Morgan Stanley
INVESTMENT MANAGEMENT

The Unexpected Winners of a Divided World

TALES FROM THE EMERGING WORLD | EMERGING MARKETS EQUITY TEAM | September 2025

AUTHOR

EMERGING MARKETS EQUITY TEAM

In a year defined by uncertainty—wars in Europe and the Middle East, rising U.S.-China tensions, and a new U.S. leadership signaling major policy changes—the world's best performing stock markets in 2024 weren't to be found among the usual safe havens. Rather, it was a number of overlooked and misunderstood frontier and small emerging markets (EM) that delivered extraordinary gains.

The five best performing markets globally in 2024 belonged to the often-overlooked frontier and small emerging markets: Argentina +114%, Kenya +79%, Pakistan +79%, Sri Lanka +70% and Tanzania +33% in U.S. dollar (USD) terms *(Display 1)*.

Each of these markets benefited from economic reform, some significant, and historically low valuations. Going forward, they, and other frontier and small EM countries, stand out as uncorrelated opportunities, isolated from global trade wars, and poised for accelerating gross domestic product (GDP) growth driven by transformative reforms and strong domestic demand.

DISPLAY 1

Top Performing Stock Markets in 2024 (USD)

Past performance does not predict future results

GLOBAL RANK	COUNTRY	INDEX	2024 PERFORMANCE
1	Argentina	S&P MERVAL	114.2%
2	Kenya	Nairobi All Share	79.4%
3	Pakistan	Karachi Stock Exchange 100	78.7%
4	Sri Lanka	Sri Lanka CSE All Share	70.2%
5	Tanzania	Tanzania All Share	33.2%
6	Israel	Tel Aviv 35	26.7%
7	U.S.	S&P 500	25.7%
8	Hong Kong	Hang Seng	25.6%
9	Taiwan	Taiwan Exchange	24.3%
10	Malaysia	FTSE Bursa Malaysia KLCI	21.2%

Source: MSIM. As of December 31, 2024. Markets with more than $1 million in average daily trading volume. It is not possible to invest in an index.

While global investors focus on big tech and artificial intelligence (AI) in U.S. markets, frontier and small emerging market countries offer a different opportunity: large, rapidly expanding economies, and home to the fastest-growing consumer bloc in the world. These economies are attracting global capital to industrialize and build critical infrastructure—from hospitals to digital payment systems—while their uncorrelated financial markets can offer much-needed diversification at historically low valuations.

Despite investor perceptions to the contrary, the MSCI Frontier Markets Index has lower historical volatility than most other major global indices like MSCI World or MSCI EM.

Below we outline five key themes for the frontier and small emerging markets asset class in 2025:

1 Reform, Recovery & Resurgence

Many frontier and small emerging markets have experienced severe economic distress over the past year or two. Yet as we noted in a previous report, (Hidden Gems: Unearthing the Potential of Hidden Markets, July 2024), these crises have driven bold reforms, including slashing budget deficits, tightening monetary policy and loosening currency controls. Countries like Argentina, Egypt, Nigeria, Pakistan, Sri Lanka and Turkey are now on a path to recovery, with several making the list of the best-performing markets globally last year.

When coupled with other high-growth economies like Vietnam and Bangladesh, this sets the stage for a resurgence in growth for countries belonging to the MSCI Frontier Markets Index. They are projected to see GDP growth accelerate from 3.4% in 2024 to 4.1% in 2025, while emerging markets are expected to expand by 3.9% and developed markets (DM) are estimated to grow by 2.0% *(Display 2)*. In essence, frontier economies are poised to outpace the rest of the world.

