

Emerging markets – Where AI and commodity themes drive valuation upside

BY ALLEN CHAPRACKI, CFA, AND MATT ORTON, CFA¹

Following a year when the MSCI Emerging Market Index gained 33.4% compared to 17.9% for the S&P 500 Index, it's natural to wonder whether emerging markets can continue to outperform United States equity markets.

Until 2025, there was reason to doubt it. Emerging markets (EM) had struggled for a decade to keep pace with U.S. equities, largely due to volatility in China and a lack of sustainable catalysts elsewhere.

Now, however, we believe there are factors that could support continued outperformance, including:

- signs of improving earnings growth,
- a relative valuation discount to the S&P 500, and
- possible further weakness of the U.S. dollar.

Improving global economic growth has the potential to support key sectors, such as financials and commodities, while exposure to some of the most critical companies across the global semiconductor and memory supply chains may provide continued upside in information technology.

Valuations also remain attractive, with the MSCI Emerging Markets Index trading at a 2026 forward price-to-earnings (P/E) ratio of

Key takeaways

- Potential multi-year outperformance for emerging markets (EM) compared to U.S. equities.
- Valuations remain attractive for emerging market equities relative to the S&P 500 Index.
- Critical exposure to artificial intelligence, commodities, and tailwinds from further U.S. dollar devaluation support the case for potential further strong performance.

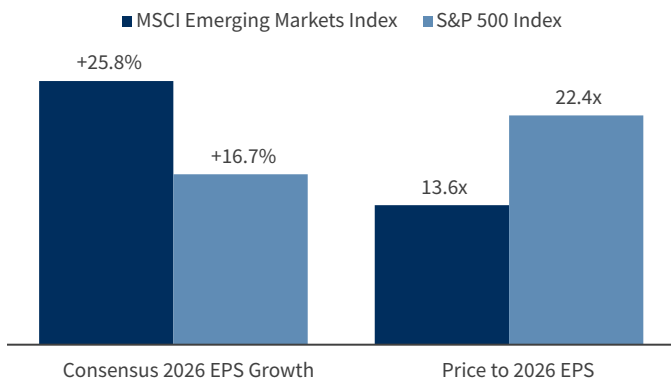
¹ Matt Orton, CFA, is Chief Market Strategist at Raymond James Investment Management. Allen Chapracki, CFA, is Director of Risk and Analysis, Chartwell Investment Partners

13.6x compared to 22.3x for the S&P 500. While sector differences and higher volatility in emerging markets help to explain the valuation gap, a discount of this magnitude relative to the S&P 500 was last seen in the late 1990s and early 2000s, just ahead of a bull run that lasted through 2007.

In short, there are reasons to believe that 2025 was no fluke. Below, we discuss four of those reasons and their potential to drive emerging market performance in the years ahead.

There's growth abroad, and it comes at a discount

Index fundamentals



Source: Bloomberg, as of 1/27/2026.

Help from a devalued U.S. dollar

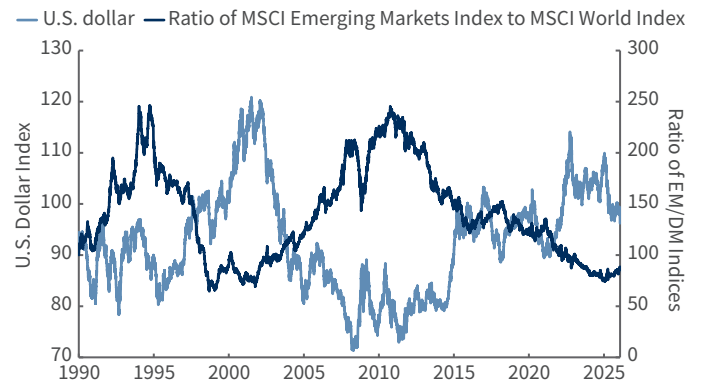
A weaker U.S. dollar acts as a tailwind for emerging market equities by supporting the appreciation of local currencies, reducing the cost of imported goods, and boosting commodity prices.

It also benefits countries with higher inflation and significant external financing needs by reducing growth-related costs and strengthening household purchasing power.

Finally, a weak dollar is typically associated with higher capital inflows into emerging economies, which support economic growth and local markets.

A falling dollar is a tailwind for emerging markets

EM/DM relative performance vs. the U.S. dollar



DM = developed markets
Source: Bloomberg, as of 1/27/2026.

AI growth is global

The growth in artificial intelligence (AI) is supported by several large companies based in emerging market countries that may offer potential portfolio diversification benefits.

For instance, the U.S. stock market and technology sector were rattled in January 2025 when Chinese AI company DeepSeek announced the release of a high-performance AI model that could be produced at a fraction of the cost and with fewer resources than the models from leading U.S. firms. The U.S. equity market and technology sector recovered, but the shock was a reminder that U.S. companies may not sustain their lead in AI forever.

