging markets are broadening financial inclusion by using smartphone apps and payment technologies to model their users' creditworthiness and so offer them current accounts, insurance, and credit cards.

A focus on innovation – reinvesting cash flows generated today to reinforce their franchise for tomorrow – is a useful indicator of whether a company's focus is on long-term growth rather than short-term gains. The majority of the global leaders in innovation are currently to be found in the US and emerging markets, particularly Asia. Interestingly, the shares of the first group tend to be widely owned and richly valued; the shares of the second are not.

The resulting disparity in valuations, when combined with lower interest rates and the weaker dollar, should draw attention to the opportunity that emerging markets – and particularly high-quality emerging-market companies – are currently offering. Only one question remains: when will you take it?

³FactSet as at 31 July 2025

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