

Thriving in a Concentrated World: The Emerging Markets Active Manager Playbook

White Paper
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SUMMARY

Index concentration is reshaping equity investing worldwide, and emerging markets are its latest frontier. The rise of the Magnificent Seven in U.S. equity markets brought this phenomenon into sharp focus, but a parallel story—less discussed but equally consequential—is unfolding in emerging markets. A handful of AI-driven structural winners, which we refer to as the EM Fabulous Five (EM Fab Five), have come to dominate the MSCI Emerging Markets Index in both weight and returns, creating one of the most challenging environments for active managers in recent memory.

While many were caught off guard, we preemptively recognized the distinct nature of this cycle as one rooted in a structural, worldwide transformation rather than in cyclical, regional forces. Drawing on lessons from past concentration episodes, we made targeted refinements to our portfolio construction and risk management frameworks, embedding index awareness as a natural extension of our investment process. Rather than an alteration to our strategy, these adjustments ensure that our unique fundamental stock selection and alpha generation approaches are not silently eroded by an increasingly concentrated and evolving index.

KEY HIGHLIGHTS

- The EM Fab Five account for a quarter of the MSCI Emerging Markets Index today and drove nearly 40% of its returns between 2023 and 2025.
- Unlike prior concentration episodes, which were cyclical and regional, today's concentration is rooted in the AI revolution—a structural, global transformation that is likely to make today's index leadership more enduring than those of the past.
- From almost 10% of emerging markets AUM in 2005 to over 40% at the end of 2025, the growth of passive management mechanically and continuously reinforces the dominance of the largest index constituents.
- Concentration is not a headwind to be endured—it is a challenge to be navigated with skill, conviction, and cost efficiency.
- For active managers, redefined position limits, index awareness, and disciplined tracking error management are no longer optional; they have become essential for active risk management and portfolio construction in the current environment.



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THE EM FAB FIVE: RISING INDEX CONCENTRATION IN EMERGING MARKETS

Index Concentration is Not a New Phenomenon.

Periods of elevated index concentration are nothing new to equity markets. In the U.S., the "Nifty Fifty" era, the dot-com bubble, and the rise of the Magnificent Seven each saw a handful of stocks come to dominate the benchmark. Similar dynamics have also played out globally, from Japan's asset bubble of the late 1980s to the emerging markets commodity super cycle of the mid-2000s. While history may not repeat itself with exact precision, it often rhymes, with episodes of prior concentration offering valuable lessons for active managers in how to navigate today's markets.

Historical Periods of Index Concentration

Event	Date	Region	Top Stocks	Dominant Sectors	Concentration Level
Japan Asset Bubble	1987-1989	Japan / Global	NTT, Tokyo Electric, Industrial Bank of Japan, Sumitomo Bank	Financials, Real Estate	Japan ~45% of MSCI World
Dot-Com Bubble	1999-2000	U.S.	Microsoft, Cisco, Dell, Intel	Technology	Top 10 ~29% of S&P 500
Global Financial Crisis	2008	Global / U.S.	Citigroup, Bank of America, HSBC, AIG	Financials	Financials ~40% of MSCI World Value
EM Commodity Supercycle	2007-2008	Emerging Markets	Petrobras, Gazprom, Vale, America Movil	Energy, Materials	Energy & Materials ~30% of MSCI EM
Magnificent 7	2023-Present	Global / U.S.	Apple, Microsoft, Nvidia, Alphabet, Amazon, Meta, Tesla	Technology, AI	Mag 7 ~30% of S&P 500
EM Fab Five	2023-Present	Emerging Markets	TSMC, Samsung, Alibaba, Tencent, SK Hynix	Technology, Semiconductors, AI	Top 5 ~25-30% of MSCI EM

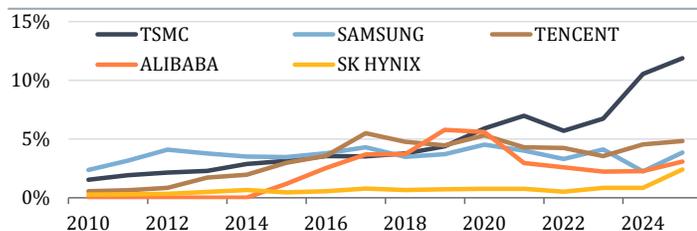
Source: MSCI, Bloomberg, and S&P. Tables are presented for illustration purposes only and should not be relied on to make an investment decision.

Introducing the EM Fab Five: The Current Concentration Trend in Emerging Markets.

