Investment Perspectives

May 2026

Quality in Emerging Markets

Key Observations:

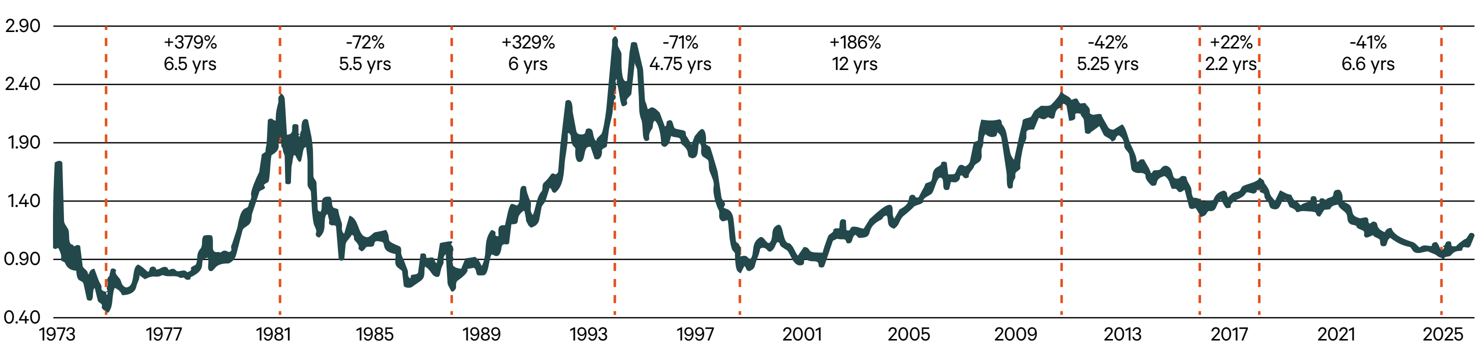
- *Following an extended period of disappointing returns, emerging markets have outperformed U.S. equities since early 2025.*
- *Emerging markets outperformance may only be in its early stages as several long-term fundamental drivers, including a shifting U.S. dollar and corporate governance improvements, align alongside attractive relative valuations and institutional allocations near historical lows.*
- *Historically, high quality businesses—those characterized by strong returns on equity, earnings stability, and sound balance sheets—tend to outperform in emerging markets over time.*
- *Currently, quality is meaningfully out of favor, creating what we see as an attractive entry for long-term investors.*
- *In our view, active management in emerging markets can reduce risks inherent in passive indices and better exploit a large, underexplored opportunity set—an approach reflected in the KAR Developing Markets strategy's differentiated, high quality focused exposure, and historically stronger downside capture than peers.*

Key Drivers Lining Up for Emerging Markets

Financial markets are characterized by long cycles in which entire asset classes, regions, and sectors can move in and out of favor, with the down cycles often extending for so long that even the most patient investors abandon ship. Emerging markets recently endured such a cycle. For more than a decade, the asset class suffered a prolonged period of underperformance, exacerbated by capital outflows and institutional apathy.

From our perspective, there are signs that the point of maximum pessimism has passed. Fundamentals that contributed to a decade of underperformance—a strong U.S. dollar, poor corporate governance and consistent shareholder dilution—are showing signs of reversal. Meanwhile, the macro conditions underpinning the case for emerging markets—demographics and faster economic development—remain intact.

FIGURE 1: EMERGING MARKETS EQUITY OUTPERFORMANCE HISTORICALLY PLAYED OUT OVER SEVERAL YEARS



Data as of February 23, 2026. Source: UBS estimates, MSCI, and Bloomberg. Global emerging markets equities relative to global, USD terms (prior to 1988, Hong Kong and Singapore used as proxies). Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Please see the end of this paper for additional information about the indices. ***Past performance is no guarantee of future results.***

Why a Shifting Dollar Matters for Emerging Markets

Emerging markets equities tend to be inversely correlated to the value of the U.S. dollar. The strength of the U.S. dollar has been a major challenge for emerging market equities, as it attracts foreign investment to U.S. assets, depresses emerging markets currencies and valuations, and can raise financing costs for developing countries attempting to defend their currency. Historically, the dollar's movement against foreign currencies takes place over many years because the mechanics create a self-reinforcing trend. Ultimately though, the value of the U.S. dollar has shown consistent mean reversion.

