

Emerging Markets in Focus: The Opportunity Ahead

Key Takeaways

- **EM Remains Overlooked Despite Improving Fundamentals:** Strong demographics and a rising middle class have underpinned long-term growth in emerging markets (EM), yet most client portfolios remain meaningfully underweight the asset class.
- **EM Combines Lower Valuations with Faster Expected Earnings Growth:** EM equities currently trade near their widest valuation discount to DM equities in two decades, and EM earnings growth is expected to outpace DM.
- **Select EM Companies Are Critical Nodes of the Global AI Supply Chain—and Trade at Discounts to U.S. Peers:** TSMC, SK hynix, and others essential to AI infrastructure are headquartered in EM, and many trade well below comparable U.S. valuations.¹
- **Geopolitical Risk Is Real, but Largely Priced In:** EM equities traded at a significant discount to developed markets (DM) even before recent tensions escalated in the Middle East. We believe investors are being compensated for this risk rather than being blindsided by it.
- **Bottom-Up Selection Can Capture What Index Exposure Misses:** Our EM universe spans approximately 65 countries and dozens of industries, whereas passive exposure generally captures fewer countries and companies.

Most investors see emerging markets (EM) as a place to access growth. We think an equally interesting story is valuation. For most of a decade, EM equities underperformed their developed market (DM) peers, weighed down by post-financial-crisis margin compression, currency headwinds, and stellar returns from a few U.S. technology giants. By 2024, EM equities traded at their widest discount to DM equities in nearly two decades.

Now, that dynamic is changing. The MSCI Emerging Markets Index (MSCI EM) appreciated over 50% from the end of 2024 through 30 April 2026—outpacing both the S&P 500 Index and MSCI EAFE Index—reflecting recovering earnings momentum, stabilising currencies, and renewed investor recognition of EM's role in the global economy.² Earnings drove this recovery, yet the valuation gap remains compelling in our view.

Geopolitical risks are real, and we take them seriously. What we think remains underappreciated about EM is the combination of compressed valuations, an earnings growth outlook that outpaces DM, and its central role in the infrastructure that the world is building right now. For long-term active managers, we believe the EM opportunity set is as rich as it has been in years.

Contributors

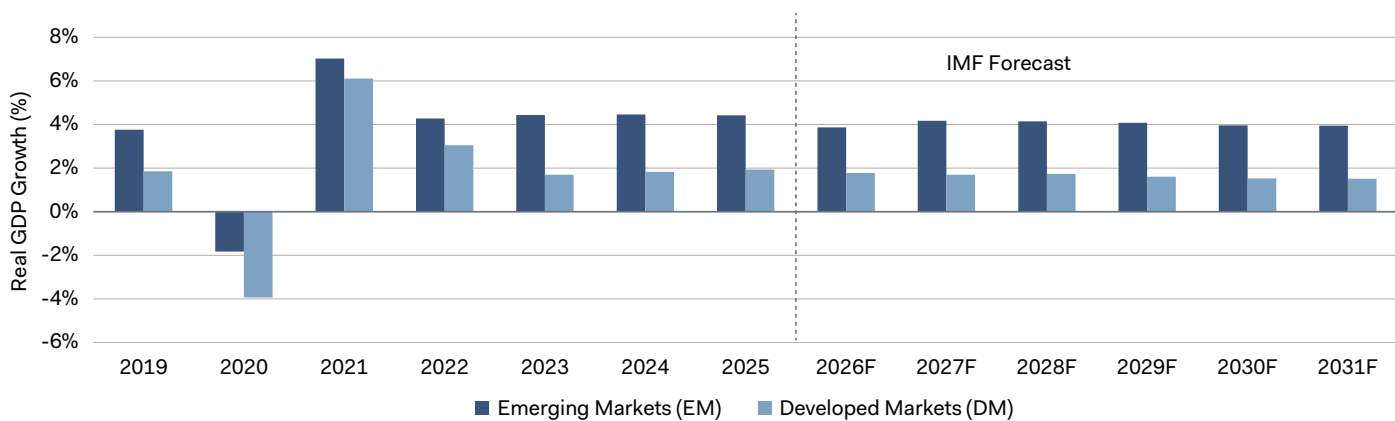


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Figure 1. Economic Growth Has Been Stronger in EM than in DM and Will Likely Remain So



Source: International Monetary Fund.

The Structural Foundation: A Growth Story Intact

The foundational case for EM rests on two pillars: scale and secular growth. EM economies represent over 85% of the world’s population and have driven half of global GDP growth since 2000—yet most client portfolios remain meaningfully underweight the asset class. According to the International Monetary Fund, EM economies are forecast to continue outpacing DM, as shown in Figure 1. We believe this mismatch between economic weight and investment allocation represents a significant, long-term opportunity. EM exposure also offers diversification benefits as economic cycles, sector composition, and policy dynamics often differ meaningfully from those in DM.

