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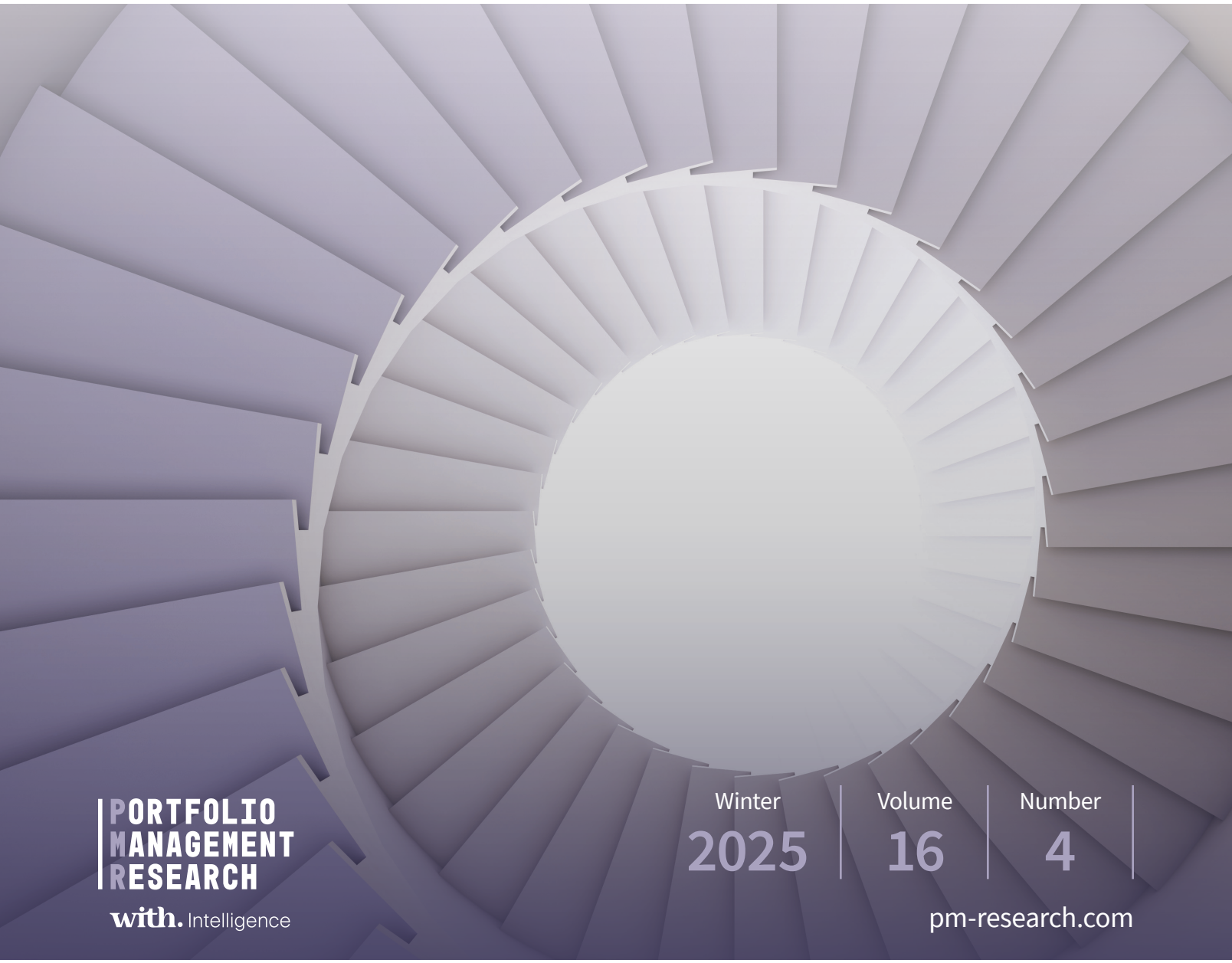

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Long-Term Investing in Emerging Markets:
Identifying Drivers of Total Shareholder Return in Emerging Market Equities

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Long-Term Investing in Emerging Markets: Identifying Drivers of Total Shareholder Return in Emerging Market Equities

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KEY FINDINGS

- **A disconnect between topline economic growth and per-share returns:** Despite a rising share of global GDP and a larger universe of listed securities, emerging markets (EMs) have lagged developed markets since the 2008 global financial crisis, largely because of persistent share dilution and sagging profitability.
- **A bifurcated market of under- and overachievers:** "Long-term compounders" in EMs sustained returns by emphasizing profitability, stable cash flows, and disciplined capital allocation.
- **Opportunities for investors:** With potential opportunities for active management of EM equities, active managers may seek to identify compounders based on key fundamental metrics. Managers of systematic or index-based strategies may consider tilting toward profitability, high-dividend yield, disciplined dilution, and stable earnings.

ABSTRACT

Emerging market (EM) equities have historically held a central position in global equity allocations seeking growth and diversification, yet they have underperformed developed market equities by nearly 5% annually since the 2008 global financial crisis. Key factors limiting returns were currency depreciation versus the US dollar and persistent share issuance, diluting earnings growth. Despite these headwinds, certain EM stocks consistently outperformed by demonstrating specific operational strengths beyond mere revenue expansion. Guided by a framework of decomposing total shareholder return, this research identifies fundamental attributes common to these outperforming stocks, namely investment quality, return-of-capital policies, and the balance between growth and profitability—traits evident even in EM regions beyond China. This framework is relevant for both active and systematic investors. For discretionary managers, identifying high-quality companies with capital-return policies may reveal opportunities, and indexed investors could employ systematic approaches that emphasize similar factors.

Once heralded for their high growth potential, emerging market (EM) equities have significantly underperformed developed market (DM) equities since the 2008 global financial crisis (GFC), casting doubt on the traditional EM

narrative (e.g., see Stone 1992; Divecha, Drach, and Stefek 1992; Errunza 1994). Meanwhile, new developments—such as China's policy shifts and range-bound equity market and India's ongoing capital market reforms—underscore diverging trajectories across EM countries. As a result, investors could be reconsidering the relevance of EM stocks in global equity portfolios.

We begin by highlighting the expanding EM investment opportunity set and by examining the components of total shareholder return, paying special attention to share issuance, a phenomenon that often undermines growth in earnings per share (EPS). We then draw on the longer history of EM equity index data and apply a new equity factor model that connects operational levers to stock returns. Our analysis aims to clarify which fundamental attributes have helped certain EM companies thrive. The framework we propose is designed to aid portfolio managers of both active and indexed strategies in better identifying those signals associated with firms capable of converting emerging economies' expansion into total shareholder returns.

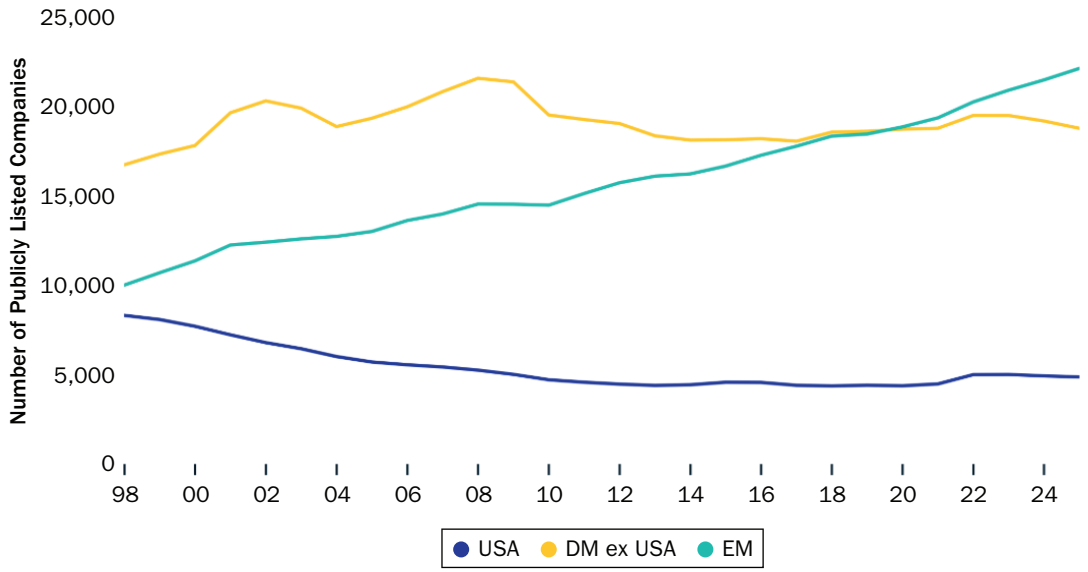
EM OPPORTUNITY SET

The number of listed companies in global equity markets has grown steadily over the past two decades, driven primarily by EMs. The number of listed securities in EMs has increased by roughly 100% since 1998, supported by expanding capital markets such as those in China and India. In contrast, the universe of publicly listed companies in developed markets (DMs) has declined. In the United States, the number declined steadily from 1998 to 2010 but has risen slightly since the COVID-19 pandemic. These patterns are shown in Exhibit 1.

The share of EM securities in the Morgan Stanley Capital International All Country Word Index (MSCI ACWI) Investable Market Index (IMI) has also increased over the past two decades. Concurrently, EMs outpaced DMs in economic growth during this period.