After a fourteen-year rally, the dollar peaked in 2022, and several developments suggest it may not return to that level anytime soon, creating a potential tailwind for emerging market equities. Yield differentials between the U.S. and the rest of the world have narrowed, U.S. fiscal deficits have expanded materially, and many emerging market countries have quietly improved fiscal discipline. Furthermore, as these factors have coincided with uncertainty around U.S. trade policy, central banks have diversified their foreign reserves and reduced reliance on the dollar.

Improving Corporate Governance and Shareholder Returns

Weak corporate governance has been a longstanding and legitimate concern in emerging markets investing. Minority shareholders have often been subordinated to controlling families, state interests, or political objectives. Value-destructive capital allocation, particularly excessive equity issuance, has also been more common than in developed markets.

This dynamic is changing. Across markets like China, South Korea and India, governance reform has moved from aspiration to policy. Regulators and exchanges are incentivizing improved corporate disclosure and more consistent minority shareholder engagement, while scrutinizing related party transactions and curbing excessive share issuance.

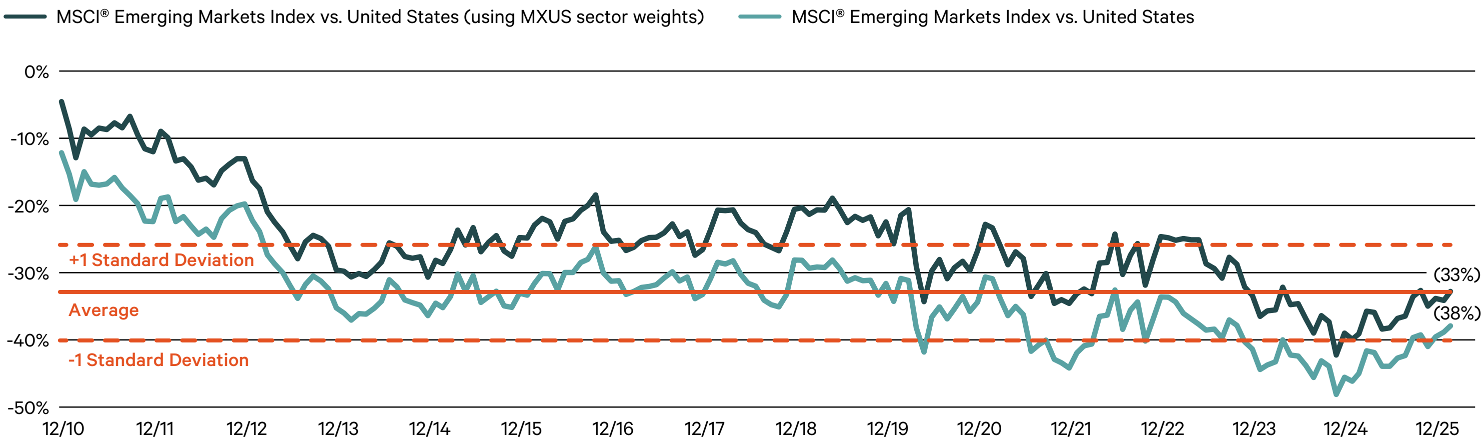
Historically, the challenge in emerging markets was not a lack of growth but a dilution of shareholders' claims on that growth. Notably, emerging markets aggregate earnings have expanded at a similar pace as the U.S. since the 2008 great financial crisis, but per-share earnings lagged due to persistent equity issuance. Today, net issuance activity across emerging markets has moved closer to neutral levels and has converged toward healthier developed market norms.

These reforms raise the floor, but they do not guarantee the ceiling. In our experience, distinguishing genuinely well-governed businesses from those merely improving on paper still requires deep, on-the-ground research and careful judgment.

Valuation and Positioning: The Opportunity Remains Compelling

Despite the rally since early 2025, we believe the opportunity in emerging markets remains largely ahead of us. Valuations are still deeply discounted relative to developed markets, even as the fundamental case for the asset class appears stronger than it has been in over a decade.

