

What is the impact on EM Market during Middle East Tension?

Video highlights:

- Conflicts in the Middle East have triggered a risk-off trend in emerging markets (EM), and energy prices rose immediately, especially for oil price. Shipping traffic through the Strait of Hormuz slowed as war risk premiums surged and vessels were rerouted. Even without a formal blockade, actual supply has decreased due to insurance costs, inspections, and self-imposed shipping restrictions.
- However, for China—where energy security has long been a strategic priority, has diversified its crude oil sources and built up inventories over time, which has mitigated short-term risks to some extent. While most of the EM economies fear a re-inflation, China has been grappling with deflationary pressures in a period of time. Moderately rising import inflation, while not without cost, is not necessarily negative in economies seeking stronger price dynamics.
- Historically, weak USD often benefits EM markets. A weaker USD starting in 2025 result a capital inflows to leave the USD and flow to other non-US currencies and non-US assets. EM markets are one such beneficiary. If the USD remains stable or weakens further in the future, EM markets are expected to continue to benefit.
- According to IMF, economic growth in EM and developing countries will continue to outperform developed countries. For instance, China's exports continues to rise, demonstrating that supply chain diversification and export competitiveness remain intact. These factors help support a gradual recovery in the Chinese economy. Meanwhile, the market generally expects strong corporate earnings growth in EM for 2026, exceeding that of many developed markets, providing substantive support for EM equities.
- In terms of valuation, the MSCI Emerging Markets Index currently shows attractive 12-month forward PE ratios relative to the MSCI World Index, even falling below long-term averages. This valuation gap provides a relatively attractive entry point.
- While EM equity holdings remained low for previously, capital inflows have begun to pick up over the past few years. If the allocations return to their 20-year average levels, it would represent an capital inflow of over \$1 trillion USD — a potential momentum that should not be ignored.

- By investing in both EM stocks and bonds simultaneously, investors can capture the growth potential of equities while utilizing the stability of bonds to balance overall portfolio volatility. In fact, EM stocks and bonds offer clear regional complementary — stocks are primarily concentrated in Asia, while bonds are focused on EMEA (Europe, Middle East, and Africa) and Latin America, helping to achieve more comprehensive diversification.

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