We believe these dynamics are secular—driven by demographics, middle-class formation, and productivity gains that don't expire after one strong year.

The market is starting to catch up: the MSCI EM’s share of the MSCI ACWI Index is now 2.6 times larger than it was in 2001.³ This breadth gives bottom-up investors a deeper set of opportunities to evaluate (e.g., greater information typically exists regarding issuers included in an index).

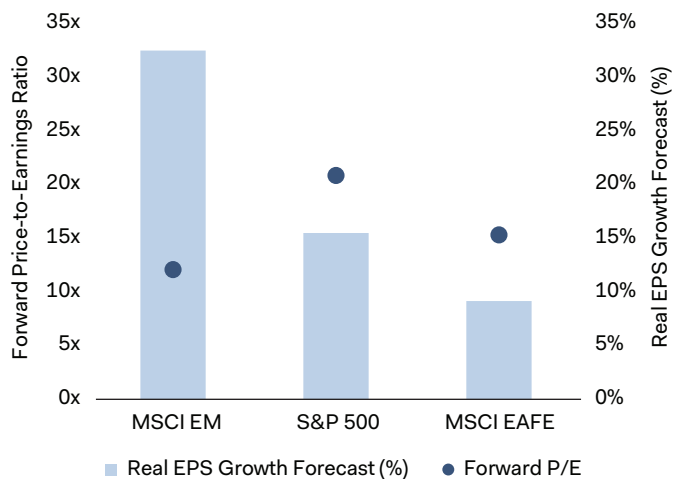
Valuation: Remains a Compelling Entry Point

Despite recent appreciation, the valuation gap between EM and DM equities sits at the fourth percentile of historical monthly observations—near its widest level in two decades—with U.S. equities trading near historic peaks.⁴ That gap reflects a mispricing in our view.

The composition of past returns can help explain why it persists. In recent years, multiple expansion contributed more to the U.S. market’s performance than underlying earnings growth. In EM, the reverse was true: earnings growth drove returns more than multiple expansion. That distinction matters looking ahead: stretched valuations constrain future returns, while attractive starting valuations paired with earnings growth create room for them to expand.

EM earnings growth is forecast to continue outpacing DM significantly—32% compared to 15% for the S&P 500 and 9% for the MSCI EAFE—and that advantage comes at a valuation discount (see Figure 2). The MSCI EM trades at only 12.1 forward earnings compared to 20.8 times and 15.3 times for the S&P 500 and MSCI EAFE, respectively.⁵ Historically, below-average valuations often provide a rewarding entry point for long-term investors, and above-average earnings growth provides an additional potential benefit.

Figure 2. EM Valuations Are Inexpensive with Higher Growth Prospects⁶



Source: FactSet, MSCI.

The AI Value Chain: An Emerging Markets Story

The valuation story has a more specific dimension. Most discussions of artificial intelligence (AI) focus on the U.S. companies designing and deploying it. Less appreciated is that the physical infrastructure those models run on—the chips, the memory, the fabrication, the power systems—is largely built by EM firms, many trading at significant discounts to U.S. peers.

Our bottom-up process identified this dynamic early. Before the broader market focused on EM's role in AI

infrastructure, we had built many positions across the value chain (see Figure 3)—including some in smaller-cap names with limited analyst coverage where we believe the opportunity for mispricing is greatest.

That value chain spans the full AI chip ecosystem:

- **Fabrication:** Taiwan Semiconductor Manufacturing Co. (TSMC) is the world's largest dedicated semiconductor foundry and the manufacturer of what many consider the most advanced AI chips, a largely irreplaceable node in the global AI supply chain.
- **Memory:** SK Hynix is a top global supplier of high-bandwidth memory (HBM), a critical component enabling the high-speed data access required by AI accelerators.
- **Packaging & Testing:** ASE Technology, a leader in outsourced semiconductor assembly and testing, assembles finished chips into complete packages that enter end markets, a crucial final step in the manufacturing process.
- **Chip Design:** MediaTek, which competes with Qualcomm in application-specific chip design, has secured a role as a key supplier to Google's tensor processing unit (TPU) programme, positioning it at the frontier of AI inference hardware.
- **Power Infrastructure:** Sieyuan Electric, a leading Chinese producer of power transmission and distribution equipment, supplies heavy electrical infrastructure, which is needed to power energy-intensive AI data centres at scale.

These companies are not peripheral to AI—they are foundational to it. And many appear underappreciated by a market still focused on the U.S. companies capturing AI's end-market value.