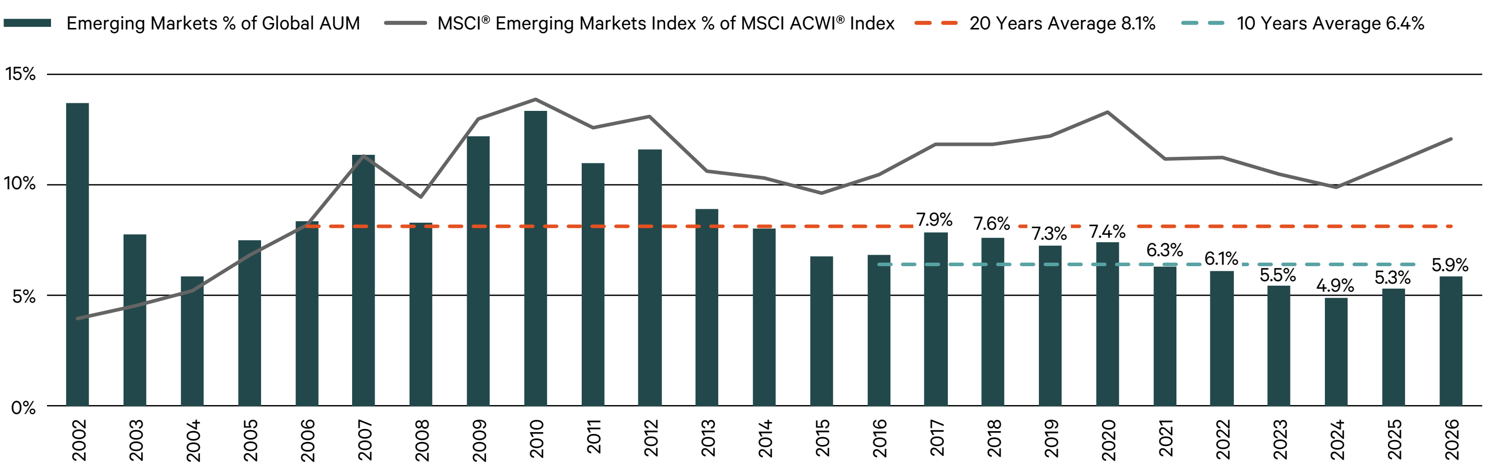
FIGURE 2: PRICE/EARNINGS MSCI EMERGING MARKETS VS. U.S. REMAIN DISCOUNTED



Data as of February 26, 2026. Source: FactSet Research Systems, MSCI, Goldman Sachs Global Investment Research. U.S. sector weights are based on the sector weights of an Invesco MSCI ETF. Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Please see the end of this paper for additional information about the indices. ***Past performance is no guarantee of future results.***

Positioning data tells a similar story. Institutional allocations remain well below benchmark weights and near historical lows, suggesting that accumulated skepticism has not yet given way to conviction.

FIGURE 3: EMERGING MARKETS SHARE IN GLOBAL EQUITY AUM



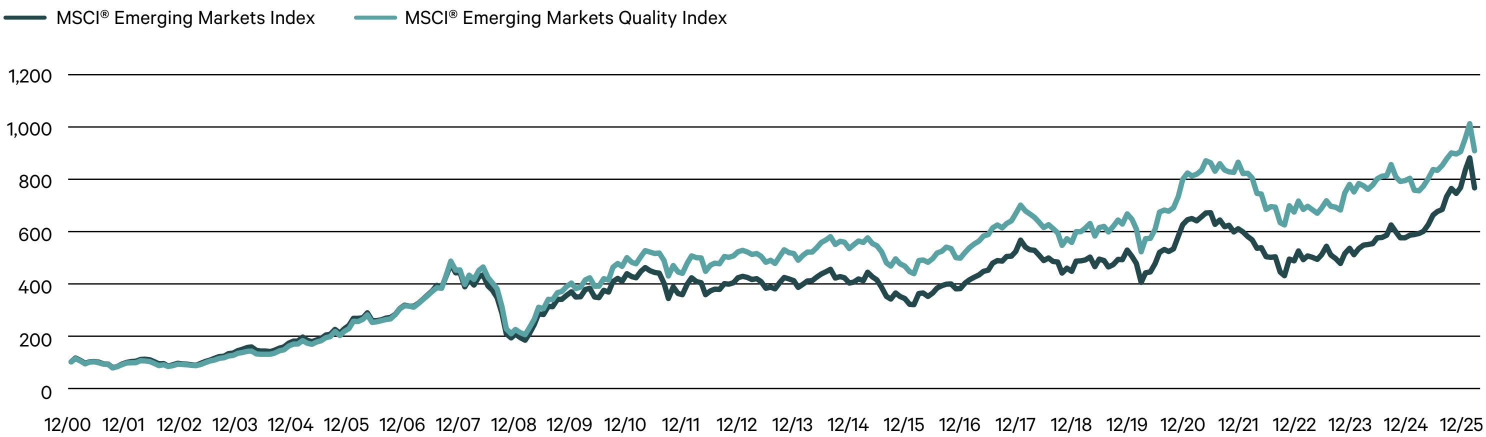
Data as of February 2026. Source: EPFR Global, Eikon. Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Please see the end of this paper for additional information about the indices. ***Past performance is no guarantee of future results.***

Quality on Sale

High-quality businesses have historically outperformed within emerging markets over full cycles, but that outperformance is rarely linear. During the early stages of a market recovery, quality often lags. When sentiment turns and capital rushes back into a previously unloved asset class, it is the most beaten-down, cyclical, and operationally leveraged businesses that tend to move first and fastest. The same characteristics that made them fragile on the way down make them elastic on the way up.

