Quarterly Commentary

Emerging Markets Equity

Global economic conditions are becoming increasingly difficult for both developed and emerging markets. Trade wars have depressed business confidence and investment. Instabilities and uncertainties are increasing, and as a result emerging markets are bearing a disproportionately large burden as global economic growth slows down. Due to the limited amount of ammunition central banks have in their holsters to address any signs of distress, the downward pressure on stock markets will likely remain acute.

China's growth fell to its slowest pace in nearly three decades as a resurgence of trade tensions with the U.S. and lingering domestic financial problems take an increasing toll. Because of the escalation in the trade fight, China allowed its currency to sink to an 11-year low sending financial markets tumbling. Additionally, they announced new tariff hikes and are threatening to block American companies from doing business in China. The two sides are deadlocked so any resolution is unlikely in the short term. As a result, the Chinese central bank is watching carefully to avoid any financial shenanigans. While China's troubles are mostly rooted in trade there are some strong areas, like retail sales, which have ticked up and the real estate market which has been a bright spot in the economy (although it is cooling).

Political unrest has been raging in Hong Kong for months as a protest against an extradition agreement with China has morphed into a broader pro-democracy movement. This conflict has helped trigger a 14% decline in the stock market, as investors worry over the fate of Hong Kong and whether a potential crackdown could trigger further conflict with the West.

India, the world's fifth largest economy, is slowing as it also slides closer to a trade war with the U.S. centered on steel and aluminum imports. A conflict is also brewing with Pakistan over the long-disputed Kashmir region after India revoked its special status. This triggered violent protests, arrests and termination of bilateral trade agreements.

Singapore's economy is now contracting. South Korea and Taiwan have suffered diminished prospects as their exports to China slow down. Flare-up of tensions in the Middle East following the attack on Saudi Arabia's oil production facilities and a series of quasi-military clashes between the U.S. and Iran threatens to close off the Strait of Hormuz which would in turn cut off the flow of one-third of global oil shipments. The Argentinian stock market collapsed more than 30% and its currency plunged 20%, after its business-friendly president lost a primary election to the center-left opponent sparking fears Argentina will backslide into its free spending ways that have led to numerous defaults and inflation crises in decades past.

The third quarter was not kind to emerging markets as they declined 4.1% (all figures in U.S. dollar terms); still they remain up 6.2% for the year-to-date. Eastern European markets were down only 2.2% in the quarter, but remain up a stellar 18.0% for the year. Emerging Asia and Latin America were down 3.3% and 5.6% respectively for the last three months and up 6.3% and 6.6% respectively for the year-to-date.

Risks are not abating anytime soon. The numerous trade conflicts engulfing the world heighten uncertainty, which is leading many businesses to delay productivity-enhancing investments that are essential to raising living standards in the emerging markets. Job creation has also been hampered as firms employ fewer workers to produce goods and services. Unfortunately, the tit-for-tat trade war is unlikely to de-escalate anytime soon so the drain in investor optimism will not likely be lifted quickly.

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