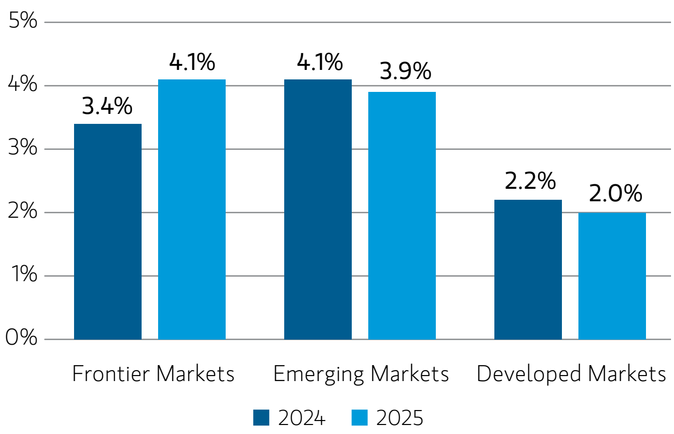
While major economies have largely tamed inflation, frontier economies should see the benefit of a further deceleration in inflation rates, which are expected to decrease from 4.3% in 2024 to an estimated 3.6% in 2025. This decline can be attributed to tighter monetary policy: across the 19 countries we actively track, 84% now have positive real policy rates, up from 5% in mid-2022.

In 2025, we are closely monitoring the Nigerian equity market as the economy may be ready to reap the benefits of its bold reforms. For similar reasons, we are optimistic about the equity market in Bangladesh, recently named The Economist's "Country of the Year" for 2024.

DISPLAY 2

Frontier Markets Lead the Pack

Real GDP growth estimates (%)



Source: Haver Analytics. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

2 Escaping China and the Tariff Trap

Rising geopolitical tensions between Washington and Beijing, coupled with China's domestic economic slowdown, have led many investors to scale back their direct and indirect exposure to the Chinese market.

Many large EMs remain highly exposed to China—whether through export channels or financial linkages, like currency movements—making them vulnerable to any slowdown in China's growth or currency depreciation triggered by tariffs. In contrast, many frontier and small emerging economies such as Egypt, Bangladesh, Pakistan, Nigeria and Turkey exhibit much lower sensitivities to both Chinese economic data, financial markets and the Chinese renminbi.

Additionally, the new U.S. administration's trade policies appear increasingly focused on China, Mexico, Canada and the Eurozone. Other countries—such as Taiwan and Korea—find themselves caught in the middle of a simmering struggle over high-tech restrictions including semiconductor exports.

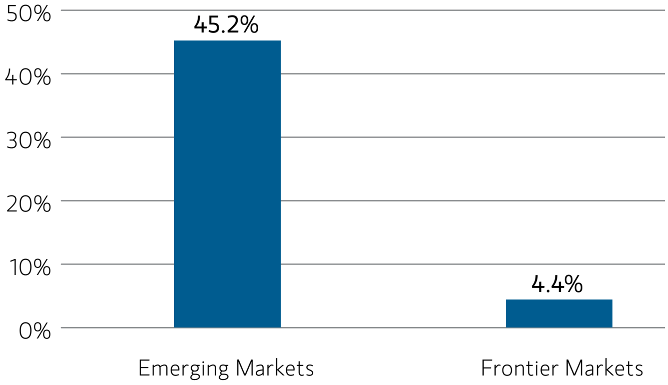
Yet, frontier and small emerging economies, with the exception of Vietnam, are not in the direct crosshairs of trade wars. Their economic growth is largely driven by internally–generated domestic demand rather than global trade, which helps insulate them from the impacts of tariffs. For example, trade accounts for only a third of GDP in countries like Egypt, Bangladesh, Argentina, Kenya and Pakistan. Frontier markets as a whole account for just 4.4% of global exports, compared to 45.2% for EMs *(Display 3)*.

Markets appear to have caught on. Since the recent U.S. elections, the financial markets' pricing in of potential tariffs has been linked to the relative outperformance of frontier market equities—which have gained +2.0% in USD terms compared to a loss of -2.7% for EMs—demonstrating the potentially favorable correlation characteristics during a time of increasing trade uncertainty.

DISPLAY 3

Disconnected From Global Trade Routes

Total share of global exports (%)



Source: Haver Analytics. As of September 30, 2024.

3 Superpowers Clash, Middle Powers Rise

Although investors remain gripped by the tug-of-war between the superpowers, the real beneficiaries of U.S.-China tensions are the overlooked middle powers—large, strategically important economies like Indonesia, Vietnam, Pakistan, Egypt, Morocco, Nigeria and Turkey—are becoming battlegrounds for influence and investment.