FIGURE 4: CUMULATIVE PERFORMANCE

Emerging Markets vs. Emerging Markets Quality

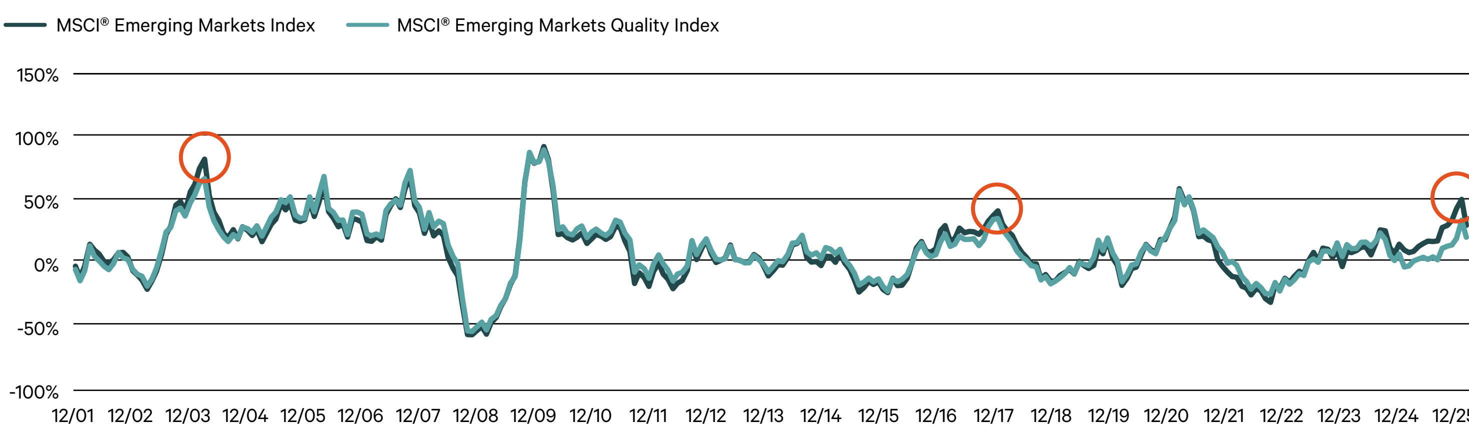


Data as of March 31, 2026. Source: FactSet Research Systems. Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Please see the end of this paper for additional information about the indices. ***Past performance is no guarantee of future results.***

The math is unforgiving in the other direction: a stock that falls 50% requires a 100% return just to break even. We assert that it is precisely the avoidance of those deep drawdowns that underpins quality's attractive risk-adjusted returns over a full cycle.

FIGURE 5: QUALITY TYPICALLY UNDERPERFORMS DURING HISTORIC RALLIES

Trailing 12-Month Performance



Data as of March 31, 2026. Source: FactSet Research Systems. Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Please see the end of this paper for additional information about the indices. ***Past performance is no guarantee of future results.***

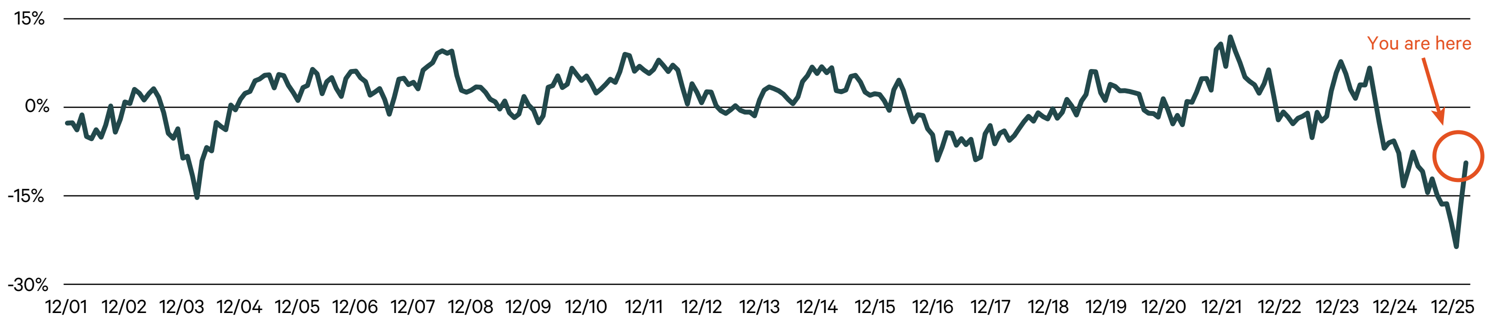
The most recent emerging market rally has followed this script closely. Much as the commodity-driven emerging markets bull market of the early 2000s opened with a sharp, cyclically-led surge that initially left quality businesses behind, the rally of 2025 was dominated by companies in the semiconductor, technology hardware and metals and mining industries. These industries are characterized by capital intensity, commodity-like pricing dynamics and barriers to entry that are lower and less durable.

