

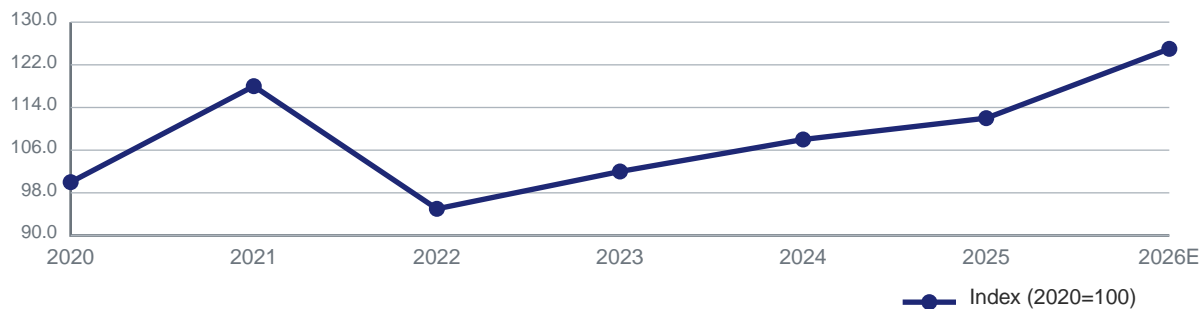
Emerging Markets Recovery: China, India, and the Next Growth Cycle

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Emerging markets are extending a leadership phase into early 2026, with China, India, and other key economies demonstrating resilience and growth potential after years of uneven performance. Policy shifts, structural reforms, and favorable demographics are creating investment opportunities in emerging market equities, bonds, and currencies. This phase represents a potential shift in global economic leadership and has important implications for portfolio diversification and international allocation strategies.

Emerging Markets Equity Index Performance (2020-2026)



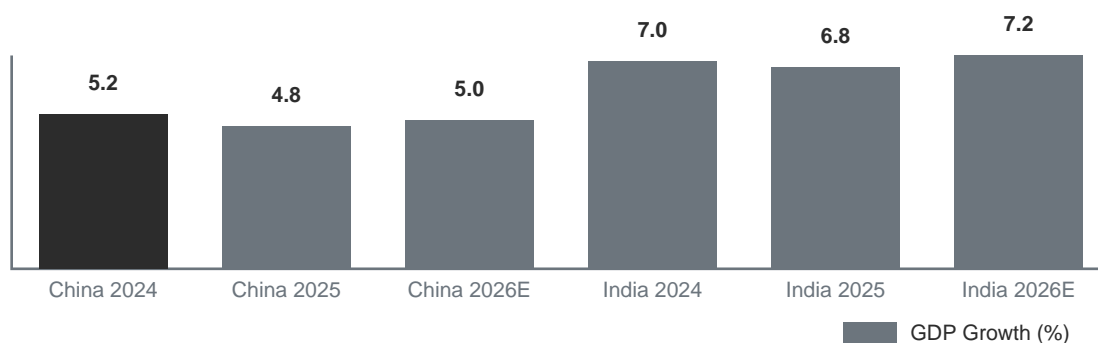
Source: MSCI Emerging Markets Index, Projections

Executive Summary

Emerging markets are in a phase of improving fundamentals in 2026, driven by policy shifts in China, strong growth in India, and continued resilience across multiple economies. Relative performance has improved in recent quarters, reinforcing a leadership narrative rather than a recovery from weak returns. China's policy pivot toward economic stabilization, including monetary easing and fiscal support, is helping offset prior property sector stress and regulatory headwinds. India's manufacturing boom, driven by "Make in India" initiatives and foreign direct investment, is creating sustained growth momentum. Other emerging markets, Brazil, Mexico, Southeast Asia, are benefiting from commodity tailwinds, nearshoring trends, and structural reforms. This backdrop supports opportunities in emerging market equities, local currency bonds, and currencies, while potentially creating headwinds for developed market assets if capital flows shift toward higher-growth emerging markets.

Key Takeaways:

GDP Growth Forecast: China vs India (2024-2026)



Source: IMF, World Bank, Government Forecasts

- China's policy pivot toward economic stabilization is supporting recovery, with monetary easing, fiscal support, and property sector stabilization measures creating tailwinds. The economy is showing signs of stabilization after years of property sector stress and regulatory headwinds.
- India's manufacturing boom, driven by "Make in India" initiatives, foreign direct investment, and demographic advantages, is creating sustained growth momentum. The economy is positioned to benefit from supply chain diversification and technology sector growth.

- Portfolio implications favor emerging market equities, local currency bonds, and currencies. The recovery creates diversification benefits and exposure to higher-growth economies. However, investors should be selective, focusing on countries with strong fundamentals, policy credibility, and structural reforms.
- The EM leadership cycle is a multi-year theme with potential for sustained outperformance relative to developed markets. However, risks remain, including policy uncertainty, currency volatility, and geopolitical tensions. Active management and country selection are critical.