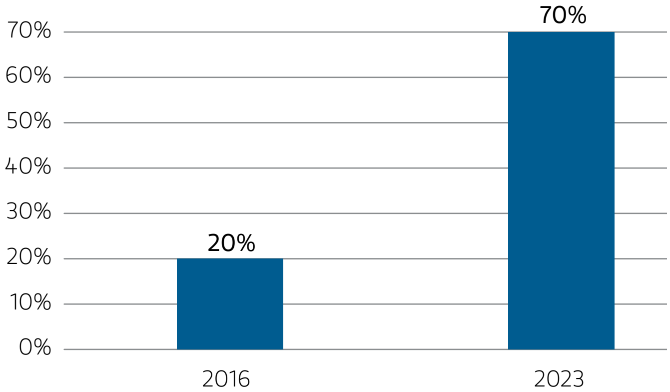
Many of these countries are leveraging superpower rivalries to secure foreign capital for industrial expansion and critical infrastructure development. This influx of strategic investment could transform these middle powers, with large, consumption-driven middle classes, into stronger, more resilient economies who will directly benefit from increased capital investment.

China's outbound foreign direct investment (FDI) tells the story: in 2016, developing economies received 20% of China's overseas investments, but by 2023, that share had soared to 70% *(Display 4)*. Emerging economies that act as strategic "connectors" to Western markets—such as Vietnam for manufacturing, Indonesia for critical minerals and Malaysia for data centers—are key recipients of U.S. and Chinese capital. A similar story is playing out across various sectors in Sub-Saharan Africa and South Asia.

DISPLAY 4

China Pivots to Rising Economies

China outbound foreign direct investment share to developing countries



Source: Haver Analytics.

4 Demographics Are Defying the Grey Wave

As financial capital investments accelerate, many frontier and small emerging markets will benefit from the continued growth of their human capital, setting them apart from much of the rest of the world. Last year marked the first time in modern history that DMs saw a decline in their working-age population, a trend we expect will accelerate in the years ahead. Over the next decade, we expect the European Union will lose more than 20 million workers.

Many EMs also face the same demographic challenges; for instance, China's labor force is expected to shrink by nearly 60 million workers over the coming decade. However, in stark contrast, over the same period, the countries of Vietnam, Indonesia, Philippines, Pakistan, Bangladesh, Egypt and Nigeria—with a combined population of 1.3 billion—are set to add an additional 132 million to their workforce over the next decade, effectively adding another Mexico *(Display 5)*.

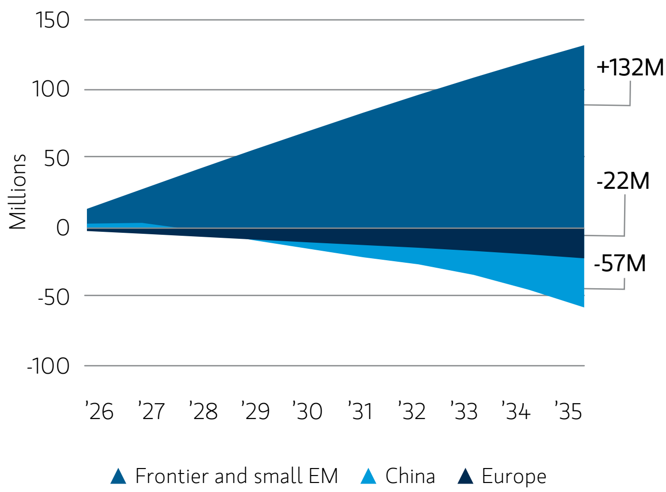
An increase in the working-age population can fuel economic growth, driving demand for goods such as consumer staples, fashion and durable goods, which should translate into strong revenue and earnings growth for publicly-traded stocks in these markets.

While global volatility may remain elevated, demographic forces will continue to underpin many secular themes, from hospital expansion in Indonesia, to mobile money in Nigeria and Egypt, to a prescription drug consumption boom in Bangladesh. These themes remain uncorrelated to geopolitics and AI capital expansion cycles, providing an attractive diversification opportunity for many global equity investors.