We believe the next phase of the cycle could support a different set of characteristics—businesses with more structural sources of demand, genuine pricing power, and competitive positions that are difficult to replicate.

Currently, quality businesses overall do not command the valuation premium they have historically attracted. We believe long-term investors should take advantage of this disconnect.

FIGURE 6: QUALITY'S OUTPERFORMANCE

MSCI® Emerging Markets Quality Index vs. MSCI® Emerging Markets Index



Data as of March 31, 2026. Source: FactSet Research Systems. Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Please see the end of this paper for additional information about the indices. ***Past performance is no guarantee of future results.***

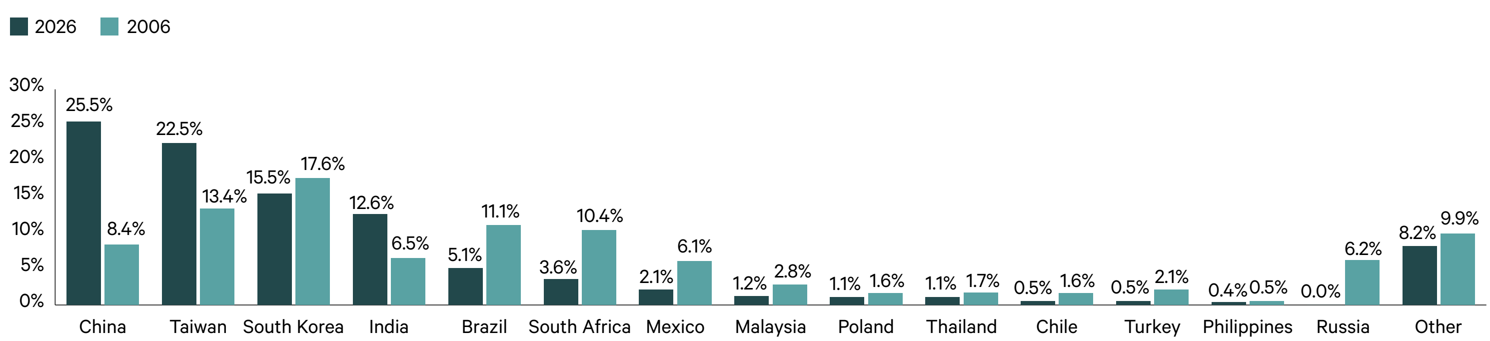
Why Active Management Matters in Emerging Markets

For investors persuaded by the macro backdrop, the instinct may be to gain exposure through passive index funds. In emerging markets, however, we believe passive investing introduces risks that can matter enormously to long-term outcomes.

Managing Concentration Risk: Market-cap weighted indices systematically overweight what has already gone up. For example, buoyed by the commodity boom, Brazil was once the largest country weight in the MSCI Emerging Markets Index only to subsequently decline 80% between 2008 and 2016. China was the largest country weight in 2020. It went on to decline by over 60% in less than two years. Today, Taiwan, South Korea, and China account for roughly two-thirds of the MSCI Emerging Markets Index with a significant portion of those markets tied to AI-related revenue expectations. This trend creates a highly correlated exposure to a single technological narrative layered with geopolitical risk.

FIGURE 7: EMERGING MARKETS INDEX CHANGES OVER TIME

MSCI® Emerging Markets Index Country Weights



Data as of March 31, 2026. Source: FactSet Research Systems. Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Please see the end of this paper for additional information about the indices. ***Past performance is no guarantee of future results.***

Avoiding the Average and the Outright Bad: State-owned enterprises remain a meaningful share of the benchmark. These businesses are often run to serve political or social objectives rather than to maximize returns for minority shareholders, and historically their capital allocation records are, as a group, poor. A passive fund must own them regardless of valuation or fundamentals.

