QUARTERLY MARKET COMMENTARY

The legendary American investor, Philip Arthur Fisher, once said "the stockmarket is filled with individuals who know the price of everything, but the value of nothing". This is perhaps a statement as much directed to those with little financial education or who merely have not done much research before making an investment decision.

However, the quote, made in 1963, has been referred to often in recent weeks as commentators question the investment decisions of some and the previous flow of capital to one particular area that has been hit very hard this year.

We are referring to 'Global Emerging Markets'. So what is the problem and is it likely to get worse?

No one can doubt that Emerging Markets are looking pretty horrible this year. The broader MSCI Emerging Market Index has fallen by more than 20% from its January high, whilst the Chinese main stockmarket, the Shanghai Composite, has fallen by nearly 25% in GBP sterling terms, year to date.

Argentina and Turkey have been in the spotlight with collapsing currencies and credit defaults to lenders. Only last year Argentina issued US$2.75billion 100 year debt at a yield of 7.9% and this was oversubscribed nearly four times. In other words, four times the number of people required to fulfil the option were interested or expressed an interest in participating in the offer. Then in April this year, Argentina's President, Mauricio Macri, called in the IMF to ask for a US$30billion loan to ward off a currency crisis. This is perhaps yield seduction at its clearest form, given that Argentina defaulted on its debt in 2002 and 2014. Never a truer case perhaps for the wise words of Philip Fisher!

In Turkey, the Lira has halved in value against the US$ this year as inflation hits 18% (August 2018 CPI) and interest rates have been increased to 17.75%. Political unrest and a possible military coup on President Erdogan is never far from the news.

In Brazil, political turmoil continues with the recent stabbing of presidential front-runner, Jair Bolsonaro, last week, following previous political tensions on the incumbent President, Michel Temer. Brazil's main stockmarket, the Ibovespa, is down nearly 19% since May.

So what is affecting the main 'Global Emerging Market' nations and is it linked? In simple terms, it is **Tighter Global Monetary Policy** and the continuing **Trade Wars**. Overall, it is not particularly surprising that 'Emerging Markets' are struggling. The political upheaval in Turkey and Brazil are simply the results of deteriorating economic conditions, following rather sanguine and settled conditions in recent years.

Turkey, for example, like many of the Emerging Market nations, has been too reliant on foreign funds. With the US Federal Reserve in the US starting to raise interest rates, it is harder for overseas markets – particularly riskier Emerging Markets – to attract those foreign funds. With the UK and Japan also on the path of increasing their own domestic interest rates, with Japan doing so by changes to their yield curve control measures, then Emerging Markets are not only struggling to attract foreign funds but there is clear evidence that 'capital flight' is being seen. This is where capital flows from one part of the global system to another.

Another connotation of the US increasing interest rates is that the US$ has been very strong this year and this is negative or adversely affects commodity centric economies. The US$ is the reserve currency of the world and most commodities are traded in US$. If the US$ gets stronger then the commodity centric economies need to buy more US$ in order to continue the same or similar level of trading. As a result, we have witnessed deteriorating current account trade balances for some of the Emerging Market nations.

And then we consider the **Trade Wars**. We have already written in detail in our last Quarterly Market Commentary (June edition available on The Goodman Partnership LLP website) about the protectionist rhetoric of Donald Trump's campaign trail and the US and Chinese sanctions imposed.

The Trade Wars only appear to be intensifying with Donald Trump recently stating on 7 September that the US will consider imposing tariffs on a further $267billion of Chinese goods. Whilst this is clearly aimed at the Chinese per se, there are wider effects on other 'Emerging Market' and Asian economies who benefit in the trade chain.

For example, a significant proportion of industrial components used by Chinese firms are actually manufactured in other Emerging Market and Asian countries. Indonesia and Taiwan are big benefactors of the Chinese manufacturing industry and with the Trade Wars intensifying, it is perhaps not surprising that these economies are now showing signs of a slowdown. There is also increasing evidence that commodity dependant importers perhaps front-loaded spending in the first quarter of this year before tariffs were applied and are now cutting back on spending.

So what is to be learned from this. Well, the globalised, borderless world (at least, as far as capital went) that we all took for granted is under threat. The US has decided that the world order no longer works in the US' favour and it is gradually rewriting the rules so that is stops getting "ripped off", as they see it. This could mean further trade tensions, not just with the Chinese, but Canada, Mexico and the EU have all been targeted by the US authorities. It is also clear in a recent tweet that President Trump has no immediate intention of allowing the US to re-join the Trans-Pacific Partnership (TPP), which the US left last year, unless he can "obtain a significantly better deal" for the US.

That said, it should also be noted that a stronger US$ is not something that President Trump particularly wants. As a man who made his name and fortune in real estate, he does understand the impact of a rising US$ on the domestic US economy and will be keen to ensure that the US currency does not get too much stronger from here. Accordingly, his direct and somewhat vitriolic tirade last month aimed at Jerome Powell, the new Federal Reserve Chairman, for increasing interest rates, perhaps came as little surprise. Clearly, President Trump has forgotten that Jerome Powell was handpicked by him and the Federal Reserve is an independent organisation not known for being influenced on monetary policy matters by serving presidents!

Therefore, in the shorter-term, it would appear that tightening global monetary policy and trade wars will continue but there is also increasing evidence that investors are buying 'Emerging Markets' on the dip.

As always, it is impossible to predict the future - especially whether stocks and shares will fall or rise. Therefore, it is important that medium to long term investors maintain a diversified portfolio to benefit from stockmarket rises when they happen and to dilute volatility when there is a fall. We strongly believe that a sensible investment strategy involves riding out stockmarket volatility.

However, for The Goodman Partnership LLP, we do remind ourselves of the phrase by another legendary American investor, Warren Buffett, who said "wide diversification is only required when investors do not understand what they are doing".

September 2018