Emerging Markets Strategy

Market Overview

Emerging markets saw an uneven rebound in August from recent volatility. The MSCI Emerging Markets Index advanced 3.4%, led by South Africa, which rose 11.4% on the back of stronger gold prices, while Taiwan (+6.4%) and South Korea (+5.9%) benefited from broader market participation and stabilization among AI infrastructure stocks. Brazil slumped 1.4% on uncertainty ahead of its general election in October while China and India both declined 0.3%. China was held back by subdued consumer spending that continued to offset export-driven growth, while domestic investor rotation toward small and mid caps held back large cap Indian stocks in spite of robust 7.8% GDP growth.

From a sector standpoint, materials (+13.7%) was the best performer, lifted by a 9% rise in gold prices. Health care (+8.7%) benefited from a rotation into more defensive areas of the market while AI-related information technology (+5.2%, IT) and industrials (+4.8%) also outperformed. Communication services (-4.0%), consumer discretionary (-3.0%) and utilities (-2.0%) were lower on profit taking after a strong July.

Rising U.S. and developed market bond yields in August did not have a meaningful impact on long-duration EM stocks, largely due to many EM countries not cutting rates as aggressively in the last easing cycle. While the Bank of Korea did raise interest rates 25 basis points during the month, the Bank of India kept its key rate unchanged. We think that many countries in our universe have strong fiscal backdrops and are well-positioned to weather periods of higher inflation.

Performance Overview

The ClearBridge Emerging Markets Strategy underperformed its benchmark in August, hurt by weakness in IT and industrials as well as stock selection in China and Taiwan.

South Africa gold miner Gold Fields was the Strategy's leading individual contributor, supported by a jump in gold prices and continued momentum from solid financial results released in July.

In South Korea, shares of Shinhan Financial continued their upward momentum following July results that featured an increased buyback program and a rate hike by its central bank. HD Hyundai Electric benefited from a Trump executive order restricting imports of foreign-made power grid equipment as the company currently operates manufacturing facilities in the U.S. and is planning to expand its presence.

In Taiwan, server manufacturer Quanta Computer, one of the recent laggards in IT space, reported strong growth as its customers are at the stage of data center buildouts where servers are now being installed. Data center power and thermal management manufacturer Delta Electronics rebounded from the July selloff as it gave a positive second-half outlook.

Three Chinese stocks were the primary detractors in August. Sieyuan Electric and battery supplier CATL were pressured by negative sentiment related to the U.S. trade restriction order on power equipment. While the order could limit its long-term expansion plans, Sieyuan does not sell directly to the U.S. power grid and maintains a healthy domestic business. CATL is equally well-positioned outside the U.S. Tencent, meanwhile, was also a victim of poor sentiment as investors continued to view the company as a laggard in the domestic LLM space.

In addition, not holding strong-performing U.K. gold miner Anglogold and South Korea technology component supplier Samsung Electro-Mechanics weighed on relative performance.

Portfolio Positioning

Activity was limited in August with an addition to recent buy Zhongji Innolight, a Chinese supplier of optical modules to AI data centers globally, the primary transaction.

Outlook

At a high level, our AI-related portfolio holdings have come through the latest rout with fundamentals intact and we believe that continued delivery of strong operational and financial results can help allay any fears on the steepness of the July selloff. We had previously trimmed positions in these stocks as they gained in price throughout the first half of 2026, but more recently we have maintained our positions, seeing no reason to react to short-term price action. While we acknowledge that these stocks have endured periods of high volatility, we think our benchmark-relative weights in these stocks are reasonable given the high conviction we have in their fundamentals.

We remain positive on the outlook for the IT hardware industry as we continue to see a supportive combination of growing global demand and constrained supply. The latest indications are for the supply-demand situation to tighten further heading into 2027, which should support to our AI-related IT and industrial holdings.

While performance in EM had been relatively concentrated in recent months, we view the rotation into non-tech areas through the first two months of the third quarter, especially in South Korea, as generally healthy. That market, the third largest in the index and second largest in the portfolio, continues to benefit from a solid economic foundation and robust growth attributes.

We continue to see long-term positive drivers for the portfolio from several areas, in particular: China, India and IT. In China, we see a stabilization in macro conditions combined with market valuations that are still relatively cheap on a global basis. It has become a two-speed economy, with domestic weakness offset by export and industrial strength. At the same time, China continues to produce world-leading innovation across multiple industries beyond tech, including industrials and consumer sectors. In India, although the market has underperformed recently, we see long-term opportunities in high-quality, domestic-focused companies that the market has overlooked.

Portfolio Highlights

The ClearBridge Emerging Markets Strategy underperformed its MSCI Emerging Markets Index benchmark in August. On an absolute basis, the Strategy delivered positive contributions across three of the nine sectors in which it was invested (out of 11 sectors total). The primary contributor to performance was the IT sector, while the consumer discretionary and communication services sectors were the main detractors.

Relative to the benchmark, overall stock selection and sector allocation detracted from performance. In particular, stock selection in the IT, industrials and health care sectors and an underweight to materials hurt results. On the positive side, stock selection in the financials sector contributed to performance.

On an individual stock basis, the primary relative detractors were Sieyuan Electric, CATL, Tencent and not holding Anglogold and Samsung Electro-Mechanics. The largest relative contributors included Gold Fields, Shinhan Financial, Delta Electronics, HD Hyundai Electric and Quanta Computer.

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