Exploiting Inefficiency: The broader emerging and frontier market universe includes thousands of companies ignored by major indices. There are over 15,000 listed companies in Emerging and Frontier Markets, compared to just 1,200 included in the MSCI Emerging Markets Index[1]. Many of these companies are under-covered by analysts, lightly owned by institutions, and operate in markets where information asymmetry is real and persistent. In our view, these inefficiencies are a blind spot for passive strategies and an opportunity for disciplined active investors.

KAR Developing Markets Strategy: How We Differentiate

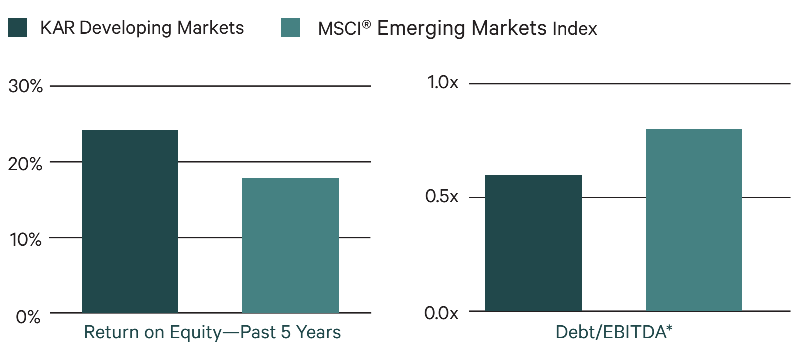
For over four decades, our mandate at KAR has remained unchanged: seek to identify, meticulously research, and own high-quality businesses with durable earnings growth, high returns on capital, strong balance sheets, and management teams capable of sustaining competitive advantage.

When we apply this methodology to emerging markets, this discipline produces a concentrated portfolio drawn from a vast opportunity set spanning both emerging and frontier economies—one we believe can serve as a core allocation for investors seeking differentiated emerging markets exposure.

How we differentiate:

- **Defining "Quality":** Our research process seeks to identify businesses with the capacity to generate high returns on capital over long periods, and we work to understand the specific characteristics that make those returns sustainable (Figure 8).
- **Breadth of Opportunity:** We invest across the full market cap spectrum and across both emerging and frontier markets. In our experience, this widens the opportunity set and diversifies economic exposure with the aim of avoiding excessive correlated exposures.
- **Concentration and Conviction:** Our portfolio is more concentrated than the average emerging markets strategy. This has resulted in higher active share and reflects our view that genuine quality is scarce. We own only what we consider the highest-quality subset of a very large investable universe.
- **Risk Awareness:** Capital preservation is central to our process. Since inception, the KAR Developing Markets strategy has captured just 78% of the benchmark's downside while peers have captured 93% (Figure 9).

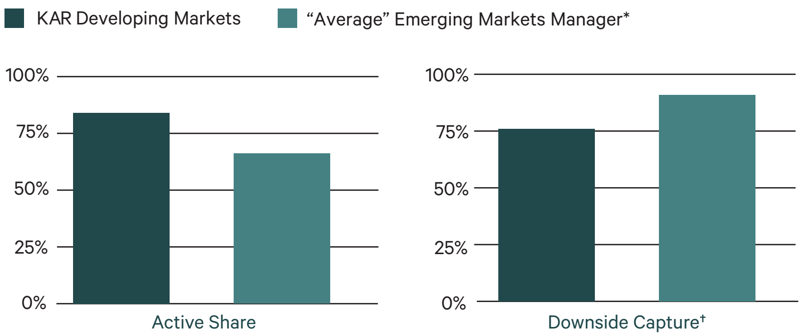
FIGURE 8: SELECTED PORTFOLIO CHARACTERISTICS VS. BENCHMARK



**KAR utilizes the interquartile method when calculating Debt/EBITDA. The interquartile method excludes outliers from an aggregate statistic such as weighted average. The interquartile method does not assume that data from the top or bottom of the distribution are outliers—only the extreme ends are excluded—and that it can be applied consistently as a quantitative method for most fundamental characteristics. Debt/EBITDA utilizes net debt for the calculation.*
Data as of March 31, 2026. Source: FactSet Research Systems, BNY Mellon. The statistics presented above are based on a representative portfolio. Actual results may vary. Other principal consultant firms may use different algorithms to calculate selected statistics. Estimates are based on certain assumptions and historical information. Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Please see the end of this paper for additional information about the indices. Returns may be affected by currency fluctuations. ***Past performance is no guarantee of future results.***