EXHIBIT 1

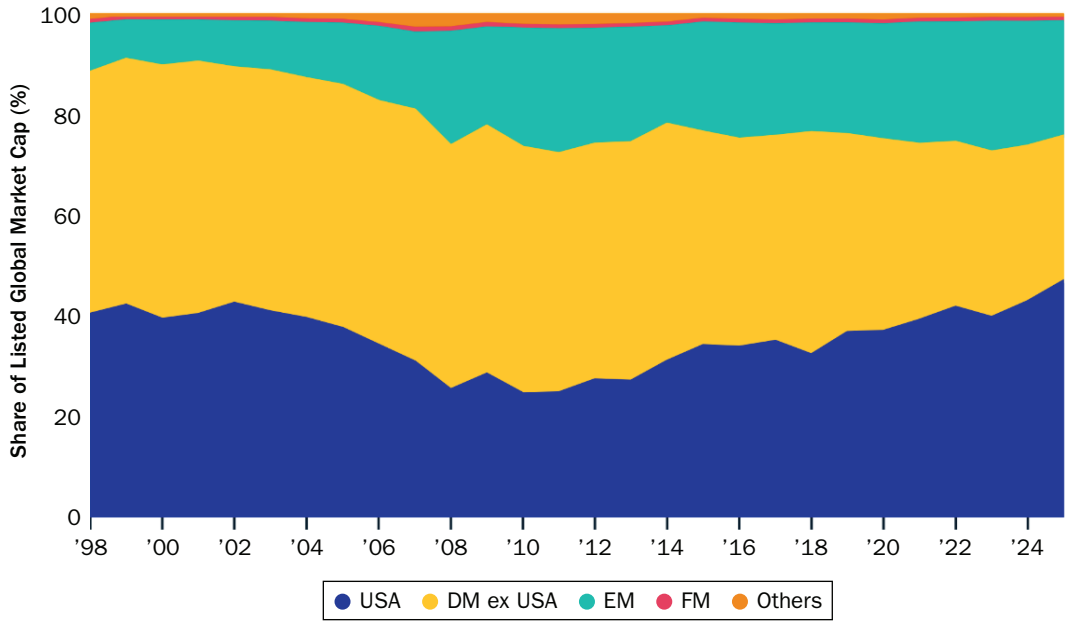
Rise in the Number of Listed Companies Globally Driven by EM Issuance



NOTES: The data period spans 1998–2024, with the number of companies measured at year-end, excluding the over-the-counter market. The counts for DM, DM ex USA and EM are based on listed securities classified as eligible for the MSCI World, MSCI World ex USA, and MSCI Emerging Markets indexes, respectively.

EXHIBIT 2

EM Share of Listed Market Cap Has Remained Flat Since the GFC



NOTES: The data period spans 1998–2024, excluding the over-the-counter market. The market cap for DM, DM ex USA, EM, and frontier market (FM) is based on listed securities classified as eligible for the MSCI World, MSCI World ex USA, MSCI Emerging Markets, and MSCI Frontier Markets indexes, respectively. Others refer to those securities that are listed in regions not grouped into any of the mentioned MSCI indexes.

The share of global GDP represented by EMs (measured by the MSCI ACWI GDP Weighted Index) rose to over 40% by 2024 from just over 20% in 2002.

Despite this growth, EMs' share of total listed market capitalization has remained flat at around 20% since the global financial crisis (GFC), as shown in Exhibit 2. We examine potential causes of the disconnect between economic growth and market capitalization in EMs in the next section.

EXAMINING EM UNDERPERFORMANCE

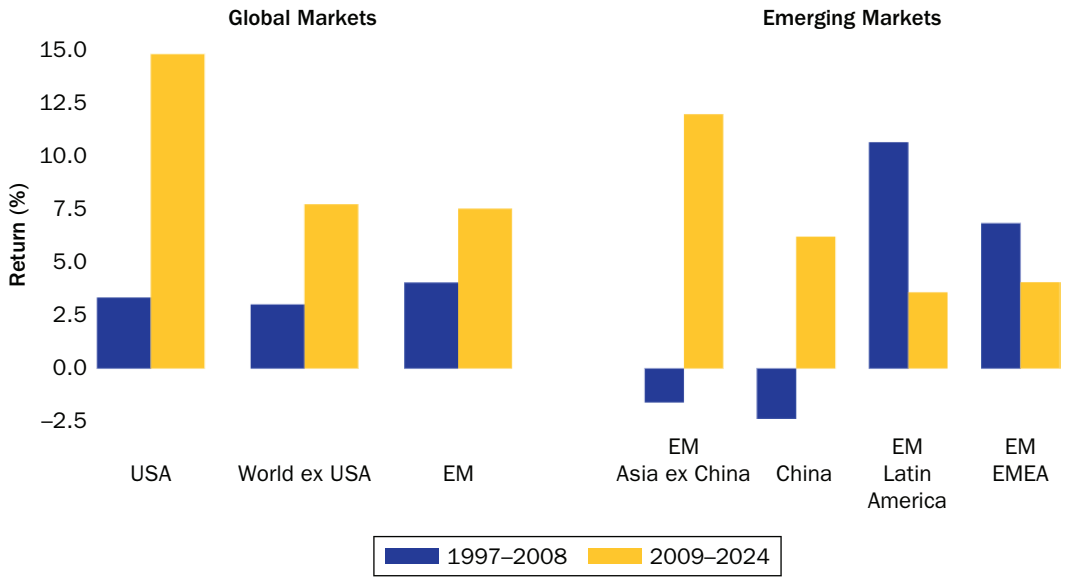
EM equities have underperformed DM equities since the GFC, as Exhibit 3 illustrates. US equities have led all major equity markets since 2009, largely driven by growth-oriented technology stocks. This was not the case, however, in the 10 years leading up to the GFC when EM equities led major markets, fueled by growth in Latin America.[1]

China's significant weight in EM indexes, combined with its lower returns, explains a large part of EM equities' underperformance since 2009. In contrast, EM Asia ex China—driven by India, Taiwan, and Korea—has performed competitively with US equities since 2009, marking a turnaround from the 1997–2008 period when the Asian currency crisis resulted in capital flight, currency devaluation, and slow economic growth that weighed on stock returns.

[1] Although the MSCI USA, MSCI World ex USA, and MSCI Emerging Markets indexes have price history from before December 1996, we start our analysis in December 1996 to align with the fundamental-factor data we use later in this article.

EXHIBIT 3

EM Equities Trailed DM Equities After the GFC



NOTES: Annualized returns are gross in US dollars from December 31, 1996–December 31, 2008, and from December 31, 2008–December 31, 2024. The regional markets are represented by the MSCI USA, MSCI World ex USA, MSCI Emerging Markets, MSCI Emerging Markets Asia ex China, MSCI China, MSCI Emerging Markets Latin America, and MSCI Emerging Markets Europe, the Middle East, and Africa (EMEA) indexes, respectively. The period analyzed is the longest common history for the indexes.

Over the past two decades, the correlation between EM and US equities has consistently remained below 50%. Exhibit 4 highlights that although correlation of World ex USA with US equities has remained relatively high and stable since the GFC, the correlation of EM equities with US markets has notably diverged, particularly as the US technology stocks have led global market performance. The declining correlation in EM equities underscores the influence of market-specific factors, such as China's underperformance and differing economic paths within various EM regions.

Performance Decomposition

Since the GFC, growth in dividends and earnings has contributed the most to performance across all regions (we describe our decomposition methodology in Appendix A). US equities benefited from a combination of multiple expansion and growth in dividends and earnings, driven by both rising profit margins and expanding sales (see Exhibit 5).

EMs, as a whole, experienced declining margins, which affected earnings growth. Within EM ex China, muted earnings growth and currency depreciation against the US dollar negatively impacted returns. Valuation expansion, particularly in India, was a key source of returns, but not so in China, where valuation-multiple expansion was modest. Importantly, deteriorating per-share profitability (shown in turquoise in Exhibit 4) in both EM ex China and China, rather than weak topline growth, was the primary reason for lackluster earnings growth.

Earnings Growth and Share Dilution

To better understand the lower EPS growth in EMs, we analyzed factors that contributed to this phenomenon. Historically, investors have been attracted to EMs due to strong rates of economic growth compared to DMs. As Exhibit 6 illustrates, however,