While the term Magnificent Seven has become something of a household name, the parallel story unfolding in emerging markets has received far less attention. A handful of structural winners, mirroring the AI-driven dynamics in U.S. markets, have come to dominate the MSCI Emerging Markets Index. By the end of 2025, the top five index names—TSMC, Tencent, Alibaba, Samsung, and SK Hynix—accounted for more than a quarter of the benchmark's total exposure, the highest level of concentration in recent history. TSMC, Samsung, and SK Hynix supply advanced semiconductors that power AI systems, while Tencent and Alibaba are key ecosystem beneficiaries of the new technology. Together, the EM Fab Five represent a larger exposure and market capitalization than any emerging market country other than China.

The Rise of the EM Fab Five

Weight in the MSCI Emerging Markets Index (%)



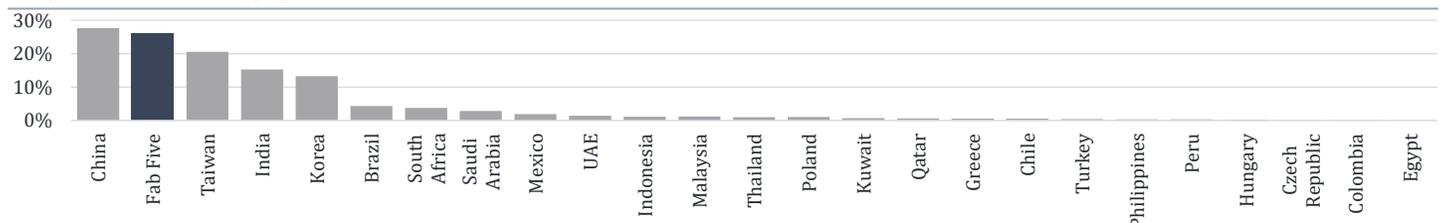
Top 5 Stocks by Weight: USA vs. Emerging Markets

Combined Weight of Top 5 Index Constituents (%)



The EM Fab Five Outweigh Almost Every Country in the Index

Weight in the MSCI Emerging Markets Index (%)



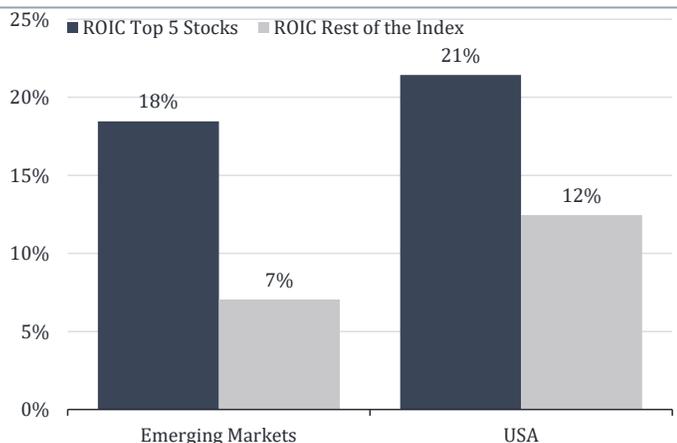
Source: Bloomberg and MSCI. Stock and country weights reflect the average annual weight of each stock or country. All data through January 31, 2026, unless otherwise stated in the graph. Top 5 stocks represent the top 5 index constituents by weight for each year. Emerging Markets data reflects the MSCI Emerging Markets Index (ticker: NDUEEGF). USA data reflects the MSCI USA Index (ticker: NDDUUS). Graphs are presented for illustration purposes only and should not be relied on to make an investment decision.



Nowhere is the EM Fab Five's index domination more striking than in the case of TSMC. The Taiwanese chipmaker grew from a 3.1% index weight in 2015 to 12.5% by January 2026—over a fourfold increase that has made it the benchmark's dominant constituent. For context, the stock's individual weighting now rivals major country allocations, such as Korea and India, and exceeds those of established markets like Brazil, Saudi Arabia, and South Africa.

