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Emerging Markets Outshine U.S. as Dollar Slips and China Rebounds

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Emerging markets are outperforming both U.S. stocks and bonds this year, in a surprising shift driven by a weakening U.S. dollar and renewed strength in Chinese tech. This marks one of the few times since 2011 that developing economies have taken the lead over major U.S. indices, signaling a notable shift in global investor sentiment.

The MSCI Emerging Markets Index tracks equities across 24 developing nations and is up 15.3% year-to-date. That puts it ahead of the S&P 500 Index's 7% gain and the MSCI World Index's 9.5%, which follow large-cap stocks in more developed economies. This level of outperformance is rare; only three times since 2011 have emerging market stocks beaten either benchmark.

Bond markets are telling a similar story. A JPMorgan index that measures local currency bonds in large emerging economies has climbed 11% so far in 2025. By comparison, the FTSE World Government Bond Index and its developed markets counterpart have gained around 7%. These numbers are particularly striking given that emerging market bond funds suffered years of outflows and volatility.

The rally is closely tied to the sharp decline in the U.S. dollar. Malcolm Dorson, head of emerging markets strategy at Global X, noted that "both EM stocks and bonds benefit from a direct inverse relationship with the dollar." The dollar has dropped about 10% this year against a basket of other major currencies, making it its worst first-half performance since 1973, when President Richard Nixon took it off the gold standard.

Currency Concerns

A weakening dollar opens the door for central banks in emerging economies to lower interest rates, thanks to stronger local currencies. That improves inflation dynamics and boosts the appeal of local stocks and bonds. As Dorson explains, stronger currencies give these nations more flexibility on monetary policy and make their markets far more attractive to global investors.

This isn't the way many predicted things would go. Economists originally expected tariffs under President Donald Trump's "America First" trade strategy to lift the dollar by reducing the need for U.S. businesses to exchange dollars for foreign currencies. Treasury Secretary Scott Bessant even estimated that a 10% tariff would boost the dollar's value by 4%. But instead, investors fear tariffs could slow growth and have weighed on the currency.

Concerns over the federal deficit compound these fears. The Congressional Budget Office estimates that Trump's signature economic policy package, dubbed the "Big Beautiful Bill," will add roughly $3 trillion to the deficit over the next decade. Larger deficits often lead to inflation concerns and more government borrowing, putting pressure on bond markets and the dollar.

Meanwhile, Chinese equities, making up nearly one-third of the MSCI Emerging Markets Index, have staged a major comeback. Beijing kicked off 2025 with a wave of stimulus, directing state-run insurers and funds to pour money into sagging stocks. Momentum surged when DeepSeek launched its powerful AI model R1, leading Alibaba shares to jump 68% in just one month. That single event erased nearly $1 trillion from U.S. tech stocks as global investors reevaluated their holdings.

Crucially, President Xi Jinping signaled an end to China's tough stance on its tech sector, urging companies to "show their talent" at a roundtable meeting with industry leaders. Tech founder Jack Ma, previously sidelined by regulators, reemerged as a key figure. In March, Beijing announced a state-backed venture capital fund to funnel 1 trillion yuan ($138 billion) into emerging technologies over the next two decades.

All told, emerging markets are benefiting from a combination of currency shifts, economic policy changes, and renewed tech optimism. As U.S. markets contend with debt pressures and an uncertain rate environment, investors find opportunities in places they had once written off.