EXHIBIT 4

Evolving Correlation Patterns Highlight EM Divergence from the United States

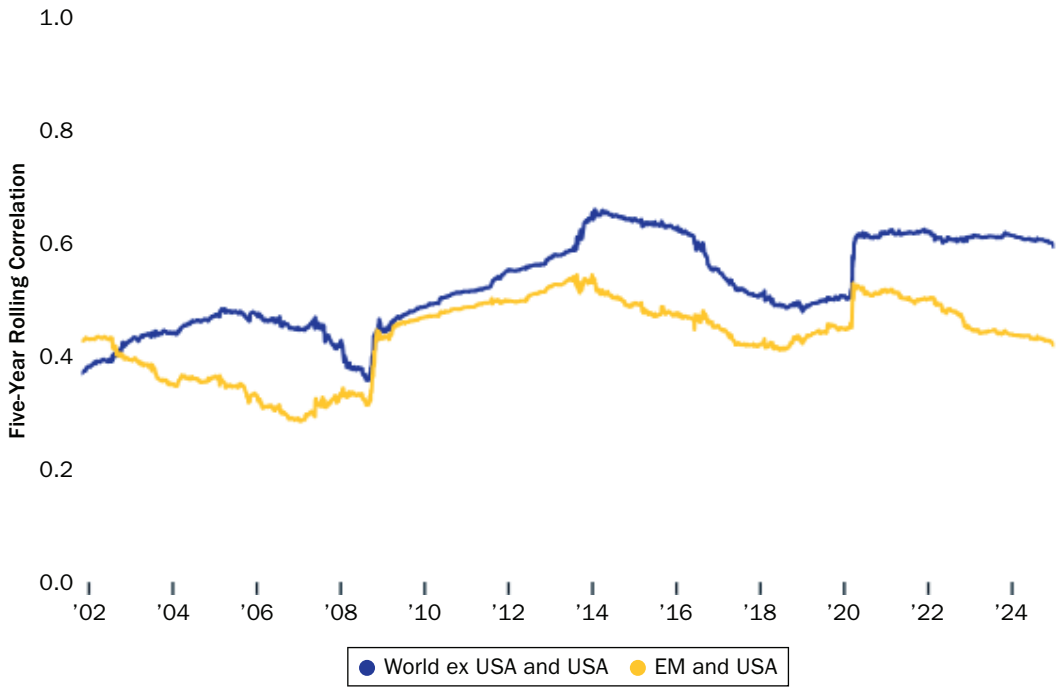
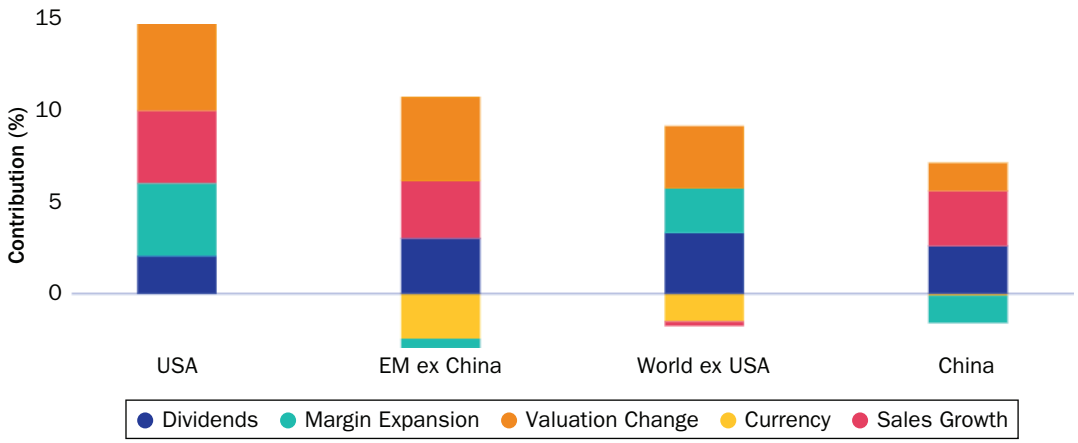


EXHIBIT 5

Strong USD and Lower Earnings Growth Weighed on EM Returns After the GFC



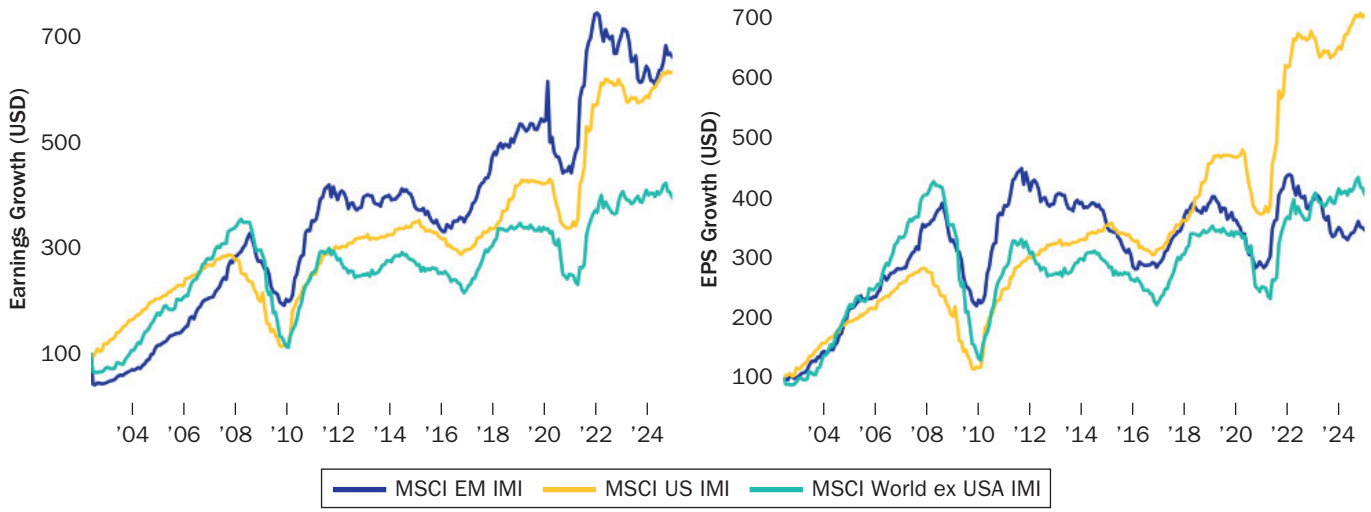
NOTES: Return contributions are annualized in gross US dollars from December 31, 2008–December 31, 2024. The regional markets are represented by the MSCI USA, MSCI Emerging Markets ex China, MSCI World ex USA, and MSCI China indexes, respectively.

EMs achieved 8.7% annualized growth in aggregate earnings—outpacing 8.5% US growth—yet this growth did not translate into similar gains in EPS.

Per-share profitability is important for stockholders because it measures a company's operational efficiency, accounting for interest payments and facilitating comparisons across companies. Some companies, however, may use certain financial strategies to keep their EPS figures healthy even when their fundamentals are weak. Such practices underscore the need to take a holistic view of a company's finances

EXHIBIT 6

Total EM Earnings Rose While Per-Share Earnings Trailed DM



NOTES: The sample period is from May 31, 2002–December 31, 2024. Index earnings are calculated bottom-up using month-end values. Earnings per share is trailing EPS at month-end frequency. Returns are annualized. MSCI investable market indexes (IMI) cover all investable large-, mid-, and small-cap securities, targeting approximately 99% of each market's free-float-adjusted market capitalization.

while interpreting EPS trends. That said, EMs registered an annualized EPS growth rate of 5.6%, lagging the EPS growth rate in the United States of 9%.

Ideally, aggregated corporate earnings growth should align with GDP growth over the long term. New share issuances, however, could cause a disconnect between earnings growth and GDP growth. Both an initial public offering and an existing firm's financing expansion with secondary, or rights, offerings can dilute share values. Share dilution reduces existing investors' claims on future earnings and dividends. Companies may issue new shares for purposes such as capital expenditure, new acquisitions, or retiring debt.

On the one hand, this dynamic could lead to slippage between EPS and GDP growth rates, as noted by Bernstein and Arnott (2003). Share buybacks, on the other hand, reduce the number of outstanding shares and can subsequently boost EPS. Share buybacks grew in the United States throughout the 1990s and 2000s, supported by corporate strategies to return excess cash to shareholders. A commonly accepted rationale for share buybacks includes stock-price support, capital-structure optimization, and special tax treatment for cash repatriated from overseas.

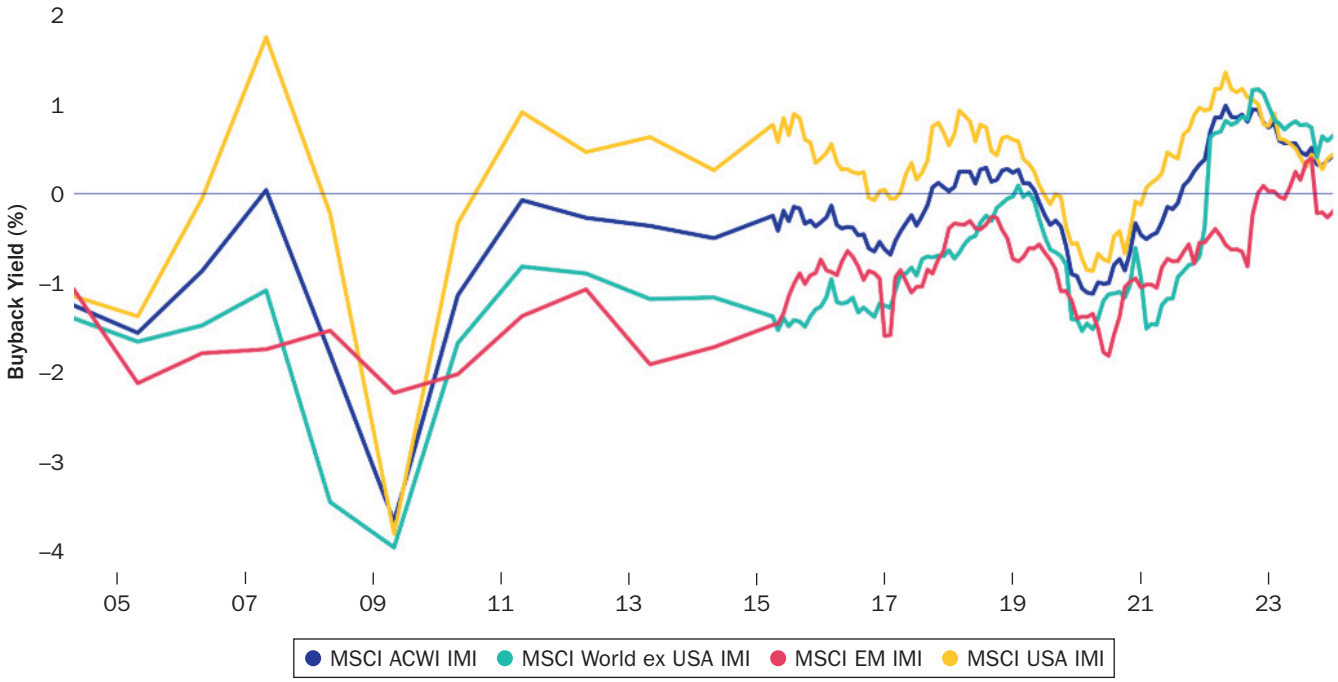
In an equity index, the combined impact of share dilution and buybacks on EPS can be assessed using the buyback-yield metric, shown in Exhibit 7. Index buyback yield is the weighted average of each constituent's buyback yield at month-end. For each stock, buyback yield is calculated as the change in its trailing 12-month share count relative to its current share count.

