Talking Heads with Zhikai Chen

Daniel Morris: Hello and welcome to the BNP Paribas Asset Management Talking Heads podcast. Every week, Talking Heads will bring you in depth insights and analysis on the topics that really matter to investors. In this episode, we'll be discussing emerging market equities. I'm Daniel Morris, Chief Market Strategist and I'm joined today by Zhikai Chen, Global Head of Emerging Market Equities. Welcome, Zhikai, and thanks for joining me.

Zhikai Chen: Thank you, Daniel. Thanks for having me.

DM: If we look at the performance of emerging market equities relative to developed market equities, it went through a rough patch from 2010 for quite a few years. Over the last few years, that's turned around. So far in 2026, as of early September, EM equities outperformed developed market equities – EM up about 22% versus 13% for the MSCI World Index in dollar terms. However, you need to differentiate either by country or by sector. You still have investors that are underweight emerging market equities, maybe not quite convinced yet that this outperformance is sustainable. What's your view on how investors should be allocated to EM equities?

ZC: There is volatility in performance over different time periods as EM equities investing is by nature higher on the risk-reward spectrum. But if you look at the longer-term horizon and in USD terms compared to say [the] MSCI World – [the] United States, Europe and Japan – emerging markets as a region has outperformed since 1999. I don't dispute that a big part of that has been the outperformance in the last couple of years.

Year to date it has outperformed by double digits. It outperformed by double digits in 2025 as well. In our view, this outperformance is multi layered. While most investors are probably aware that emerging markets is the economic growth engine of the world and historically outsized in the world's resource supply, investors are probably less attuned to the dynamism and competitiveness of its manufacturing and, increasingly, knowledge-based industries that's now driving corporate returns.

EM in my view is too large and now too critical for equities investors to be underexposed to it. The diversity of return is also apparent in emerging markets. Most of the attention has been focused on North Asia. If you take a look at the subcomponents within emerging markets, Latin America has also outperformed [the] US, Europe, Japan and MSCI World over the last two years. So, this is not purely a hardware story. It's about the diversity of the gains that you could have by having some parts of your investment in emerging markets equities, in my view.

DM: You mentioned the outperformance this year being driven a lot by North Asia and we think of the semiconductor and tech hardware space. There are concerns about how sustainable that outperformance is, though you've just highlighted it's not just North Asia. Latin America has been a contributor as well. If you think about a longer-term horizon, can this outperformance be sustained?

ZC: I think this is probably the trillion-dollar question. The critique is that the recent performance in emerging markets is very concentrated in technology. However, I don't think this is a bug. This is actually a feature of the regional indices. Emerging markets shares a similarity with the US equity markets where the information technology share[s] of the benchmark are quite significant – above 35% in both benchmarks. So, EM outperformance due to the much faster earnings growth concentrated in technology companies should not be a surprise.

Speaking of the information technology outperformance, there is a very large and critical question about the substantive AI capital expenditure that's currently underpinning the earnings in this sector – about the scales of the returns of this historical investment. That's probably beyond the scope of this chat, but emerging markets' key advantage here is being what I call the 'picks and shovels' of the spending.

The year-to-date tally of the hyperscaler spending? Roughly $860 billion in capital expenditure in 2026. By 2027, this is expected to exceed $1 trillion and this will continue to drive earnings in a lot of EM corporates. There's certainly a question whether this significant amount of capital investment will get a decent return. But for the emerging markets companies that we invested in, this capital expenditure is currently being converted into massive free cash flow. The top three companies we are looking at in emerging markets are projected to earn a free cash flow of roughly $300 billion in 2026.

All three are in the top five companies in terms of operating income generation. So, there are valid concerns about the substantive AI (artificial intelligence) capex, but this capex are [is] translating into free cash flow for the companies in emerging markets. For fundamental investors, we think earnings will drive share prices and given this change in cash flow, we believe the EM outperformance can be sustained. We go into this particular issue in a more detailed note that will be published in our Viewpoint series which listeners may want to take another look with regards to this particular trend.

DM: Where might investors find that?

ZC: This is on Viewpoint on the BNP Paribas Asset Management website.

DM: You mentioned the strong performance of tech and semiconductor stocks in emerging markets driven by all that capex spend, and importantly that the performance you've had for these stocks has fundamentally been driven by earnings as opposed to just an increase in valuations. At the same time, you could argue it's too much of a good thing as investors are starting to worry about capacity constraints – how much can these companies produce? How do you see that balance shifting over the next few quarters?

ZC: From what we can see, some of these semiconductor companies' second quarter results basically increased their earnings by five-fold on a year-on-year basis compared to last year. A lot of the AI chips require a specialised type of memory, what we call high bandwidth memory, or HBM memory. This type of memory is cannibalising a lot of previous supply of wafers that's going into commodity memory production. So, as we continue to accelerate the AI capex, the demand for this high bandwidth memory will continue and is leading to a supply and demand outlook that we believe will sustain at least for the next 12 months.

DM: Thank you very much, Zhikai. Some of the key points you made: In your view, though you admitted you were perhaps a bit biased, emerging markets are too large and too critical for investors to ignore, and it would be a mistake to underweight EM equities. Part of that argument is based on the fact that the outperformance we've seen – and you expect to continue – is not just driven by Asia but also Latin America.

You thought AI capex spending was going to continue for a while, and whether or not that will ultimately generate a sufficient return on the investment in the near term, it's really developed market companies that are providing the capex funds and a lot of emerging market companies that are benefiting from it.

Zhikai, thank you very much for joining me.

ZC: Thanks, Daniel. Thanks for having me.

DM: That's it for this week's episode of Talking Heads. If you would like more information about our capabilities in emerging market equities, please reach out to your asset management contact or check out Viewpoint, our website for investment insights at viewpoint.bnbparibas-am.com, where you can also find the paper that Zhikai mentioned.

Viewpoint brings you commentary and analysis in a variety of formats, from investment outlooks to asset allocation videos and podcasts to help investors make better informed decisions.

You've been listening to the BNP Paribas by Asset Management Talking Heads podcast with me, Daniel Morris and Zhikai Chen, Global Head of Emerging Markets Equities.

Please do join me next week. Until then, take care.