Geopolitical Risk: Navigating, Not Avoiding

Geopolitical risk is a persistent feature of EM investing. Our objectives are to 1) distinguish between risks that impair long-term earnings power and those that are more transitory, and 2) assess to what extent these risks are already reflected in valuations.

EM equities traded at a significant discount to DM before recent tensions in the Middle East escalated—and that discount has widened, not narrowed, since. This pattern is consistent with MSCI EM data available since 2003: EM valuation discounts have tended to widen during geopolitical stress and compress as conditions stabilise. Across several episodes of Middle East conflict—including Gulf War I, the Iraq War, and the 2006 Lebanon conflict—EM equities recovered meaningfully within 12 months of peak tension. We believe the historical evidence suggests that these risks are already reflected in current valuations.

Our perspective on Taiwan Strait risk is similar. The Dodge & Cox Worldwide Funds—Emerging Markets Stock Fund holds semiconductor manufacturers and related supply chain companies headquartered in Taiwan, and we assess this risk at the portfolio level—stress-testing its aggregate exposure across a range of scenarios. The structural importance of Taiwan's semiconductor ecosystem—and the high cost of disruption for all parties—remains a meaningful deterrent to military conflict, in our view.

More broadly, our approach emphasises scenario analysis and portfolio diversification. The Fund holds over 250 companies across countries, sectors, and market capitalisations, including a significant number of smaller, less-covered companies that may operate in niche markets or serve local needs, and can provide a different risk-return profile than larger, more globally oriented firms.

Figure 3. The Emerging Markets Stock Fund's AI Exposure Is Diversified Across the Value Chain⁷

Information Technology				Cons Disc/ Comm Services	Industrials		
Semiconductors & Hardware				Data Center Hardware	Applications	Infrastructure	
AI Chip Design & Supply (Fabless)	Advanced Foundry/ Memory & HBM	Testing & Packaging	Semiconductor Equipment & Electric Components	Servers & Systems	Foundational Models (LLM) & Applications	Power Grid & Data Center EPC	Energy Storage & Power Infrastructure
▪ MediaTek	▪ TSMC ▪ SK hynix ▪ Samsung Electronics	▪ ASE Technology ▪ Powertech Technology	▪ ACM Research	▪ Lenovo	▪ Alibaba ▪ Baidu ▪ NetEase ▪ Prosus ▪ Tencent	▪ Larsen and Toubro ▪ Sieyuan Electric	▪ CATL ▪ Sungrow Power Supply

Source: Dodge & Cox. Fund holdings as of 31 March 2026.

A Case for Active Selection: Not All EM Is Alike

Managing geopolitical risk and identifying value within the AI infrastructure are two expressions of the same discipline: bottom-up selection across a wide universe. Our EM universe spans approximately 65 countries and dozens of industries—breadth that lets us concentrate where we believe the case is strongest and avoid where it isn't.

Three questions are worth asking about any EM allocation:

- 1 Is your exposure broad enough to capture the structural growth case, or concentrated in fewer markets and themes?
- 2 Does your EM portfolio have exposure to the long tail—the smaller, less-covered companies where active selection can add the most value?
- 3 Are your investments being made selectively in the most compelling EM opportunities, or is the allocation effectively buying the Index?

We welcome the opportunity to walk through how the Emerging Markets Stock Fund answers each one.

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The Emerging Markets Stock Fund invests in securities and other instruments whose market values fluctuate within a wide range so your investment may be worth more or less than its original cost. Emerging market investing involves more risk, including currency risk and a greater risk of political and/or economic instability. The Fund may use derivatives to create or hedge investment exposure, which may involve additional and/or greater risks than investing in securities, including more liquidity risk and the risk of a counterparty default. Some derivatives create leverage.

See [Disclosures](#) for a full list of financial terms and Index definitions.

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1. The use of specific examples does not imply that they are more or less attractive investments than others in the investment universe.
 2. All returns are in U.S. dollars. From 31 December 2024 through 30 April 2026, the MSCI Emerging Markets Index had a net total return of 52.96% compared to 24.60% for the S&P 500 Index and 39.25% for the MSCI EAFE Index. Index performance does not represent fund performance and past performance cannot predict future results.
 3. Unless otherwise specified, all Fund weightings are as of 31 March 2026.
 4. Dodge & Cox calculated the percentiles based on relative historical forward price-to-earnings valuations for the MSCI EM vs. MSCI World, based on monthly observations from 30 June 2003 to 30 April 2026. The first percentile represents a trough-level relative valuation.
 5. Unless otherwise specified, all characteristics are as of 30 April 2026.
 6. The Real EPS Growth Forecast is calculated as the increase in the EPS growth from the actual last 12 months to the estimated next 12 months.
 7. The use of specific examples does not imply that they are more or less attractive investments than the portfolio's other holdings.