Weekly Digest

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Investec Wealth & Investment

The weekly insight into world stock markets

Ruffled Feathers

Animal spirits in investment markets have evaporated over the past two weeks, with Turkey suddenly claiming the limelight as a posterchild for a mismanaged emerging market economy, whose weaknesses have been exposed as they have become the latest focus for American diplomatic ire - expressed through commercial penalties.

Having had their attention drawn, investors have punished Turkish assets ruthlessly. At the time of writing, the Turkish stock exchange (the Borsa Istanbul) has fallen by over 20% year to date and just under 10% since the end of July. The run on the Lira that is both a symptom and a cause of the share price weakness has translated these local currency declines in share prices into losses of just under 50% and 25% in Dollar terms over the same time periods.

This Turkish Bath now has investors sweating about the possibility of contagion into shares more widely, as Global Equity Markets in aggregate have fallen by 2% month to date and are now 1% down Year to date in Dollar terms. The contagion is feared to come through two routes. Firstly through Emerging Markets, where share prices measured in Dollars have fallen by 6% over the month. Those countries with large balance of payments deficits and high levels of local debt financed from overseas in foreign currencies, similar to Turkey, have seen particularly sharp falls in their currencies and shares. The second source of contagion is feared to be through cross border linkages into Developed Markets. Some demand softening for foreign goods is inevitable, but the real fear is that banks outside Turkey could lose money on any loans they have made to Turkish borrowers whose cash flows will be hurt both by higher import costs alongside increased obligations on any non-Lira debt they might have committed-to. If these losses are large enough to restrict these non-Turkish banks' ability to conduct "business as usual" in their home markets, Turkish problems could have a knock-on effect.

Under normal circumstances, we would expect these jitters to quickly pass since there is good reason to expect that contagion from Turkey should be limited. Not all Emerging Markets are subject to the same structural fragilities. Those that are, namely Turkey, South Africa, Argentina, Russia and Indonesia are well-known as the "fragile five". Their notorious structural position is already taken into account by investors, so self-inflicted problems, although likely to impact financial conditions in the other members of this narrow group, should not be multiplied across other Emerging Markets. This same factor (the long-standing awareness of the risks in the fragile five) is also a reason not to fear cross border financial contagion into Developed markets through banking linkages. The press has highlighted some $140Bn in loans that European banks in Spain, France & Italy have to Turkey. However, the fact is that because such problems were always a possibility, the risks have been mitigated. The vast bulk of the loans are done through Turkish subsidiaries who have funded them with local deposits. The banks concerned may see the profits and lending capacities of their Turkish subsidiaries decimated, but there should be little impact across borders.

However, these are not normal circumstances. The Dollar has hitherto only been "weaponised" against the most serious of enemies to both America and the Western alliance. By using Trade sanctions against Turkey in a relatively low-level diplomatic confrontation, the Trump administration heightens concerns about the deterioration of relationships with China and other trading partners. Heightened fear about the ready availability of the world's functional trading currency effectively tightens liquidity (hoarding of Dollars) and is not friendly to growth.

For now, global corporations appear to be more relaxed than investors. Buoyed by firm order books they are delivering good results and do not appear to be retrenching. The consensus expects that Donald Trump will declare victory against China shortly before the Mid-Term elections, before materially damaging global growth prospects. Global corporate credit spreads (the price of borrowing) and financial sector share prices should be watched closely for signals that this may be too complacent a judgement. For now the verdict appears to be that "this too will pass".

John Haynes
Head of Research

FTSE 100 Weekly Winners

Hargreaves Lansdown	3.9%
GlaxoSmithKline	3.4%
WPP	3.3%
Direct Line Insurance Group	3.1%
Admiral Group	3.1%
RSA Insurance Group	2.0%
Melrose Industries	2.0%

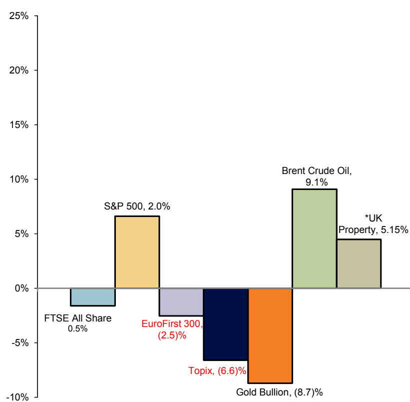
Source: FactSet

FTSE 100 Weekly Losers

Antofagasta	-14%
Evraz	-8.5%
Anglo American	-8.0%
Kingfisher	-7.1%
Randgold Resources Limited	-6.8%
Fresnillo	-6.5%
TUI	-5.7%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet

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