New share issuances and new listings have led to a negative buyback yield in EM equities since the GFC. In contrast, US firms have historically favored share buybacks, resulting in a positive buyback yield over the same period. DMs other than the United States (a universe represented by the MSCI World ex USA IMI) had a similar pattern to EMs until 2023, when buybacks turned sharply positive.

The EM buyback yield moved into positive territory in 2024, led by an increased level of buyback activity.

EXHIBIT 7

Buyback Yield Has Been Mostly Positive for US and Negative for EM over the Past 20 Years



NOTES: Data are from April 29, 2005–December 31, 2024, based on data availability. Index buyback yield is the weighted average of the index's constituents' buyback yields at month-end (annual frequency prior to April 2016). MSCI investable market indexes (IMI) cover all investable large-, mid-, and small-cap securities, targeting approximately 99% of each market's free-float adjusted market capitalization.

ACTIVE MANAGEMENT AND THE EM OPPORTUNITY SET

Despite the challenges EM equities have faced in keeping pace with DM equities' performance, the expanding opportunity set across EM countries, sectors, and companies suggests potential opportunities for the active management of EM equities.[2] Managers can seek to identify companies with strong fundamentals, pricing power, or unique competitive advantages not fully appreciated by the market.

To quantify active-management opportunities from a bottom-up stock selection perspective, we looked at the stock-specific contribution to total dispersion, or cross-sectional volatility (CSV), of the MSCI Emerging Markets IMI Index.[3] Our findings show that stock-specific risks have consistently accounted for a significant portion of CSV throughout the past three decades (Exhibit 8). Within factor group—style, individual market, and industry—individual markets have consistently dominated in their contributions to CSV. The substantial contributions from idiosyncratic risk to CSV underscores the bottom-up stock-picking opportunities for active managers, thereby creating meaningful potential to generate alpha and achieve outperformance relative to the broader market.

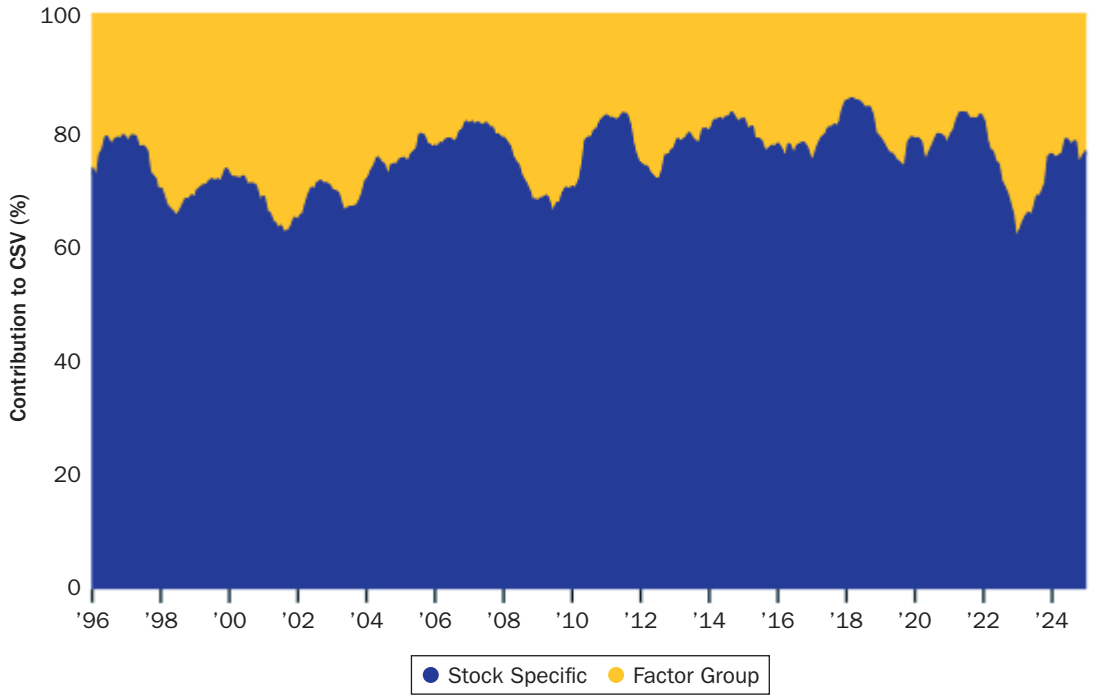
Our analysis of risk decomposition for EM active managers' portfolios (Exhibit 9) reveals that nearly 50% of the overall active risk was attributable to stock-specific effects, indicating that portfolios were likely concentrated, with large weights assigned

[2] We define sectors using the Global Industry Classification Standard (GICS®). GICS is the industry-classification standard jointly developed by MSCI and S&P Global Market Intelligence.

[3] Stock-specific risk, also known as idiosyncratic risk, refers to the risk associated with individual stocks as opposed to marketwide risks.

EXHIBIT 8

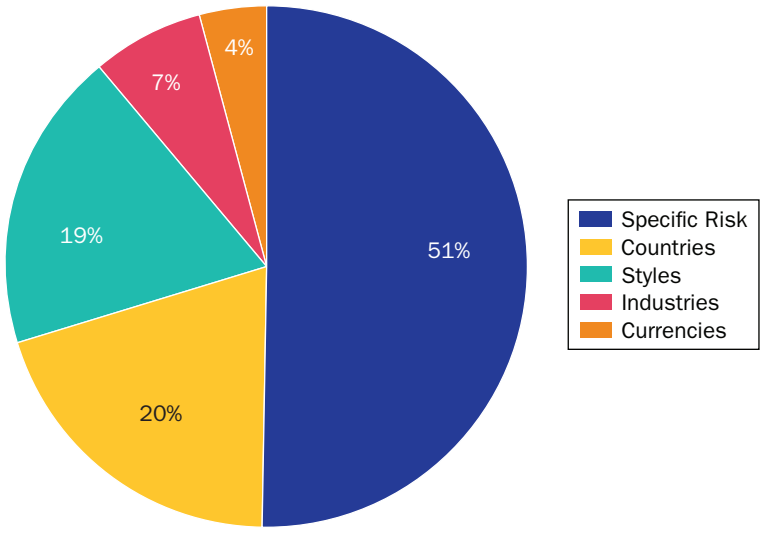
Stock-Specific Risk Has Dominated CSV for EMs



NOTE: The data period is from January 1996 to December 2024 fort the MSCI Emerging Markets IMI index.

EXHIBIT 9

Stock-Specific Views Have Been the Largest Active Bet for EM Active Managers

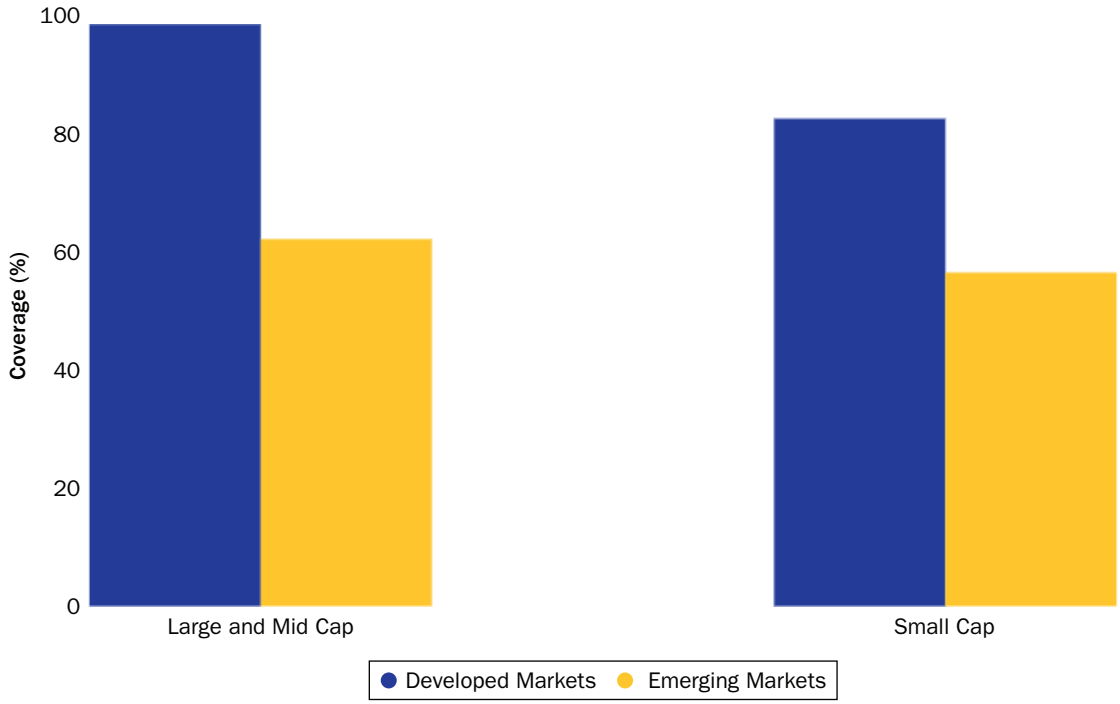


NOTES: Data as of November 30, 2024. Includes over 170 mutual funds with assets under management greater than USD 1 million and benchmarked to the MSCI Emerging Markets Index using the MSCI Emerging Markets Equity Factor Model.

