

Consistency in Emerging Markets

Emerging markets (EM) are often characterised as volatile and unpredictable, and to some extent that is fair. There are periods when performance is stellar and others when it is less so.

Over time, however, a consistent approach focused on quality growth companies has tended to deliver attractive outcomes. The question of whether such an approach works in EM is a reasonable one.

Looking back over the past decade or so, the answer appears to be yes. Returns have been positive relative to the broader MSCI Emerging Markets Index, although not without interruption. Periods such as 2016, 2022 and parts of 2025 remind us that even the most consistent strategies can fall out of favour, often driven by shifts in market leadership rather than any fundamental deterioration in the underlying businesses.

Defining “quality” is less straightforward than it might first appear. Every investor would claim to be looking for good companies. The difficulty lies in being explicit about what that means in practice. One way of framing it is through a simple set of metrics: returns, cash generation and growth. A return on equity of around 15% is a useful starting point. In emerging markets, estimating a precise cost of capital is challenging, so a consistent threshold provides a degree of discipline. It is also a relatively demanding hurdle. From a universe of several thousand companies, only a small proportion consistently achieve that level of return.

Cash generation is equally important. Growth has to be funded, and the distinction between internally generated cash and external financing matters a great deal over time. Companies that rely heavily on borrowing or repeated equity issuance often end up diluting shareholders, whereas those that can reinvest their own cash flows tend to compound more effectively. Earnings growth, in turn, provides the third leg of the framework. In a part of the world where structural growth is higher, mid-teens earnings growth is not unreasonable and allows for a meaningful compounding of value.

These measures are deliberately simple, but they help to narrow the field considerably and focus attention on a relatively small subset of businesses.

There is, however, such a thing as too much of a good thing. Very high returns, while attractive, are rarely sustainable. They tend to attract competition, and over time that competition erodes excess profitability. Varun Beverages provides a good example. The business has been highly successful, particularly following its expansion into southern India and the improvement of previously underperforming assets. Returns rose sharply as a result, but that success inevitably drew attention. New entrants, including Reliance Industries, have since made the market more competitive. It is an excellent business, but the environment has become more challenging, and returns have begun to normalise.

A slightly different example can be found in Eicher Motors, owner of the Royal Enfield brand. Here the strength lies in the brand itself. It is a dominant player in its segment, with a product that is both aspirational and distinctive. Returns have been consistently robust over time, although not immune to cyclical pressures. Regulatory changes and pricing dynamics have at times affected demand, but the underlying franchise has proved resilient.

The importance of cash generation becomes particularly clear when considering the risks of dilution. In parts of the emerging market universe, this has been a persistent issue. China offers a useful illustration.

While economic growth and aggregate corporate earnings have been strong over the past two decades, earnings per share have grown much more slowly. The gap reflects the impact of new listings, capital raising and, in some cases, state-driven dilution. For minority shareholders, this can significantly reduce the benefit of headline growth.

This is not to say that high-quality businesses do not exist in China. On the contrary, there are a number of globally competitive, entrepreneur-led companies. CATL is one such example. Its position in the electric vehicle battery market, combined with strong cash generation, allows it to invest heavily while maintaining a leading competitive position. The balance between reinvestment and return is a powerful one.

Perhaps the clearest example of this dynamic is TSMC. Over a long period, it has combined steady growth with high levels of cash generation and consistently strong returns. It operates in a cyclical industry, but the degree of cyclicity is lower than might be expected, reflecting its dominant position and disciplined approach. Rather than maximising short-term profitability, it has tended to focus on long-term relationships and capacity investment, which in turn has reinforced its competitive advantage.

Even so, there are periods when this type of steady compounding falls out of favour. Over the past year, for example, companies with these characteristics have underperformed the broader market. Some of this can be attributed to regional factors, including a difficult period for India and a more prolonged slowdown in China. Valuation also played a role, particularly where expectations had become elevated.

Such periods are not unusual and tend to be cyclical. What is perhaps more relevant is that, in many cases, valuations have adjusted while underlying fundamentals remain intact. Returns are still strong, cash generation remains robust and balance sheets are generally healthy, often with net cash positions rather than leverage.

The composition of emerging markets themselves has also evolved. Markets such as Korea and Taiwan now exhibit many of the characteristics of developed economies, while China and India remain central to the broader growth story. Beyond these, there is a diverse range of smaller markets, each with its own dynamics and opportunities.

After a prolonged period in which emerging markets were relatively unloved, there are signs that sentiment may be shifting. Performance has improved more recently, although volatility remains a feature of the asset class. For investors, the key question is less about short-term movements and more about the ability of businesses to compound over time.

In that context, a focus on companies that generate consistent returns, produce cash and grow earnings steadily continues to provide a useful framework. It does not eliminate volatility, but it does offer a way of navigating it, and over time, that has tended to be rewarded.

One day (maybe soon) the Koreans will work out how to “graduate” to DM and that will change the complexion considerably, although Taiwan (also a highly developed country) should graduate but I suspect there are political ramifications to hold this back. Either of these would be a big change to the asset class and if both were to go, it becomes a China and India story again.

Of course, there are natural changes, which can be dramatic, such as the one we are seeing today, when a small handful of stocks, this time technology stocks, become very dominant at the expense of all the others. This tends to happen to the more cyclical stocks, and this can come and go. I remember Samsung being a dominant stock in the past, but not for 20 years or so!

Biography

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Rob is a Director of Aubrey, and Investment Manager of the [Global Emerging Markets Strategy](#). He joined the firm in 2014.

An engineering graduate from Cambridge University, Rob began his career in 1988 at Thornton Management in London. Then he spent ten years in Hong Kong as an Asian fund manager with Credit Lyonnais International Asset Management. This company was later bought by Nicholas Applegate and then Colonial First State, where Rob ran the North Asian investment team as well as managing the

Asian Special Situations Fund and a number of single country funds investing in India, Pakistan, Indonesia and Thailand.

He then went on to co-found emerging markets investment boutique BDT Invest LLP in London in 2000. Whilst at BDT, Rob co-managed a number of emerging market portfolios as well as the BDT Asian and Oriental Focus Funds.

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