1 Data as of March 31, 2026. Source: Bloomberg, MSCI.

FIGURE 9: HIGH CONVICTION POSITIONING–PEER COMPARISON



**The "Average" manager is taking average data across a Morningstar-identified EM active manager universe. The observations are generalized and do not represent any specific competitor's investment approach.*
†From inception date of August 1, 2021. Downside capture is shown on a net-of-fees basis.
Data as of March 31, 2026. Source: FactSet Research Systems, Morningstar. The statistics presented above are based on a representative portfolio. Actual results may vary. Other principal consultant firms may use different algorithms to calculate selected statistics. Estimates are based on certain assumptions and historical information. Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. Please see the end of this paper for additional information about the indices. Returns may be affected by currency fluctuations. ***Past performance is no guarantee of future results.***

Our Process in Action

The following examples illustrate companies in the strategy that meet our forward-looking quality criteria.

Undiscovered Quality: Precision Tsugami China

Precision Tsugami China (PTC) is a manufacturer of equipment that cuts and shapes small, complex metal parts with a high degree of accuracy.

This equipment operates at high speeds with very low tolerance for error. Customers require machinery that delivers repeatable quality across thousands or millions of parts, knowing that even the slightest bending or vibration of the parts can cause serious operational problems for the factory.

As a result, the most important purchase consideration is the reliability of the equipment and the supplier's ability to provide parts and service quickly when needed. Price is not the primary consideration, and we believe that gives PTC an element of pricing power. This is a hallmark of a quality business in our eyes, and it explains why PTC has been able to maintain an estimated market share above 50% in China for the last 10+ years.

While most of its operations are in China, PTC is the listed subsidiary of a Japanese company also named Tsugami. We came across PTC in January 2023 while preparing for a research trip to Japan. While researching Tsugami Japan, we realized that its most profitable subsidiary was a listed entity in Hong Kong.

FIGURE 10: COMPANY CHARACTERISTICS*

			QUALITY	GROWTH	VALUE		
Company	Symbol	Analyst Coverage	Return on Equity—Past 5 Years	Earnings Per Share Growth—Past 5 Years	P/E Ratio—Trailing 12 Months	EV/EBITDA	Dividend Yield†
Tsugami China	1651 HK	2	24%	21.7%	4.2x	2.1x	12.2%
Star Micronics	7718 JP	2	10%	15.9%	6.2x	2.6x	4.2%
Tsugami Japan	6101 JP	3	16%	21.0%	8.7x	4.7x	3.2%

**As of purchase date February 7, 2023.*
†A company's dividend yield is a financial ratio that shows how much the company has paid out in dividends in the most recent year relative to its stock price at the end of such year. Dividend yield is being shown as a characteristic of the stock and not to infer how the stock has or will perform, as dividends are not the only component of a stock's performance. Dividends are subject to change from year-to-year, and a company's dividend yield could be lower or higher in future years.
Source: FactSet Research Systems. Holdings are subject to change. Holdings are based on a representative portfolio. Individual investors' holdings may differ slightly. All information is provided for informational purposes only and should not be deemed as a recommendation to purchase the securities mentioned. Kayne Anderson Rudnick has chosen to review the securities in this document based upon objective, non-performance based criteria. It should not be assumed that securities recommended in the future will be profitable.

At the time, PTC was an obscure small cap. It was only covered by two local analysts, and it had very limited foreign and institutional ownership. This may explain why the company traded for a significantly lower valuation despite an impressive track record.

After further research on PTC and the industry, we purchased a position in February 2023. Since our initial purchase, our confidence in the business has grown over time and we remain shareholders today.

Out of Favor Quality: Arca Continental

The quality characteristics of larger, well-covered companies are often more fully appreciated. But opportunities arise when temporary market dislocations create a meaningful gap between price and value—situations where the underlying competitive strength of the business is unaffected. We aim to act decisively when that gap is wide enough to provide a compelling margin of safety.

Arca Continental is an example of this. Arca has held the exclusive bottling and distribution rights for Coca-Cola in parts of Mexico for exactly 100 years. It is responsible for distributing roughly ⅓ of Coca-Cola's volumes in Mexico, which is arguably Coca-Cola's most successful country globally.