SOURCE: Lipper, MSCI.

EXHIBIT 10

EM Stocks Have Lower Global Analyst Coverage Relative to DM



NOTES: Data as of December 31, 2024. Coverage is defined as the ratio of the number of securities covered by at least three analysts in a region to the total number of securities in that region. Analyst count is approximated using the maximum number of analysts' estimates for securities for any measure or fiscal period.

SOURCES: IBES, MSCI.

to a relatively small number of stocks.[4] Country, currency, and industry exposures were also meaningful, but they exerted less impact compared with stock-specific risk. This finding highlights that bottom-up stock picking remains a central strategy among active managers focused on EMs.

One indicator of the active-management opportunity set is the relatively limited analyst coverage of EM stocks compared to those in the developed markets. Fewer analysts tracking these stocks can lead to mispricing opportunities, particularly in the small-cap segment. Exhibit 10 shows that analyst coverage of individual stocks is significantly lower in EMs compared to DMs.

These insights prompt a closer look at the characteristics of companies that prospered despite the challenges faced by EMs since 2009. A good understanding of the traits of these long-term compounders could inform approaches to stock selection and risk-exposure management.

CHARACTERISTICS OF LONG-TERM "COMPOUNDER" STOCKS

Concentration of Returns and Wealth Creation

The previous analyses underscore the important impact that dividends and earnings have had historically on overall market returns. Equally important is the

[4] The average number of securities in the sample of active managers was 143, and the effective number of securities was 47, indicating significant concentration. The effective number of securities in a portfolio quantifies its diversification by adjusting for the relative weights of individual holdings, reflecting the number of equally weighted securities that would provide the same level of concentration risk.

narrow leadership within EM stocks. Research by Bae, Chanwoo, and Wei (2006) found that stock returns in EMs have tended to be more skewed than in other regions, with significant gains contributed by a few high-performing stocks.

We found that EMs had the highest return concentration across major regions (Exhibit 11). Our analysis grouped individual stocks into equally sized quintiles based on their contribution to total return from 2009–2024. Over this period, the top quintile contributed more than 80% of the total return in DMs and over 100% of the total return in EMs.

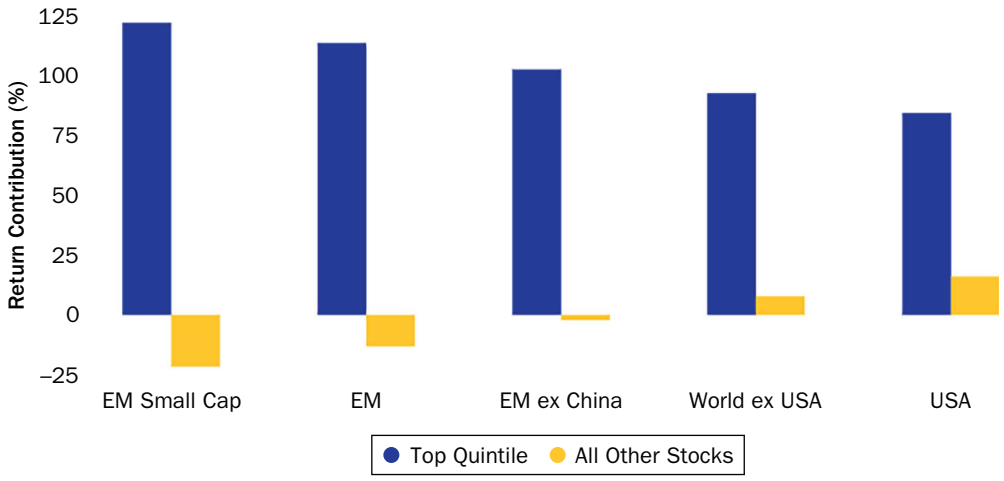
These results partly reflect the asymmetric, right-tailed nature of individual stock returns in EMs, where a handful of stocks can dominate performance, a finding also made by Hwang and Satchell (1999). Winner-takes-most dynamics often appear in fast-scaling industries such as technology or internet platforms. In EMs, these effects can be even more pronounced, with a handful of companies—sometimes state-backed with policy support—capturing outsized advantages.

Another contributing factor is the mechanics of index weighting: When a large stock delivers market-level or above-market returns, its higher weight magnifies its return contribution to the index, compounding over time and further skewing overall return contributions.

These observations align with Bessembinder et al. (2023), who found that over a century of US stock market history a small fraction of firms drove the bulk of wealth creation through consistent compounding.[5] Identifying such firms ex ante is notoriously difficult. Here, instead, we examine their common ex post attributes, which may provide insights into how EM compounders can arise despite the broader challenges in these markets.

EXHIBIT 11

EM Stocks Historically Had the Most-Concentrated Return Contributions



NOTES: Return contributions are gross in USD from December 31, 2008–December 31, 2024, and are shown as a share of each market's total return. The regional universes are represented from left to right by the MSCI Emerging Markets Small Cap, MSCI Emerging Markets, MSCI Emerging Markets ex China, MSCI World ex USA, and MSCI USA Indexes, respectively. Quintiles are equally sized and based on contribution to total return.

[5] More recently, Mauboussin and Callahan (2024) showed a related result on the skewness in value creation. They found that most of the value creation in economic profit (as measured by return on investment less cost of capital multiplied by invested capital) resided in the top decile of firms in the United States over the period 2019–2023.

Exhibit 12 underscores the historically narrow leadership in EM stocks by listing the 10 largest individual contributors to performance in the EM, EM ex China and EM small-cap segments. Notably, many of these top performers also came from the financial and technology sectors.

Fundamental Factors in EMs

We examined the characteristics of the top-quintile compounder stocks (represented by the blue bars in Exhibit 11), using the MSCI Emerging Markets Equity Factor Model (EMEFM), which categorizes EM stocks as China or EM ex China. The regional breakdown aligns with the significant performance differences between these two regions since 2009. The regional categorization also motivates a comparison of compounder stocks in the broader EMs and the narrower region of EM ex China.

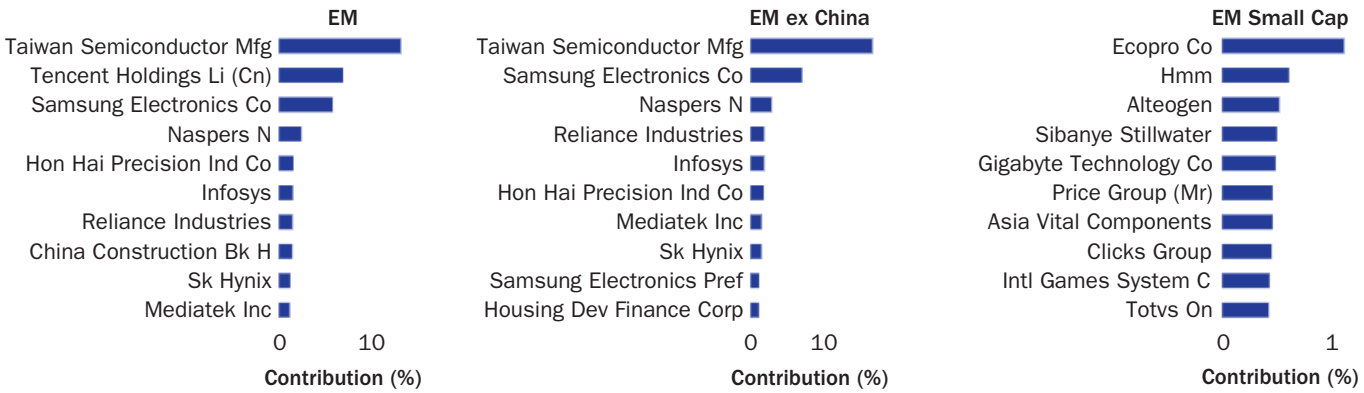
We focused specifically on fundamental factors closely related to a company's operations. These factors included those measuring growth, earnings, investment patterns, capital-allocation policies, and operational efficiency. We define these factors in Exhibit 13 and show their long-term behavior in Appendix B.

Common Attributes of Compounder Stocks

Since the GFC, top-quintile compounder stocks have generally returned more capital to shareholders through dividends, demonstrated more-conservative investment

EXHIBIT 12

Ten Largest Return Contributions in EMs Since 2009



NOTES: Return contributions are gross in USD from December 31, 2008–December 31, 2024, and are shown as a share of total return. We show only the 10 largest contributors for illustrative purposes. The regional universes are represented from left to right by the MSCI Emerging Markets, MSCI Emerging Markets ex China, and MSCI Emerging Markets Small Cap Indexes, respectively.

EXHIBIT 13

Key Fundamental Factors Related to Operations and Efficiency in the MSCI EMEFM

Factor	Measure	Descriptors
Earnings Quality	Accounting transparency	Accruals in balance sheet and cash flow, cash earnings
Investment Quality	Capital efficiency	Long-term growth in share issuance, assets, and capital expenditures
Earnings Variability	Operational consistency	Variability in sales, earnings, cash flows, and forward multiple
Profitability	Operational efficiency	Asset turnover, gross margin, gross profitability, and return on assets
Dividend Yield	Capital-return policy	Trailing and forward dividend yield
Growth	Demand expansion	Trailing sales, earnings growth, and forward earnings growth

patterns, and were more profitable compared to stocks in the bottom quintiles. These compounders also exhibited more-consistent operations (as measured by sales, earnings, and cash flow). Notably, they were not necessarily high-growth firms. They also did not exhibit higher earnings quality, as measured by accruals.