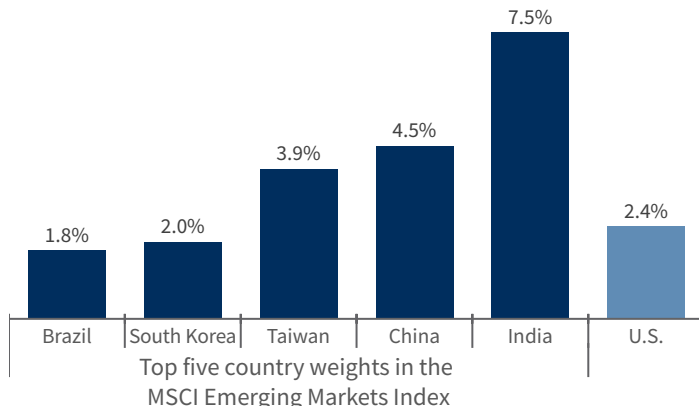
Moreover, it's worth noting that the top five positions in the MSCI Emerging Markets Index significantly influence the growth of AI and are often associated with key bottlenecks including memory and semiconductor fabrication.

EM financials: Banking on growth, AI, and competitive fundamentals

Emerging markets have 22% exposure to the financial sector, which is supported by strengthening gross domestic product growth across several emerging market countries.

Emerging markets sport robust economic growth

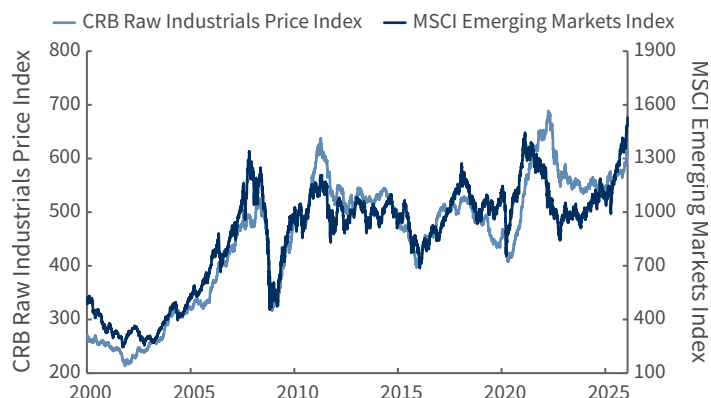
Bloomberg consensus 2026 real GDP growth



Source: Bloomberg, as of 1/27/2026.

So go commodities, so go emerging markets

Commodities vs. emerging markets indices



Source: Bloomberg, as of 1/27/2026.

The financial sector also benefits from growth in AI, adoption of fintech and digital infrastructure, and credit growth in households and businesses. Additionally, emerging market financials trade at a significant discount on a price-to-book ratio compared to the S&P 500 and the S&P 500 Financials Index. They also have a higher dividend yield and earnings growth.

Emerging markets have commodities the world needs

Many of the world's industrial metals, precious metals, and rare-earth minerals are mined in emerging market countries, providing additional potential portfolio diversification benefits.

We believe commodity prices are poised to trend higher due to two key factors. First, there's a structural supply and demand imbalance caused by the growing needs of the makers of semiconductor chips, military technology, electric vehicles, and solar panels. Second, in a variety of industries, the commodity supply cannot be quickly ramped up to meet the demand:

• Industrial metals

– Copper:

- Demand is growing from AI data centers (wiring/electronics), military applications (advanced weaponry, missiles, etc.), electric vehicles (approximately three times as much copper is used in electric vehicles as in traditional internal combustion engine vehicles), electric transmission, and solar panels.

- Chile, Indonesia, and Peru are the world's top global producers of copper.

– Aluminum (made from bauxite ore)

- Versatile, lightweight, and corrosion-resistant metal used across transportation and aerospace, construction, packaging, electronics, consumer goods and appliances, and industrial applications (e.g., solar panels).
- China is the world's largest producer of aluminum.

– Steel (made from iron ore and coal)

- Primarily used in construction (bridges, infrastructure), as well as transportation, machinery, energy infrastructure, and household appliances.
- China is the largest global producer of steel.
- China, India, and Indonesia lead coal production, while Brazil is the top producer of iron ore.

• Precious metals

– Gold

- Gold's value is appreciating as central banks (primarily emerging markets) purchase it to help diversify away from U.S. Treasuries, hedge against U.S. dollar debasement, and seek a safe-haven asset amid global instability.
- Mexico and South Africa are among the top global gold producers.