We purchased Arca in July 2025 and added to our position later in the year. At the time, two things were weighing on investor sentiment: uncertainty about a potential excise tax hike on sugary drinks, and an abnormally cool, rainy season that was keeping people at home and weighing on consumer demand across Mexico.

Both factors were likely to weigh on near-term earnings. But an analysis of Arca's history showed that it has historically been able to pass on higher excise taxes and preserve margins. Coca-Cola has been a dominant brand in Latin America for decades, and the combination of strong brand affinity with a relatively low price point meant to us that demand is relatively inelastic. Simply put, we believe bottlers like Arca have pricing power.

FIGURE 11: EXPANSION OF BRAND PORTFOLIO AND PRODUCT BREADTH

2006		2025
28	Brands	+135
128	SKUs	+1,800

Data as of December 2025. Source: Arca Continental. Holdings are subject to change. Holdings are based on a representative portfolio. Individual investors' holdings may differ slightly. All information is provided for informational purposes only and should not be deemed as a recommendation to purchase the securities mentioned. Kayne Anderson Rudnick has chosen to review the securities in this document based upon objective, non-performance based criteria. It should not be assumed that securities recommended in the future will be profitable.

From our perspective, Arca's manufacturing and distribution footprint would be difficult to replicate. It has 45 bottling plants and 345 distribution centers, which enables it to serve 1.4 million points of sale more cost-effectively than any competitor (or Coca-Cola itself). As we see it, this combination of pricing power and local scale advantages underpins our belief that Arca Continental is a high-quality business.

We believe that last year's scrutiny of near-term earnings created a dislocation between the price of the stock and the value of the business. Much of our research effort is devoted to developing deep familiarity with businesses that we believe are exceptional during periods when their prices offer no particular opportunity—so when a dislocation does occur, we are ready to act with speed and conviction.

Conclusion

After more than a decade of neglect, emerging markets appear to be entering a new phase shaped by improving macroeconomic conditions, strengthening governance standards, and attractive relative valuations. At the same time, dispersion within the asset class remains high, reinforcing the importance of active management and rigorous company-level research. In this environment, backward-looking investors may fail to distinguish between businesses benefiting from cyclical momentum and those positioned for durable, long-term value creation.

Our approach emphasizes forward-looking assessments of competitive durability, capital discipline, and governance in practice—an approach illustrated by the two investments highlighted above. In each case, we focused on the sustainability of competitive advantages, the quality of earnings and reinvestment, and management behavior across market cycles, rather than near-term business results or benchmark considerations. This discipline also requires the willingness to invest when high-quality businesses are temporarily out of favor, creating a disconnect between price and long-term fundamentals. With quality currently underappreciated within emerging markets, we believe the KAR Developing Markets strategy is well positioned to navigate this next phase through differentiated stock selection and a consistent focus on long-term capital preservation and growth.

MSCI® Emerging Markets Index *is a free float-adjusted market capitalization index tracking the equity performance of global emerging markets.* ***MSCI Emerging Markets Quality Index*** *is based on the MSCI Emerging Markets Index, its parent index, which includes large and mid cap stocks across 24 Emerging Markets (EM) countries. The index aims to capture the performance of quality growth stocks by identifying stocks with high quality scores based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth and low financial leverage. The Indices are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.*

Glossary: *Return on equity (ROE)–Past 5 Years: a measure of financial performance calculated by dividing net income by shareholders' equity for the latest five-year period. Active Share: A measure of the percentage of stock holdings in a manager's portfolio that differ from the benchmark index. Downside Capture Ratio: A measure of a manager's ability to retain capital as the market declines. A value below 100 indicates that a manager was able to outperform in down markets. EV/EBITDA (Enterprise Value-to-Earnings Before Interest, Taxes, Depreciation, and Amortization): a financial metric used to evaluate a company's total value relative to its operational cash profit. Trailing P/E Ex-Negative Earnings: Per share stock price divided by the latest 12-months earnings per share. Earnings Per Share Growth–Past 5 Years: Illustrates the growth of earnings per share over latest 5-year period. Debt/EBITDA (Debt-to-Earnings Before Interest, Taxes, Depreciation, and Amortization): Returns total debt as a percent of EBITDA for the period and date(s) requested in local currency by default. For US GAAP companies with operating lease liabilities, this is calculated as Total Debt minus Operating Lease Liabilities divided by Earnings Before Interest, Taxes, Depreciation & Amortization. For all other companies, this is calculated as Total Debt divided by Earnings Before Interest, Taxes, Depreciation & Amortization.*