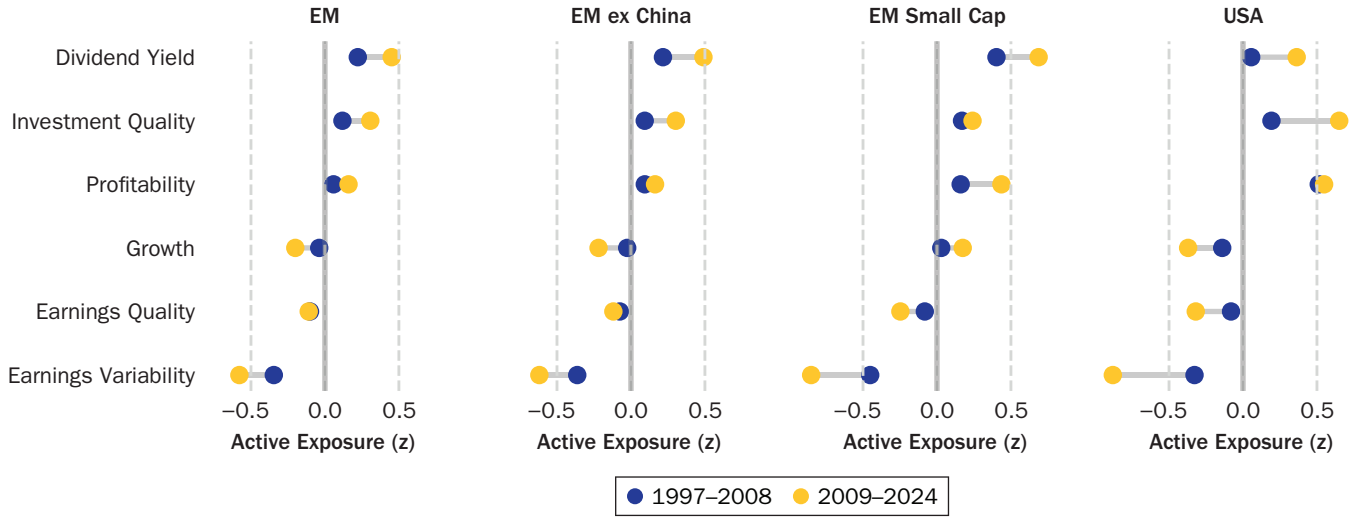
This factor profile was consistent across broad EM, EM ex China, and smaller-cap EM stocks, as shown in Exhibit 14.[6] Four factors (dividend yield, investment quality, profitability and low earnings variability) were significant attributes in all three segments, with low earnings variability being the most significant. Furthermore, the similarity in small-cap stocks indicates that these four characteristics were not limited to just the largest firms. For comparison, the factor profile of compounder stocks in the US equity market is also shown.

Only in the small-cap segment was high growth strongly linked with compounder stocks. This finding may reflect that smaller stocks are at an earlier stage in their business life cycle, which allows them to expand into growing markets, with high sales and earnings growth driving compounding. In contrast, larger EM stocks, being more mature, relied more on operational efficiency than growth.

The individual descriptors of the dividend-yield, investment-quality, and profitability factors, as shown in Exhibit 15, provide additional nuance. Notably, trailing dividend policy, share buybacks, and return on assets (ROA, highlighted in red text in the exhibit) were the most dominant descriptors—a pattern also observed across EM, EM ex China, and EM small caps.[7] The lower ranking of gross profitability suggests that the competitive advantage of compounder stocks may be tied more to cost leadership and operational leverage than to pricing power.

EXHIBIT 14

Dividend Yield, Investment Quality, Profitability, and Low Earnings Variability Were Most Associated with Compounder Stocks



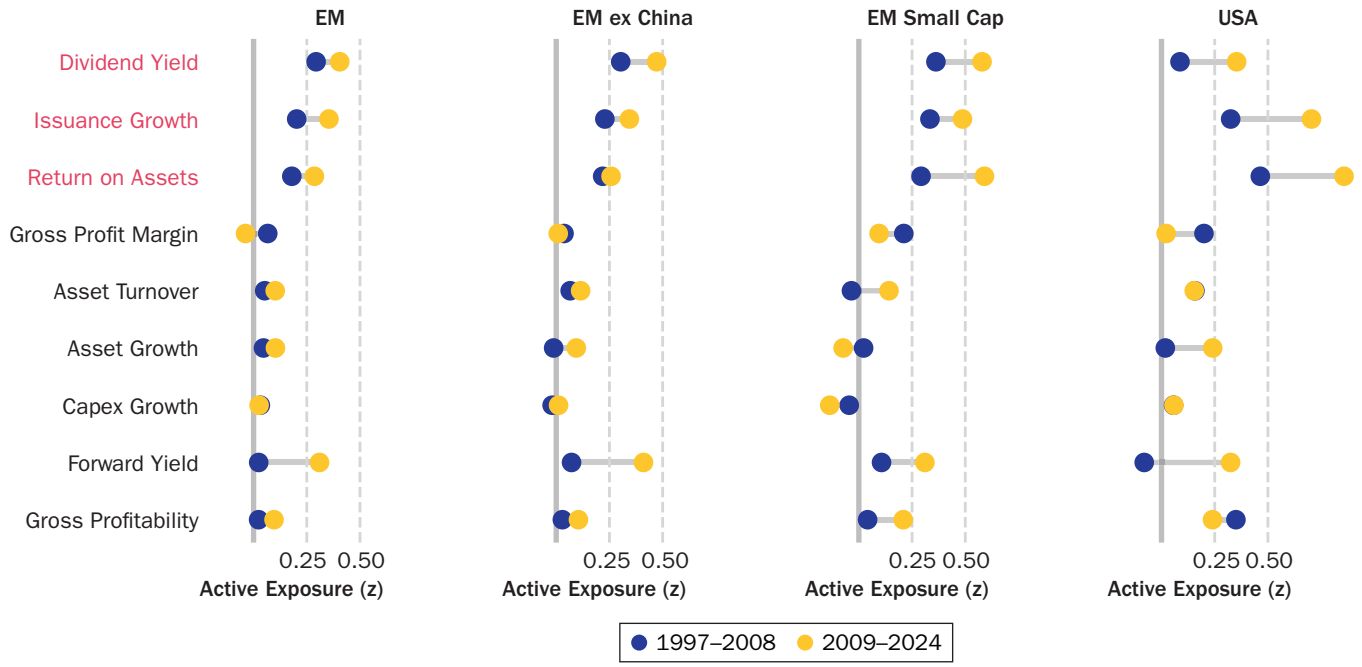
NOTES: Exposures are based on the MSCI EMEFM. End-of-month exposures are averaged from December 31, 1996–December 31, 2008, and from January 31, 2009–December 31, 2024. Exposures are the quintile spread, where quintiles are based on return contributions. The regional universes are represented from left to right by the MSCI Emerging Markets, MSCI Emerging Markets ex China, MSCI Emerging Markets Small Cap, and MSCI USA Indexes, respectively.

[6] Note that the negative exposure to the earnings-variability factor indicates that top-quintile compounder stocks had more stable earnings than the bottom quintile of stocks.

[7] A positive exposure to issuance growth indicates that a firm (or portfolio) is relatively more conservative in its net share issuance than the market or, in this case, the bottom-quintile cohort of stocks.

EXHIBIT 15

Trailing Yield, Share Buybacks, and ROA Most-Dominant Descriptors



NOTES: Descriptor exposures are based on the MSCI FactorLab. End-of-month exposures are averaged from December 31, 1996 to December 31, 2008, and from January 31, 2009 to December 31, 2024. Exposures are the quintile spread, where quintiles are based on return contributions. The regional universes are represented from left to right by the MSCI Emerging Markets, MSCI Emerging Markets ex China, MSCI Emerging Markets Small Cap, and MSCI USA Indexes, respectively.

Early Hints of Future Success

Because we identified the stocks that drove the market's performance since 2009 and then linked those stocks back to their fundamental characteristics, our analysis inherently includes hindsight bias. To address this bias, we also tested the fundamentals of the top-quintile compounder stocks during the preceding previously unexamined 10-year period (1998–2008). Appendix C shows the number of stocks that existed in this decade.

