Baillie Gifford™

Your capital is at risk. Past performance is not a guide to future returns. The following update is based on a representative portfolio. As such, stock examples may not be held in every client portfolio, and performance may differ.

Mike Gush: One of the defining features of investing in emerging markets is that it almost never feels comfortable. That is true even when returns are strong. Over the past year, despite trade wars, real wars, bubble fears, and China's ongoing property woes, emerging markets managed to deliver returns of over 30 per cent in US dollar terms. That was driven by at least two powerful forces.

First, the continuing AI investment cycle. And second, strength in many commodities. But what now? Well, after a year like 2025, the skepticism tends to fall into two camps. Some may view it as a one off or a bit of a catch up for emerging markets. They might expect returns to get harder again relative to the superior US market. Others may see it as mostly a sentiment improvement, just a rerating, in other words, and not the start of something more durable.

We don't think either frame is particularly useful. The more helpful way, I think, is to say that the conditions that held back emerging markets for much of the last 15 years have broadly shifted, and that creates a different sort of investment environment.

So as we enter 2026, we are struck by the resilience of emerging markets countries overall across several major emerging economies. Current accounts are stronger. Inflation is more contained, and policy credibility has improved. That gives central banks room to support growth if needed. And this is a very different starting point from previous emerging market cycles. And looking ahead, if we see the expected combination of US rate cuts and stubborn US inflation, then the chances of a renewed strong dollar to upend the E.M. strength feels low.

It's also worth taking deliberate note of the new US security strategy, which marks a change in tone. It's explicitly accepted more multipolar world, where power is distributed across regions rather than dominated by one. And as we've discussed with you before, this feels very positive for trade, capital and supply chains in emerging markets.

Now add one more ingredient. Emerging markets remain structurally underowned even after a strong year many global allocators remain cautious. Less than a third of global funds are overweight emerging markets. Or consider the point another way. If you look back at the historic weighting of emerging markets in the ACWI index, we still have a long way to go to get back to the 2009 peak of around 14 per cent.

Now, against what feels like a very positive backdrop, how are we thinking about the portfolio? Well, first, those companies most closely associated with AI have unsurprisingly been a major return driver over the past year or so, and we've made some modest reductions where appropriate to ensure portfolio diversification. In particular, your holdings in Korea have had a very strong run including Samsung Electronics and SK Hynix, and they've also been supported by a wider governance reform backdrop in the country.

Second, we've been spending more time on the second order beneficiaries of AI capex. A constraint that is becoming clearer is power. Datacentres, grid infrastructure, storage and transmission are already becoming the bottlenecks in the system, perhaps with China being the notable exception. We've been adding exposure selectively across areas like power generation, energy storage and materials that sit in the supply chain. And it's worth saying that your materials sector exposure also contributed very positively to returns in 2025.

Third, we've been upgrading the growth profile of your China holdings by making some additions. Consumer confidence is still subdued, but the idea of supporting consumption is now explicitly embedded in the government's new Five Year Plan. And that really matters because it anchors policy firmly in that direction.

The potential fuel is significant. Chinese households have around US$23 trillion in bank deposits, which is comparable to its entire equity market. In the US, the picture is very different. The equity market dwarfs the size of household deposits. At a time when deposit rates are low in China, when Chinese bond yields aren't offering much and the property market has clear challenges, we also need to be, at the very least, open minded to more equity market flows. We don't assume a rush into equities, but even a gradual shift would be meaningful here, given the scale.

Overall, I'm feeling really upbeat. It would be too complacent to declare that we're at the beginning of a golden era for emerging markets, but we're comfortable saying that the setup is better than it has been in some time. Company and country fundamentals are strengthening, positioning remains light, but sentiment is improving. You don't have to pay hefty developed market multiples for this superior emerging markets growth. Thank you as always for your continued support.

Emerging Markets

Annual past performance to 31 December each year (%)

	2021	2022	2023	2024	2025
Emerging Markets All Cap Composite (gross)	-7.8	-26.5	15.1	6.9	40.6
Emerging Markets All Cap Composite (net)	-8.5	-27.1	14.2	6.1	39.4
Emerging Markets Leading Companies Composite (gross)	-7.5	-25.4	11.9	6.6	35.3
Emerging Markets Leading Companies Composite (net)	-8.3	-26.0	11.0	5.8	34.2
MSCI Emerging Markets index	-2.2	-19.7	10.3	8.1	34.4

Annualised returns to 31 December 2025 (%)

	1 year	5 years	10 years
Emerging Markets All Cap Composite (gross)	40.6	3.2	10.5
Emerging Markets All Cap Composite (net)	39.4	2.4	9.6
Emerging Markets Leading Companies Composite (gross)	35.3	2.2	10.8
Emerging Markets Leading Companies Composite (net)	34.2	1.3	9.8
MSCI Emerging Markets index	34.4	4.7	8.9

Source: Revolution, MSCI. US dollars. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised.

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