Emerging Market Massacre – February 4, 2014

You wouldn't know it by looking at the markets, but the view coming out of the World Economic Forum in Davos indicated that economists, corporate CEOs and even small businesses are more upbeat about the economic outlook than any time since the end of the recession.

The past few weeks have been marked by a sharp sell-off across emerging markets (EM) and their currencies. During this broad-based emerging market move, it became apparent that emerging countries with true fundamental weakness are the most vulnerable to the removal of the liquidity blanket as the Fed begins tapering its quantitative easing policy (QE).

Dependence on China as an export market and the tendency for the U.S. dollar to rise as the Fed tapers its asset purchases are both negative for emerging markets. While the U.S. looks that much more stable and fundamentally superior to other global economies, a stronger dollar will hurt US exports to EM.

The tapering of QE in the US was first flagged back in late May of last year, during which time we thought a lot of this current market reaction was already priced in. So why are we seeing a pronounced negative reaction this time? Recent events have merely highlighted these vulnerabilities again, this time with the political backdrop across many EM countries dominating global media headlines, as well with elections in Colombia, Brazil, India, Indonesia and South Africa.

We expect that the emerging market currency influence and related volatility will probably play out over this trading week and perhaps into next. We think that the decline in U.S. markets will be confined and don't sense that a dramatic decline is at hand here. Without any significant corrections over the past two years, it doesn't take much to spook investors. And perhaps we all have gotten slightly spoiled into thinking the market only goes in one direction!

So where are we looking for our 2014 growth drivers to come from? We think many of the same catalysts that underscored the second-half pickup will remain the primary influences this year. Businesses ramped down capital spending late last year, but orders have since strengthened and the 2014 investment outlook looks promising. Profits are healthy and corporations are flush with funds. Consumers are getting their swagger back, thanks to improving job prospects and wealth gains stemming from rising asset values. Meanwhile, homebuilders are picking up construction to meet expected demand.

Please let us know if you are interested in our help in executing these thoughts or strategies.

Warmest Regards,

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