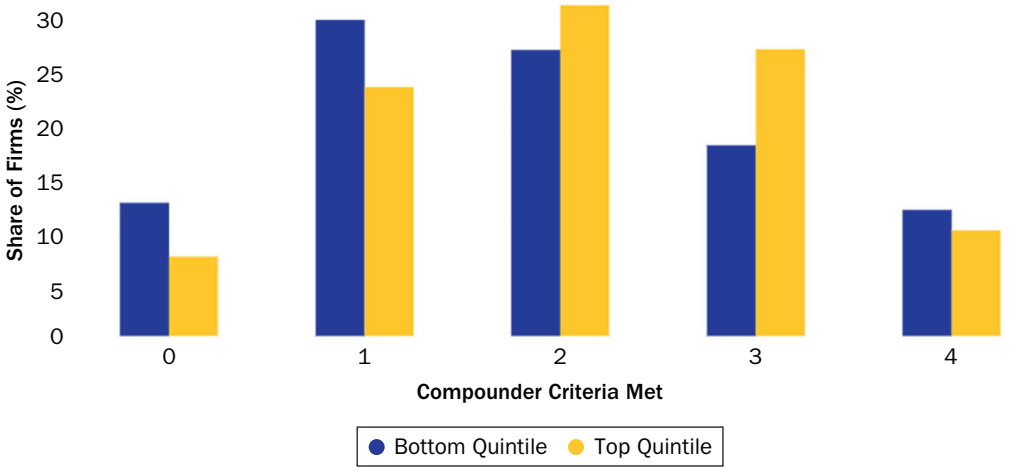
The results, represented by blue circles in Exhibits 12 and 13, demonstrate that compounder stocks exhibited a consistent factor profile in the earlier period. This profile again included higher-dividend yields, share buybacks, earnings stability, and profitability. No single factor appeared to drive outperformance on its own. Rather, meeting multiple criteria seemed to further distinguish compounders. In the out-of-sample decade, almost 70% of compounders simultaneously showed favorable exposure to at least two of the four factors we identified as dominant, compared to 55% in the bottom quintile of stocks (Exhibit 16). Taken together, this suggests that early signs of capital discipline and operational efficiency, supported by multiple quality attributes rather than a single standout metric, may have contributed to these firms' later success (Appendix Exhibit C1).

Transition from Growth to Profitability

As we stated earlier, one of the long-standing reasons for investing in EM equities has been these stocks' potential for higher economic growth relative to DM stocks; however, aggregate GDP growth in EMs has not consistently translated into stronger

EXHIBIT 16

EM Compounders Had Multiple Quality Attributes, Evident in the Decade Ending 2008



NOTES: Monthly observations from December 31, 1997 to December 31, 2008. We define favorable as having a positive exposure to the factors' dividend yield, investment quality, and profitability and a negative exposure to earnings variability.

EPS growth. Moreover, robust sales growth was not a defining attribute for the top quintile of long-term EM performers. In fact, their exposure to the growth factor was, on average, no higher than that of lower-performing stocks, and even declined from the earlier (1998–2008) to the later (2009–2024) period (as shown in Exhibit 12).

We examined correlations of factor exposures at the individual-stock level, spanning the entire universe of EM firms over an extended period. The results showed that firms emphasizing rapid growth often exhibited lower dividend yields, diminished investment-quality measures, and higher earnings volatility (Exhibit 17)—all of which run counter to the attributes observed in compounder stocks.

Furthermore, we found that high-growth EM firms often did not maintain their pace over extended periods. For instance, only about half of the stocks in the top-growth quintile retained that rank one year later, whereas the highest-profitability quintile showed a much longer half-life of more than five years (Exhibit 18). These observations align with Chan, Karceski and Lakonishok's (2003) finding that extraordinary growth typically reverts to the mean, and with Bouchaud et al. (2019), who documented the "profitability anomaly," whereby profitability remains persistent even as topline growth subsides.

This discrepancy between the longevity of profitability and the fleeting nature of growth may underscore the importance of operational moats and quality growth in long-term compounders. Even as their topline growth moderated, their ability to maintain margins allowed them to preserve earnings power—and ultimately drive total return.

Implications for Indexed Investors

Although the preceding discussion has centered on active management and stock selection, our findings also resonate with indexed and systematic approaches. Factor-based indexes aim to overweight or underweight constituents based on certain characteristics, rather than simply reflecting market capitalization. By doing so, they can systematically incorporate the same attributes observed in EM compounder stocks, such as profitability, share buybacks, and dividend consistency.

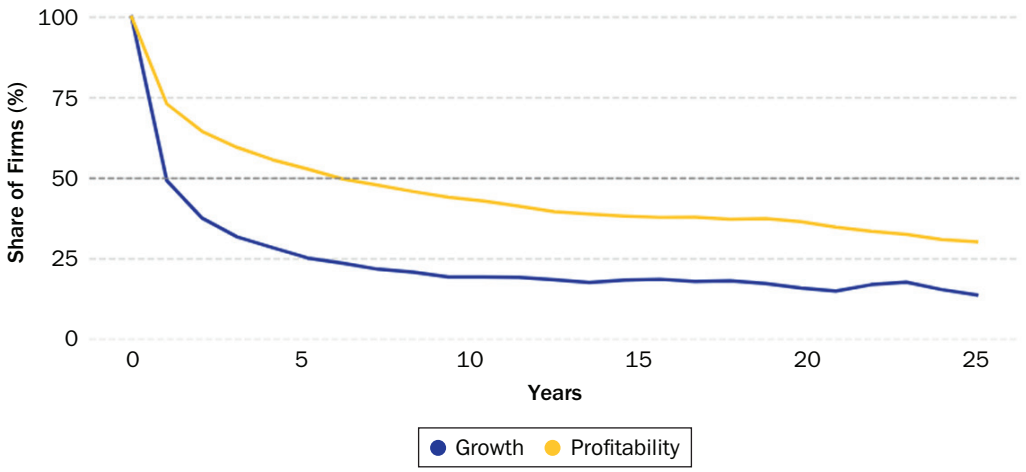
EXHIBIT 17

High-Growth Firms Tended to Have Lower Dividend Yield, Lower Investment Quality, and More-Volatile Earnings

NOTES: Correlation of stock-level exposures for the MSCI Emerging Markets IMI from December 31, 1997 to December 31, 2024, based on the MSCI EMEFM. We show only select factors.

EXHIBIT 18

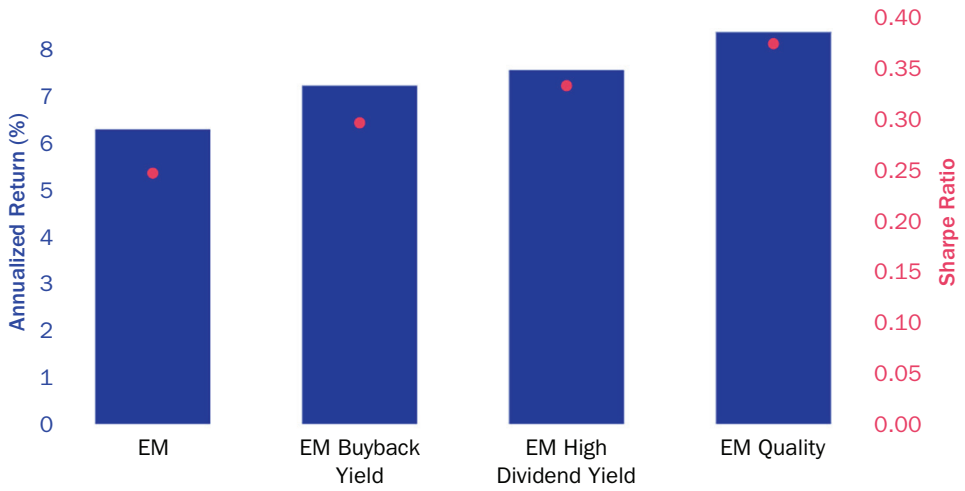
Fifty Percent of the Most-Profitable Firms Retained That Status Five Years Later



NOTES: Stocks in the MSCI Emerging Markets IMI are grouped into quintiles based on growth and profitability exposures. Exposures are based on the MSCI EMEFM. Quintiles are reformed every month from December 31, 1997 to December 31, 2024. The percentage of stocks that remain in the top quintile is tracked over the ensuing years through December 31, 2024.

EXHIBIT 19

Indexed Approaches to Capture the Long-Term Compounders That Outperformed Broader Market



NOTES: Returns are gross in US dollars from June 30, 2005 to December 31, 2024, the longest-available common period. Sharpe ratios are also for the same time period. From left to right, the indexes shown are the MSCI Emerging Markets, MSCI Emerging Markets Buyback Yield, MSCI Emerging Markets High Dividend Yield, and MSCI Emerging Markets Quality Indexes.

For example, the MSCI Emerging Markets Quality Index tilts toward profitable companies with lower earnings variability (and lower indebtedness) than the broad market, capturing many of the operational-discipline traits already discussed. Similarly, the MSCI Emerging Markets Buyback Yield Index focuses on firms that actively repurchase their stock, reflecting the capital-return discipline observed among compounders. Yield strategies, including the MSCI Emerging Markets High Dividend Yield Index, emphasize companies with higher and more-persistent dividend payouts, again aligning with one of the key traits we identified. Exhibit 19 shows the long-term performance and Sharpe ratios of these three indexes. These examples illustrate how systematic indexes can be used to target the attributes that historically characterized EM compounders and offer an additional implementation vehicle for investors who may not pursue a traditional stock-picking strategy.

CONCLUSION

EM equity markets have undergone substantial expansion over the past 30 years, as illustrated by the growth in the number of listed companies. Nevertheless, this progress has been overshadowed by muted equity-market performance, especially for international investors, since the GFC, driven by share dilution, currency headwinds, and China's range-bound performance.

Beyond these headlines, however, the EM universe displayed significant concentration in stock-level returns, with certain compounder firms achieving sustained gains. Using one of the latest MSCI equity factor risk models, we were able to highlight the operational attributes that set these compounders apart. Specifically, higher profitability, disciplined capital return (including share buybacks), stable earnings, and meaningful dividend payouts were traits shared across major EM blocs, including the increasingly relevant EM ex China region.

For active managers, such findings highlight the relevance of assessing these corporate fundamentals. For systematic investors, the performance of factor-based indexes that overweight these attributes indicate the potential of strategies that may similarly seek to capture exposure to long-term high-quality companies within a broader EM portfolio.