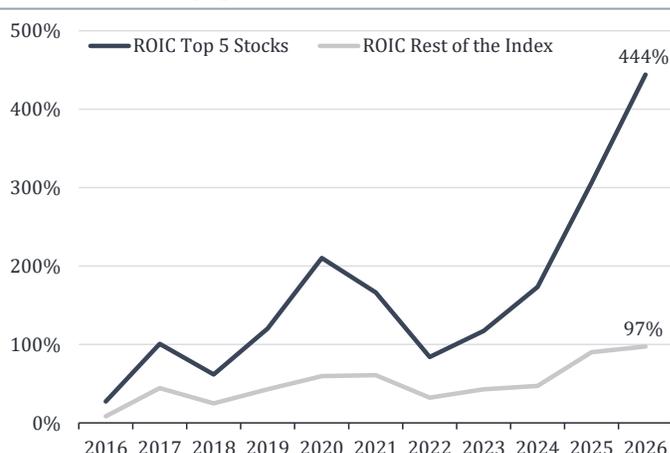
Top 5 Stocks Historically Outperform the Rest of the Index

ROIC (% , Last 10 Years)



Outperformance of Top 5 Stocks Reaches Record Levels

ROIC for MSCI Emerging Markets (% , Last 10 Years)



Source: Bloomberg and MSCI. All data as of January 31, 2026. Top 5 stocks represent the top 5 index constituents by exposure for each year. Emerging Markets data reflects the MSCI Emerging Markets Index (ticker: NDUEEGF). USA data reflects the MSCI USA Index (ticker: NDDUUS). ROIC reflects Return on invested capital and is a financial measure of the profitability of an investment. Past returns are not a guarantee of future results. Graphs are presented for illustration purposes only and should not be relied on to make an investment decision.

The dominance of the EM Fab Five extends beyond their index weight—it is equally visible in their contribution to returns. This is not without precedent; historically, when the largest index constituents outperform, they tend to drive a disproportionate share of overall index returns. Over the past ten years, the top five stocks in the MSCI Emerging Markets Index delivered an average return of 18%—more than double the 7% returned by the rest of the index.

One of the characteristics that makes the current episode remarkable is the degree to which this dynamic has been amplified. The EM Fab Five are not only larger than any prior top five grouping in the index's recent history but they have also outperformed by an extraordinary margin. In 2025 alone, these five stocks outpaced the broader index by an average of 86%. From 2023 to 2025—the period marking the emergence and rapid acceleration of AI as a transformative force — these five stocks drove nearly 40% of the index's total returns while representing just 20% of its weight.

A Global Transformation, Not a Trend: The AI Revolution.

Past concentration events—Japan's asset bubble, the dot-com era, the emerging markets commodity super cycle—were largely cyclical or valuation-driven, leading ultimately to a mean-reversion. The rise of AI is different. It offers the possibility of a structural transformation of the global economy, comparable to pivotal events like the industrial revolution. This suggests that today's dominant companies may prove far stickier than their predecessors.

What further sets this episode apart is its global synchronicity. Previous emerging markets concentration episodes reflected idiosyncratic regional dynamics—commodity booms, state-owned enterprises, country-specific cycles. Unlike the Brazilian iron ore producers or Russian energy companies that once defined emerging markets indices, the EM Fab Five are critical nodes in global technology supply chains. Today's emerging markets concentration is an extension of the same mega-trend driving the Magnificent Seven, making it a coordinated worldwide phenomenon rather than an isolated one. This global embeddedness in a structural transformation means the EM Fab Five are arguably better positioned to sustain their dominance than past index heavyweights.

The Rise of Passive Funds and Implications of Price-Insensitive Capital

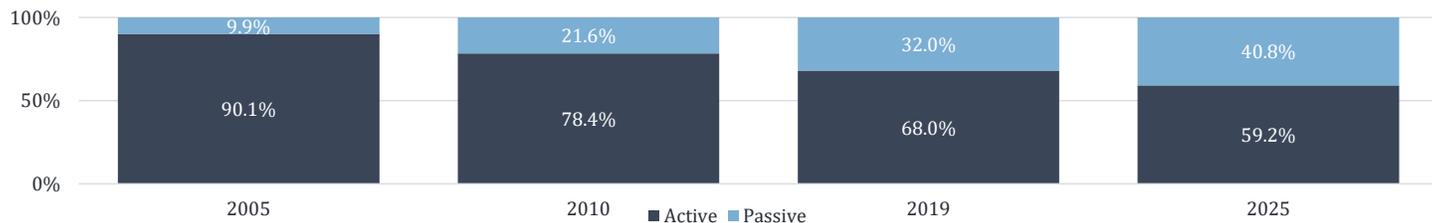
As passive funds have grown to dominate global equity markets, they have created a self-reinforcing cycle: Rising stock prices increase index weights, compelling passive funds to buy more of those same stocks, which drives prices higher still. The scale of this shift is striking—passive holdings accounted for just around 10% of foreign money in emerging markets in 2005, rising to nearly 40% by the end of last year, worth around \$750 billion according to eVestment. This means price-insensitive capital now flows automatically to the largest index constituents at an unprecedented magnitude, something that was not true in prior



concentration episodes. The decline of active management has further eroded the traditional counterbalancing force that would otherwise correct overvaluation and keep concentration in check.