China's Policy Pivot and Recovery

China is showing signs of economic stabilization in 2026, driven by a policy pivot toward economic support after years of property sector stress and regulatory headwinds. The People's Bank of China has implemented monetary easing measures, including interest rate cuts and reserve requirement reductions, to support credit growth and economic activity. Fiscal policy has shifted toward stimulus, with infrastructure investment and consumer support measures providing tailwinds. Property sector stabilization measures, including support for developers, mortgage rate reductions, and housing market policies, are addressing one of the key drags on economic growth.

The policy shift reflects recognition that economic stability is a priority, balancing growth objectives with structural reforms. While regulatory oversight of technology and other sectors remains, the focus has shifted toward supporting economic recovery rather than aggressive regulatory tightening. This creates a more favorable environment for corporate investment and consumer confidence. However, challenges remain, including high debt levels, demographic headwinds, and geopolitical tensions that could impact trade and investment flows.

China's recovery has important implications for global markets. As the world's second-largest economy, China's growth trajectory impacts commodity demand, global trade, and emerging market performance. A stabilizing Chinese economy supports commodity prices, benefits trading partners, and creates positive spillover effects for other emerging markets. However, the recovery is expected to be gradual rather than rapid, with structural challenges requiring time to address.

India's Manufacturing Boom

India is experiencing a manufacturing boom in 2026, driven by "Make in India" initiatives, foreign direct investment, and demographic advantages. The country's large, young population, over 1.4 billion people with a median age of 28, provides a competitive advantage in manufacturing and services. Government policies supporting manufacturing, including production-linked incentives and infrastructure development, are attracting foreign investment. Companies are establishing manufacturing facilities in India to diversify supply chains and access the large domestic market.

The technology sector is a key growth driver, with India becoming a major hub for software development, IT services, and technology manufacturing. The country's strong engineering talent pool and cost advantages are attracting technology companies seeking to diversify operations. Manufacturing sectors including electronics, automobiles, pharmaceuticals, and textiles are experiencing strong growth, supported by government incentives and improving infrastructure.

India's growth trajectory is supported by structural reforms, including the Goods and Services Tax (GST), bankruptcy code, and financial sector reforms. These reforms are improving the business environment and attracting investment. However, challenges remain, including infrastructure gaps, regulatory complexity, and fiscal constraints. The country's large population and growing middle class create significant domestic demand, supporting sustainable growth even if global trade faces headwinds.

Other Emerging Market Opportunities

Beyond China and India, other emerging markets are showing recovery potential. Brazil is benefiting from commodity tailwinds, with strong demand for agricultural products, metals, and energy supporting export revenues. The country's fiscal reforms and monetary policy credibility are improving investor confidence. Mexico is benefiting from nearshoring trends, as companies relocate manufacturing from Asia to North America, creating investment and employment opportunities.

Southeast Asian economies, Vietnam, Indonesia, Thailand, are benefiting from supply chain diversification and foreign direct investment. These countries offer competitive manufacturing costs, improving infrastructure, and strategic locations for serving Asian and global markets. Eastern European economies are navigating geopolitical challenges while maintaining growth potential, with some benefiting from EU integration and infrastructure investment.

However, emerging markets face common challenges, including currency volatility, policy uncertainty, and geopolitical risks. Country selection is critical, with investors focusing on economies with strong fundamentals, policy credibility, and structural reforms. Active management and regular monitoring are essential given the rapid pace of change in emerging market conditions.

Investment Implications

For investors, the emerging markets recovery creates several investment themes. Emerging market equities offer exposure to higher-growth economies and diversification benefits. Country selection is critical, with China, India, and select other markets offering the strongest opportunities. Sector selection is also important, with technology, manufacturing, and consumer sectors showing particular strength.

Local currency emerging market bonds offer yield advantages and potential currency appreciation, though currency risk requires careful management. Hard currency emerging market bonds (denominated in U.S. dollars) offer lower currency risk but may miss currency appreciation benefits. Currency exposure can be managed through hedging strategies or selective allocation.

The emerging markets recovery may create headwinds for developed market assets if capital flows shift toward higher-growth emerging markets. However, the recovery is expected to be gradual, and developed markets should continue to offer investment opportunities. A balanced approach, with selective emerging market allocation as part of a diversified portfolio, is appropriate for most investors.

Portfolio Allocation Considerations

Portfolio allocation to emerging markets should be based on risk tolerance, investment horizon, and diversification objectives. Traditional portfolio theory suggests 10-20% allocation to emerging markets for global equity portfolios, though this can vary based on individual circumstances. The current recovery environment may warrant increased allocation for investors with higher risk tolerance and longer investment horizons.

Country selection is critical, with focus on economies with strong fundamentals, policy credibility, and structural reforms. China and India offer the largest opportunities but also face significant challenges. Other emerging markets may offer diversification benefits and specific sector opportunities. Sector selection should focus on growth areas, technology, manufacturing, consumer, while avoiding sectors facing structural headwinds.

Currency management is important, as emerging market currencies can be volatile. Investors should consider currency hedging strategies or selective currency exposure based on their risk tolerance and views on currency trends. Active management and regular portfolio rebalancing are essential given the rapid pace of change in emerging market conditions.

