Emerging from the shadows

FEML has delivered strong results during a challenging year.

Update
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It's been a long time coming, but emerging markets are finally having their moment in the sun and, far from merely having their 15 minutes of fame, the outlook for emerging markets looks constructive, in our view.

The MSCI Emerging Markets Index has soared so far this year, up 31% in US dollar terms to 10/11/2025, versus a return from the MSCI USA of 15.4%. We see plenty of compelling reasons to suspect we could see a prolonged period of strong absolute and relative performance from emerging markets.

The weaker US dollar has played a key role in this outperformance. The Dollar Index Spot Price has fallen c. 9% since the start of 2025, in part down to the fact that investors are increasingly questioning the sustainability of the US fiscal backdrop. Indeed, many developing economies are in strong fiscal positions and valued cheaply both relative to their long-term history and to the US market.

While enthusiasm around AI has driven US markets higher in recent years, in fact, technology leadership, particularly within the artificial intelligence and electric vehicle supply chains, has this year helped countries such as China and Taiwan, which provide investors worried about the valuations of the Magnificent Seven with opportunities to diversify away from them.

A nascent but continuing recovery within China, which we'll cover soon, completes the story.

When it comes to investing in as heterogenous an asset class as emerging markets, active management is key as they can ignore large, low-quality and inefficient businesses in favour of high-quality, less-well-covered private enterprises.

We would highlight **Fidelity Emerging Markets (FEML)** as a quality and differentiated strategy within emerging markets. FEML benefits from a highly experienced management team, led by Nick Price and Chris Tennant, who have 27 and 14 years at the company under their belts respectively. They can also call on a team of around 50 analysts dedicated to emerging markets, with teams based in London as well as embedded analysts on the ground, across key regions.

Performance has been impressive, with FEML's three-year net asset value and share price total returns standing at c. 56% and 64% respectively, versus a c. 50% return from the MSCI Emerging Markets Index, as at 10/11/2025.

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FEML benefits from its high-conviction, go-anywhere mandate, allowing Nick and Chris the flexibility to build a portfolio that looks different from the index. In addition, the extensive use of derivatives, including through short positions, allows management to add alpha through betting against companies with fundamental vulnerabilities such as weak balance sheets, poor management or structurally challenged business models.

Opportunities among Chinese 'experiences'

The backdrop for the China consumer remains complex. House prices remain depressed, and growth is still negative, in effect dampening consumer appetite, with consumption as a proportion of GDP still low in China versus developed markets. Yet, there are green shoots, as policy measures such as lower interest rates should help to stimulate some demand.

In the consumer space, two trends stand out: shifting consumer preferences in favour of domestic over international brands; and underpenetrated 'experience' categories like music streaming and travel.

Bosideng, which makes goose down jackets, is a well-managed, quality company that has a c. 15% market share in the down apparel market. Its impressive return profile compares favourably with, for instance, France's Moncler.

There is low competition within the Chinese online music market, with Tencent Music Entertainment (TME) commanding a huge c. 80% share of it, putting it in a strong position, even in the global context where competition is rife.

Taiwan

April's market falls sparked by Liberation Day presented FEML's managers with plenty of opportunities to buy at cheaper valuations. One area they took advantage of was buying more into Taiwan, the home of the technology supply chain.

TSMC remains the largest holding within the trust, but other names also have place, including E ink, which makes e-paper displays – the pricing signs on supermarket shelves, for instance, or the tags on your luggage at the airport.

E ink's share price fell c. 37% in the space of a month between March and April, yet the company has a market share of c. 90% in an attractive market (e-paper is a much more sustainable way of displaying information).

Low valuations

One country with an attractively valued stock market is Mexico, which should benefit from its proximity to the US, as American businesses look to move their manufacturing chain closer to home. The fact that manufacturing labour costs are now cheaper in Mexico than they are in China helps.

Mexico is also home to lots of high-quality compounders such as Gruma, which makes flour tortillas, where the ROE is c. 28% and the stock has an attractive dividend yield, along with a share buyback. Two-thirds of Gruma's revenues come from the US and it has a number of production facilities in the States, which should protect it from any potential increase in tariffs. FEML notes that were the company listed in the US, it would trade at a significant premium to its current multiple of c. 11x.