The Rise of Passive Funds

Active and passive funds as a % of total emerging markets AUM



Source: eVestment screen feature: Equity LO funds with a geographic focus on Global Emerging Markets (“Global Emg Mkts”) total AUM from December 2005, December 2010, December 2019, and December 2025. Graphs are presented for illustration purposes only and should not be relied on to make an investment decision.

For active managers in emerging markets, the implication is clear: Underweighting the EM Fab Five is not just a valuation call—it is a decision to swim against a powerful and growing structural current. The question is no longer whether to own these stocks or not, but rather how to thoughtfully size and manage their exposure.

THE IMPLICATIONS FOR ACTIVE MANAGEMENT

An environment where a handful of stocks exert disproportionate influence on both index exposure and returns is notoriously challenging for active managers. The central tension is clear: How does an active manager, with an approach built on diversification and fundamental stock selection, navigate a market where a handful of stocks exert exceptional influence on both index exposure and returns? At ABS, we have incorporated lessons from past cycles to ensure our investment process continues to deliver value in this evolving environment.

We remain firm believers in active management’s ability to deliver superior risk-adjusted returns, especially in emerging markets, where inefficiencies create fertile ground for alpha generation. The solution is not in abandoning active management but rather ensuring that the value added through fundamental stock selection is not eroded by poorly managed exposure to index heavyweights.

Redefining Position Limits.

A concentrated index demands a revision of portfolio construction. Conventional guidelines, such as a maximum 10% single-stock position, have a valid purpose, but were designed for a different era. Applied today, such a constraint creates a perpetual underweight to a stock like TSMC, which alone represents more than 12% of the MSCI Emerging Markets Index. What’s more, when an index heavyweight materially outperforms, that structural underweight becomes a material performance drag. Rather than inherited from a prior era, position limits must be calibrated relative to the benchmark and the concentration environment in which a manager operates.

The Importance of Index Awareness.

By their very nature, active fundamental managers have historically directed their attention toward stocks with compelling fundamentals—and paid little regard to a stock simply because it carries a large index weight. The focus has always been on finding the best ideas, not on monitoring what is not owned. While this was a reasonable luxury when index concentration was moderate, the cost of being underweight a large benchmark name today is no longer negligible.

Today, not owning an index heavyweight can represent the largest single active risk position in a portfolio. Such a position demands a strong conviction view, and a neutral or modestly negative outlook can no longer simply translate into zero exposure. Active risk must be taken deliberately and with conviction. We have formally embedded index awareness into our investment process, ensuring that every significant underweight is an explicit, high-conviction decision rather than a secondary consideration.

Managing Tracking Error Slippage.

Failing to adopt an index-aware approach in a concentrated market carries a material hidden cost: tracking error slippage. A decade ago, holding zero exposure to the largest stock in the emerging markets index implied a 4% underweight. Excluding a stock like TSMC today implies an underweight of nearly three times that magnitude. As the gap between portfolio positioning and index weights widens, tracking error expands—often in ways that are not intentional and may not be aligned to original



investor expectations. With this in mind, active risk must be managed and monitored with the same rigor and intentionality as alpha generation.

Rethinking the Cost of Active Management.

Active management comes at a cost, and we believe that cost is justified for intentional active decisions. Where index concentration demands a position close to benchmark weight, it is important to find efficient ways to access that exposure without compromising the cost effectiveness of the overall portfolio. The goal is simple: Ensure every basis point of fee is backed by a deliberate active decision that adds value.

CONCLUSION

Index concentration is not a passing phase; it is a new reality for emerging markets investing, and one that demands a deliberate and evolved response. The EM Fab Five have fundamentally altered the landscape, and the forces sustaining their dominance—the AI revolution and the relentless growth of passive flows—show little signs of abating. For active managers who refuse to adapt, concentration will continue to be a silent and costly headwind.

For ABS, it is something else entirely. We drew lessons from past concentration episodes and made targeted refinements to portfolio construction and active risk management, ensuring that our investment process is fit for this environment. Index awareness is embedded in our strategy, our position limits reflect today's market realities, and every active decision is deliberate, high-conviction, and cost-efficient. The result is an approach where our unique fundamental stock selection and differentiated alpha generation is not obfuscated by the mechanics of an increasingly concentrated index. In a market where concentration is the defining challenge, we believe that this is a meaningful and durable edge.

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