Weekly perspective on current market sentiment June 4, 2025

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Last week's S&P 500 Index: +1.9%

Not chasing emerging market outperformance

Key takeaways

- Analyst emerging-market (EM) earnings estimates for coming quarters are appearing to bottom out and some EM economic data came in modestly better than expected.
- But we think the rally in the MSCI Emerging Markets Index (MXEF) is well ahead of the economic fundamentals. We are not chasing the EM outperformance.

On a year-to-date performance basis, the MXEF has soundly beat the S&P 500 Index (SPX), notching a 7.5% percent gain against the U.S. large-cap benchmark's 1% increase, according to Bloomberg data at the time of this writing. This has garnered much attention from the financial press as some pundits continue to speculate that the era of "American exceptionalism" has come to an end, or at least that the concept is meaningfully diminished.

Even while a number of EM economies are sputtering (think China, the 800-pound EM gorilla) and likely would not fare well in a drawn-out global trade war, some investors are adjusting portfolio allocations to feature more EM exposure and less U.S. But is this the right move now for long-term investors who are trying to build wealth in stocks over time? In short, we don't think so.

A quick glance at MXEF performance over the past 20 years (June 2, 2005, to June 2, 2025) shows the index meaningfully below the level seen in late October 2007, just before the start of the Great Financial Crisis. Over the same time frame, the SPX is up nearly 400%. While countries like China are trying to turn their economies more toward domestic consumer consumption and reduce their reliance on exports for growth, the fact remains that they are still dependent on the developed world, especially U.S. consumers, buying their "stuff." Global trade volumes in the near term are likely to remain subdued as developed economies slow. That weighs on EM earnings.

Much of the outperformance in the MXEF this year can be traced to a combination of factors. First, coming into this year, U.S. equities, as gauged by the SPX, were not cheap. Investors were counting on robust performance from not only the largest-cap tech and tech-like individual companies, which have had a big influence on the index in the past couple of years, but also the view that earnings and individual equity performance within the SPX would show more of a broadening trend. More sectors, industry groups, and individual stocks making up the SPX and participating in the rally would be a positive sign in our view. But uncertainties over tariffs and related growth and inflation concerns weighed on SPX performance in the first three months of this year.

Other factors at play have included consensus analyst EM earnings estimates for coming quarters appearing to bottom out and a number of EM economic data reports that came in modestly better than expected. We believe EM economic and earnings expectations are not likely to pan out in coming quarters.

If investors are carrying Emerging Market Equities exposure above our recommended portfolio weighting, we suggest trimming from that position and reallocating toward the favored U.S. Large Cap Equities and U.S. Mid Cap Equities. We think the rally in the MXEF is well ahead of the economic fundamentals. As a result, we are not chasing the EM outperformance we have seen so far this year. Remain underweight.

Risk considerations

Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks.

Definitions

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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