Go-anywhere approach

We mentioned FEML's unconstrained approach to investing allows the managers to discover uncovered and off-the-radar gems trading on attractive valuations with big runways for growth. Here, we'd highlight Georgia's TBC Bank as a good example.

Georgia has a population of almost 4m, and its two biggest banks, TBC and Bank of Georgia, have a combined market share of c. 80%. This dominance allows TBC to earn returns of equity of c. 25%, and a dividend payout ratio of c. 35%, while its recent launch of a digital bank in neighbouring Uzbekistan, which has a population 10 times that of Georgia, offers huge scope for expansion.

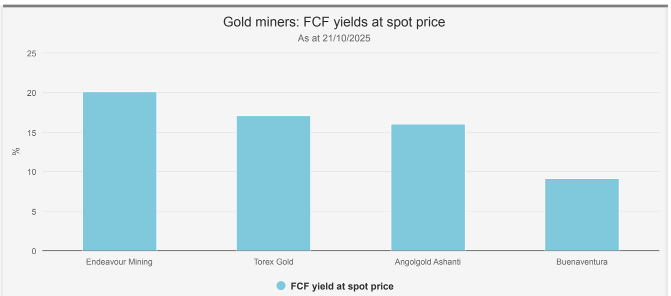
Despite its current and potential future profitability combined with an experienced CEO with an excellent track record of running fintech companies, TBC trades on a lowly price-to-earnings ratio of just c. 5.7x, making it seemingly unloved.

Metals and electrification

Gold has been benefitting from a number of powerful trends, turning the physical asset into one of the biggest winners of 2025. Ongoing concerns around fiscal discipline in developed economies, especially the US, have led to bond market volatility and strengthened the case for gold. Meanwhile, central banks, particularly those in the east, have been diversifying away from US Treasuries and stocking up on their gold reserves following Russia's invasion of Ukraine.

This has a knock-on impact to gold miners, where FEML sees the potential for expanding margins as higher gold prices coincide with lower energy costs. Despite recent strength, many still offer appealing free cash flow yields.

Fig.1: Gold Miners Are Profitable



Source: Fidelity analyst estimates

The metals story isn't just about gold though. Electrification provides investors with another potential way to profit from commodities and copper is a favoured play here.

The shift in the generation mix requires a re-engineering of the grid in favour of copper, while electric vehicles require a substantial amount of copper, too. These two factors should provide powerful tailwinds to long-term demand for copper.

FEML holds several miners such as Peru's Buenaventura, which mines gold, silver and copper, giving it the potential to benefit from long-term trends for a trifecta of metals. Sieyuan Electric, a Chinese electrical equipment maker, provides exposure to electrification.

Outlining FEML's key differentiator, the managers can also look to benefit from both sides of the trade within certain industries, taking a long position in structural winners and shorting the losers within a particular sector.

Battery makers is a case in point. China's CATL has a c. 30% market share and is benefiting from consolidation within the market, providing structural tailwinds. In contrast, the Korean battery industry is crippled with over-capacity, with many companies fighting broken balance sheets.

A compelling option

As we said earlier, emerging markets is a vast and heterogenous asset class that remains exposed to external shocks, currency fluctuations and shifts in investor sentiment that can make them more volatile than their developed counterparts, something we've witnessed in major markets like China and India recently.

Broader emerging and frontier regions, though, have shown stronger returns and lower volatility this year than many might have expected in a year marked by trade tensions, shifting US tech sentiment and tariff uncertainty.

It's important to favour emerging market trusts with experienced management teams backed up by strong on-the-ground analyst teams with strong local knowledge, in our view.

FEML's ability to take both long positions in companies with strong upside potential and short positions in those with red flags around their balance sheets or facing structural headwinds introduces a valuable source of differentiated alpha that sets it apart from most long-only peers, all delivered at a comparatively low cost – the second lowest charges in the sector.

This has all paid off and FEML has delivered strong results in a year marked by uncertainty, contributing to a narrowing discount. We think FEML's differentiated proposition makes it a compelling long-term option for investors seeking exposure to emerging markets' complex and evolving potential.

Should the trust's performance momentum and the broader revival in emerging market sentiment continues, we see further scope for the discount, currently c. 8%, to tighten.

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