APPENDIX A

INDEX TOTAL-RETURN DECOMPOSITION

The decomposition of an index's total return between two periods begins by gathering price, earnings, and sales data for the index, along with its gross (i.e., total) returns in both local and US dollar terms. The data follow the MSCI Fundamental Data Methodology at the index level.

Total return is split into its log-based components: valuation changes (e.g., changes in the price-to-earnings ratio), dividends (cash income), currency (foreign-exchange movements), and earnings (derived from sales growth and margin expansion).

By using log components, we transform what are typically multiplicative effects into additive elements. This approach clarifies the genesis of performance, whether derived from the market's repricing of fundamentals (valuation), payouts (dividends), changes in exchange rates, and/or actual corporate growth (earnings). A detailed methodology is provided below.

1. Decompose gross index level into various components:

$$gross_{usd} = \overbrace{\frac{gross_{usd}}{gross_{local}}}^{Currency} * \overbrace{\frac{gross_{local}}{price_{local}}}^{Dividends} * \overbrace{\frac{price_{local}}{price\ to\ sale}}^{Sales} * \overbrace{\frac{price\ to\ sale}{price\ to\ earnings}}^{Profit\ Margin} * \overbrace{price\ to\ earnings}^{Valuation}$$

2. Total index return is split into its log-based components:

$$\begin{aligned} Log\,(Total\ \ return) = {} & Log\,(Currency) + Log\,(Dividend) + Log\,(Sales\ growth) \\ & + Log\,(Margin\ \ expansion) + Log\,(Valuation\ \ change) \end{aligned}$$

such that each component is a return over the period from $t-1$ to t, for example,

$$Log\,(Currency) = Log\,(Currency_t / Currency_{t-1})$$

3. Annualize the total index return from time $t-1$ to t.
4. Calculate log contributions to annualized total returns for all the components, for example,

$$Dividend\ contribution = \frac{Log\,(Dividend)}{Log\,(Total\ return)} * return_{annualized}$$

5. Annualized total index return = Currency contribution + Dividend contribution + Sales growth contribution + Profit Margin contribution + Valuation change contribution.

APPENDIX B

FACTOR RETURNS IN EMERGING MARKETS

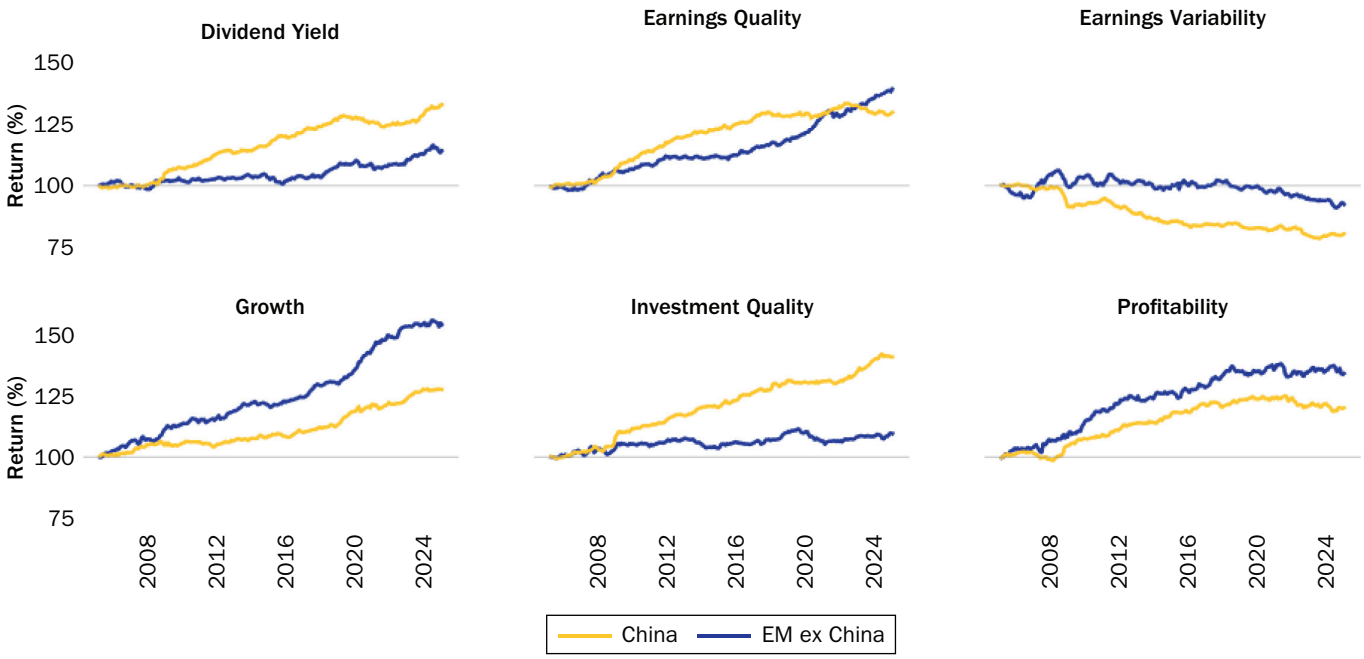
The MSCI Emerging Markets Equity Factor Model is estimated based on two nonoverlapping regional blocs: China and EM ex China. We focus on six key factors from this model and show their returns in Exhibit B1. Differences in factor premiums highlight the variation in systematic risks, behavioral anomalies, and investor preferences between the two regions. Two observations are worth noting.

First, all factors showed significant risk-adjusted returns, either positive or negative. This result indicates that investors valued firms differently based on their growth trajectories or management decisions. Specifically, firms that were more efficient (higher profitability), had returned capital (higher dividend yield), allocated capital conservatively (higher investment quality), expanded end markets (higher growth), had a higher proportion of cash earnings (higher earnings quality), and operated predictably (lower earnings variability) outperformed those lacking these attributes.[8]

Second, although factor returns had the same direction across China and EM ex China, we observed differences in magnitude. For instance, the investment-quality factor had a

EXHIBIT B1

Fundamental Factors Had Similar Direction, but Different Risk-Adjusted Returns, Across China and EM ex China



NOTES: Returns are cumulative from the MSCI EMEFM from December 31, 2004 to December 31, 2024, corresponding to the earliest full-year start date for factors across China and EM ex China, regions represented by the MSCI China and MSCI Emerging Markets ex China Indexes, respectively. We show only selected fundamental factors.

[8] Note that the sign on earnings variability is opposite that of the other five factors we analyzed, with a positive exposure to earnings variability indicating more-volatile earnings. Subsequently, a negative return to the earnings-variability factor indicates that companies with more-volatile earnings trailed companies with more-stable earnings.

lower return in China compared to EM ex China.[9] Chinese companies that aggressively expanded capital expenditures were less penalized for overinvestment, possibly due to China's investment-led growth model or state support for firms aligned with national goals.

APPENDIX C

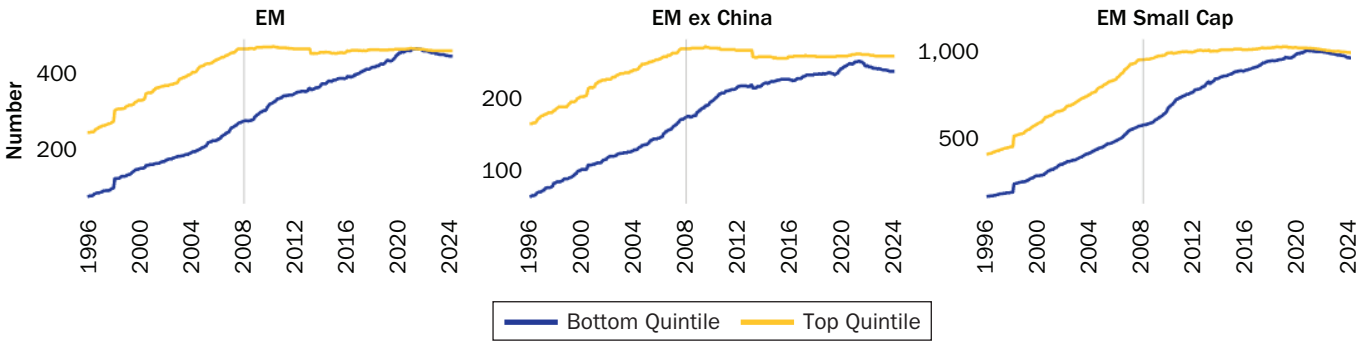
STOCK SURVIVORSHIP IN OUT-OF-SAMPLE PERIOD

We used the top and bottom quintiles of stocks, based on their total contribution to return from 2009 to 2024, for our analysis of factor exposures. We also examined stock exposures over the preceding 10 years (1998–2008). We found that there were enough securities in each quintile and in each region in the earlier period to enable meaningful comparisons of mean exposures.

Moreover, the top-quintile stocks tended to be longer-lived firms, possibly reflecting an ability to withstand market cyclicality.

EXHIBIT C1

Survivorship of Top and Bottom Quintiles of Major EM Segments for In-Sample and Out-of-Sample Periods



NOTE: Quintiles are based on return contributions for the period from December 31, 2008 to December 31, 2024.

ACKNOWLEDGMENT

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[9] MSCI FactorLab isolates the return of a factor to its component descriptors. In the case of investment quality, the share issuance descriptor is historically positive for China, as it is across other major regions. The descriptors for capital-expenditure growth and asset growth, however, were negative in China. A negative return implies that companies with aggressive investment policies outperformed those with more-conservative policies.

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