Timeline and Outlook

Near-Term Outlook (3-6 months): Emerging markets recovery is expected to continue through Q1-Q2 2026, with policy support in China and strong growth in India providing tailwinds. Key milestones include economic data releases (GDP, inflation, trade), policy announcements, and corporate earnings reports. Currency movements will be important, with dollar strength or weakness impacting emerging market performance. Commodity prices will influence commodity-exporting emerging markets.

Medium-Term Outlook (6-12 months): By mid-2026, we expect clearer evidence of sustained recovery, with economic data showing growth acceleration in key markets. Policy implementation in China should show results, while India's manufacturing boom should continue. Supply chain diversification trends should benefit Southeast Asian and Latin American markets. However, challenges remain, including policy uncertainty, currency volatility, and geopolitical tensions.

Long-Term Outlook (12+ months): The emerging markets recovery is expected to be a multi-year theme, with structural advantages, demographics, urbanization, technology adoption, supporting long-term growth. However, the pace and sustainability of recovery will vary by country, with strong fundamentals and policy credibility determining winners. Investors should maintain selective exposure to emerging markets while monitoring for policy changes, economic headwinds, or shifts in global trade and investment flows.

Timeline Overview



Source: AVANTAS Research Analysis

Risk Factors

Policy Risk: Changes in government policy, monetary policy shifts, fiscal policy changes, regulatory modifications, could impact emerging market performance. Policy credibility is critical, and policy mistakes could derail recovery. Investors should monitor policy developments and their potential impact on economic growth and market performance.

Currency Risk: Emerging market currencies can be volatile, and currency depreciation can significantly impact returns for foreign investors. Currency movements are influenced by interest rate differentials, capital flows, commodity prices, and geopolitical factors. Currency hedging can reduce risk but also eliminates potential currency appreciation benefits.

Geopolitical Risk: Geopolitical tensions can impact trade, investment flows, and market performance. China-U.S. tensions, regional conflicts, and sanctions can create headwinds for affected markets. Investors should monitor geopolitical developments and their potential impact on specific countries and regions.

Economic Risk: Economic downturns, inflation spikes, or financial crises can significantly impact emerging market performance. High debt levels, current account deficits, and external vulnerabilities can create risks. Country selection is critical, with focus on economies with strong fundamentals and policy credibility.

Liquidity Risk: Emerging markets can experience liquidity challenges, with market depth and trading volumes lower than developed markets. This can create volatility and make it difficult to enter or exit positions, particularly during market stress. Investors should consider liquidity when selecting markets and securities.

Execution Risk: Emerging market investments face execution challenges, including corporate governance issues, regulatory complexity, and operational risks. Active management and due diligence are essential. Investors should focus on companies with strong governance, transparent reporting, and proven track records.





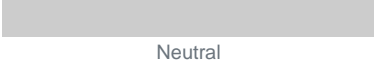

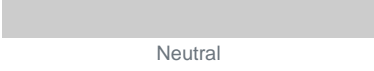
Conclusion

The emerging markets leadership phase represents a potential shift in global economic momentum, with China, India, and other key economies demonstrating resilience and growth potential. This creates investment opportunities in emerging market equities, bonds, and currencies, while providing diversification benefits and exposure to higher-growth economies. However, risks remain, including policy uncertainty, currency volatility, and geopolitical tensions. Active management, country selection, and careful risk management are essential for successful emerging market investing.

Asset Class Impact

The emerging markets leadership phase has significant implications across asset classes. Emerging market equities are primary beneficiaries, with higher growth and improving fundamentals supporting valuations. Local currency emerging market bonds offer yield advantages and potential currency appreciation. Emerging market currencies may appreciate relative to developed market currencies if capital flows shift toward higher-growth markets. Commodities benefit from increased demand from emerging market growth, particularly from China and India. Conversely, developed market assets may face relative headwinds if capital flows shift toward emerging markets, though the impact is expected to be gradual. U.S. dollar strength or weakness will be critical, with dollar weakness supporting emerging market performance.

Asset Class Impact

	Underweight	Neutral	Overweight
Asset	View		Commentary
EM Equities			Strong overweight. Higher growth and improving fundamentals support valuations, with China and India offering largest opportunities.
EM Local Currency Bonds			Overweight. Yield advantages and potential currency appreciation create opportunities, though currency risk requires careful management.
EM Currencies			Overweight. Potential appreciation relative to developed market currencies if capital flows shift toward higher-growth markets.
Commodities			Overweight. Increased demand from emerging market growth, particularly from China and India, supports commodity prices.
Developed Market Equities			Neutral. May face relative headwinds if capital flows shift toward emerging markets, though impact expected to be gradual.
U.S. Dollar			Underweight. Dollar strength or weakness critical for emerging markets, with dollar weakness supporting EM performance.
EM Hard Currency Bonds			Neutral. Lower currency risk but may miss currency appreciation benefits. Selective allocation based on country fundamentals.

Source: AVANTAS Research Analysis