DISPLAY 5

Winning the Demographic Divide

Cumulative change in working age population (2025-2035)



Source: Haver Analytics. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

5 Homegrown Heroes

As spending power grows in frontier markets, a quiet revolution is reshaping consumer habits: local brands are steadily capturing market share from global giants. While international brands still dominate aspirational categories, everyday consumer products are being claimed by nimble, homegrown competitors. A recent study found that local firms in key EMs are growing 3-4% faster than their global competitors, and have higher profit margins.

Several forces are driving this transformation. A strong USD has made imported goods more expensive, encouraging consumers to seek better value. In response, many companies are producing high-quality, affordable alternatives that resonate with local tastes. We have seen this firsthand—from groceries in the Middle East, to pet foods in Southeast Asia, and cosmetics in Egypt—where local brands are winning over consumers who prioritize value without compromising on quality.

Rating systems have commoditized trust, as online reviews and consumer ratings now carry as much weight as brand recognition. There is also the digital shift. E-commerce and food delivery platforms have leveled the playing field, eliminating the need for huge marketing budgets and massive distribution networks to stock retail shelf space.

For investors this presents a potentially powerful, long-term opportunity to tap into emerging local brands that understand their markets best.

The Growth Story Few Are Watching

In a world characterized by geopolitical tensions and declining demographics, frontier and small emerging markets have quietly outperformed and defied expectations. They are leveraging their youthful populations, rising foreign investment and relatively insulated domestic demand to ignite their economic growth on the back of recent reforms.

Trading at historically low valuations, these markets offer global investors the potential to access growth and diversification in ways that major markets cannot. For those willing to look, we believe these opportunities are often hiding in plain sight.

RISK CONSIDERATIONS

Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Investments in **foreign markets** entail special risks such as currency, political, economic, market and liquidity risks. The risks of investing in **emerging market countries** are greater than the risks generally associated with investments in foreign developed countries. The risks associated with emerging markets are magnified when investing **in frontier emerging market securities.** **Diversification** does not eliminate the risk of loss.

INDEX DEFINITIONS

The **S&P MERVAL Index** measures the performance of the largest, most liquid stocks trading on the Bolsas y Mercados Argentinos Exchange (BYMA) classified as domestic stocks. The constituents of the index must meet minimum size and liquidity requirements.

The **Nairobi All Share Index** is a market cap weighted index that measures the performance of all companies listed on the Nairobi Stock Exchange (NSE).

The **Karachi Stock Exchange 100 Index** is a total return stock index acting as a benchmark to compare prices on the Pakistan Stock Exchange.

The **Sri Lanka Colombo Stock Exchange All Share Index** is a capitalization-weighted stock market index that tracks the performance of all companies listed on the Colombo Stock Exchange in Sri Lanka.

The **Tanzania All Share Index** is a market capitalization weighted index that tracks the performance of all publicly traded companies on the Dar es Salaam Stock Exchange.

The **Tel Aviv 35 Index** is an Israeli stock market index computed by the Tel Aviv Stock Exchange tracking the performance of 35 large companies listed on stock exchanges in Israel.

The **S&P 500® Index** measures the performance of the large cap segment of the U.S. equities market, covering approximately 75% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

The **Hang Seng Index** is a free-float capitalization-weighted index of a selection of companies from the Stock Exchange of Hong Kong.

The **Taiwan Stock Exchange Index** is a capitalization weighted stock market index that measures the performance of companies listed on the Taiwan Stock Exchange.

The **FTSE Bursa Malaysia KLCI Index** is a capitalization-weighted stock market index, composed of the 30 largest companies on the Bursa Malaysia by market capitalization that meet the eligibility requirements of the FTSE Bursa Malaysia Index Ground Rules.

The **MSCI Frontier Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of frontier markets. The MSCI Frontier Markets Index currently consists of 24 frontier market country indices. The performance of the Index is calculated in U.S. dollars and assumes reinvestment of net dividends. "Net dividends" reflects a reduction in dividends after taking into account withholding of taxes by certain foreign countries represented in the Index.

The **MSCI Emerging Markets Index (MSCI EM)** is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets.

The **MSCI World Index** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

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MIDDLE EAST:

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