- Silver
 - Silver has a wide range of use cases, including industrial applications, electronics, medicine, and jewelry.
 - Silver is also used in solar panels, automotive electrical components, 5G infrastructure, and water purification.
 - Silver is in short supply because it is produced as a byproduct of other mining activities. As such, silver production is difficult to ramp up.
 - Mexico, China, and Peru are the top global producers of silver.
- Platinum
 - Platinum is primarily known for its use in jewelry and catalytic converters to reduce air pollution from internal combustion engine vehicles, but is seeing increased demand in hydrogen fuel cells, semiconductor chips, and quantum computing chips.
 - South Africa is the largest producer of platinum group metals.
- Rare-earth minerals
 - 17 metallic elements (scandium, yttrium, and 15 lanthanides) essential for high-tech applications such as magnets, batteries, and defense systems.

- China has the largest rare-earth mineral reserves and production, followed by Brazil, Vietnam, Australia, and India.
- While the United States, Myanmar, and Australia are major producers alongside China, China dominates processing and supply chains, making it crucial for global technology.

Investment playbook

After a strong 2025, emerging market equities remain well positioned compared to U.S. equities due to their fundamentals.

- Upside catalysts include strong economic growth, which translates to sustained earnings growth.
- Despite recent strong performance, valuations remain attractive.
- Secular drivers ranging from AI's buildout to the early stages of a commodity cycle also support emerging markets.
- Continued pressure on the U.S. dollar may provide further tailwinds for emerging markets and support commodity pricing, creating a cycle that would benefit emerging markets.

Given the attractive valuations and gathering momentum, investors may consider "buying the dip" to diversify into emerging markets as we see potential opportunities amid elevated market uncertainty.

Risk Information:

Investing involves risk, including risk of loss.

Diversification does not ensure a profit or guarantee against loss.

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Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. The prices of small company stocks may be subject to more volatility than those of large company stocks.

International investing presents specific risks, such as currency fluctuations, differences in financial accounting standards, and potential political and economic instability. These risks are further accentuated in emerging market countries where risks can also include possible economic dependency on

revenues from particular commodities or on international aid or development assistance, currency transfer restrictions, and liquidity risks related to lower trading volumes.

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, disease, and regulatory developments.

Definitions

Artificial intelligence (AI) – A technology that enables computers and machines to simulate human learning, comprehension, problem solving, decision making, creativity and autonomy.

“Buy the dip” - Refers to an investment strategy that consists of buying an asset or group of assets when the price has dropped on the theory that the decline will not last and that the price is likely to rise again and thus represents a discount.

Dollar debasement – The lowering in value of the U.S. dollar, sometimes in response to efforts to increase the money supply in the absence of a similar increase in overall economic output.

Earnings per share (EPS) – A company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

Gross domestic product (GDP) – The total value of goods and services provided in an economy during a specified period, often one quarter or one year.

Hedge – An investment or investment strategy that is designed to lessen the potential for losses in other investments. The price of an investment considered to be a hedge often moves in the opposite direction of the prices of the investments being hedged.

Price-to-book (P/B) ratio - measures the market valuation of a company relative to its book value. Investors use the metric in their search for potential investments. Typically, a company's market value is higher than the book value of its stock. Value investors generally view P/B ratios under 1.0 as a potentially solid investment.

Price-to-earnings (P/E) – A ratio that measures a company's current share price relative to its earnings per share. The ratio is used to help assess a company's value and is sometimes referred to as the price multiple or earnings multiple.

Tailwind – An event or market force that exerts a positive influence on an investment's performance.

Valuation - Reflects the current or projected worth of a company or other asset. Valuations can be derived using a variety of analytical models and data. Valuations can reflect the absolute value of a company considered singly or the relative value of a company compared with other companies in the market.

Valuation gap – The difference between the current price of an asset and the value that an investor has assigned to it.

U.S. Dollar Index - a measure of the value of the U.S. dollar relative to the value of a basket of currencies from most of the U.S.'s most significant trading partners.

Indices

Commodity Research Bureau (CRB) Raw Industrials Index - The oldest commodities index in the U.S. compiled by Barchart, a company that provides stock and commodities intelligence, that tracks the spot prices of sensitive commodities such as tallow, burlap, rosin, cotton, tin, cow hides, wool as well as half a dozen others.

S&P 500 Index - Measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market.

S&P 500® Financials Index - Comprises those companies included in the S&P 500 that are classified as members of the GICS® financials sector.

MSCI EAFE (Europe, Australasia, and the Far East) Net Index - Measures the performance of performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the United States and Canada. The MSCI EAFE Net Index subtracts any foreign taxes applicable to U.S. citizens but not applicable to citizens in the overseas country.

MSCI World Index - Captures large and mid-cap representation across 23 Developed Markets (DM) countries and does not include emerging markets. With 1,603 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. DM countries include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the U.K., and the U.S.

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RAYMOND JAMES | INVESTMENT MANAGEMENT

880 Carillon Parkway, St. Petersburg, FL 33716 | 1.800.521.1195 | RJInvestmentManagement.com

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