U.S. Stock Market Can’t Sidestep Emerging-Markets Trouble This Time Around

Recent troubles in developing economies could pack more punch for U.S. investors

By Justin Lahart
Oct. 14, 2015 1:39 p.m. ET

There are unsettling similarities between the financial crises of the late 1990s and the troubles that have lately stricken the global economy. One difference: today’s U.S. economy, and stock market, may be more vulnerable.

The 1997 Asian financial crisis and the 1998 Russian debt crisis exacted a horrible toll on emerging countries’ finances and economies. But those global storms barely hurt the U.S. economy, largely because the low gasoline prices, inflation and interest rates they helped engender added to U.S. consumers’ spending power.
Now, the U.S. faces a similar situation. China’s slowdown, and the commodity-price collapse it helped precipitate, have put developing economies on the ropes. U.S. exports, and the overseas operations of companies like Caterpillar Inc. and DuPont Co., are getting hurt, while tumbling gasoline and import prices, and low interest rates, are giving consumers a boost.

But today’s mix may hit the U.S. harder, and inflict longer-lasting damage on stocks. This may become apparent as third-quarter earnings season kicks into gear.

The reason: the increased heft of developing countries makes them matter more for the U.S. than they used to, while U.S. consumers’ wherewithal and willingness to boost spending is diminished. Wednesday’s earnings warning from Wal-Mart Stores Inc., and a weak September retail-sales report from the Commerce Department, underscores the latter.

Developing countries now account for 40% of global gross domestic product, according to International Monetary Fund estimates, compared with 22% in 1997. Over the same period, America’s trade exposure to the rest of the world increased, with the combined value of U.S. imports and exports rising to 30% of GDP from 23%.

The growing importance of the developing world is reflected in where U.S. companies do business. In 2013 (the latest date with available Commerce Department data), operations outside of the Group of Seven major economies accounted for 63% of sales at U.S. companies’ majority-owned foreign affiliates. In 1997, sales outside of the G-7 accounted for just 47% of U.S. multinationals’ foreign sales.
And this comes at a time when U.S. companies’ overall dependence on overseas sales has been on the rise. Apple Inc., currently the largest U.S. company by market value, booked 62% of its sales abroad last year, compared with 50% in 1997. General Electric Co. made 52% of its sales outside the U.S., versus 42% in 1997 when it was America’s biggest company.

These increased global exposures mean the U.S. risks seeing a greater trade drag than in 1998, when a growing deficit cut GDP growth by 1.1 percentage points. There are indirect effects as well. Companies with troubled overseas operations may curtail domestic expansion plans, while damage to their share prices may curb investors’ confidence in the economy.

While consumers have lately been the best thing the U.S. economy has going for it, low gasoline prices, increased spending power and rock-bottom interest rates aren’t generating the same sort of enthusiasm.

Forecasting firm MacroEconomic Advisers estimates consumer spending increased at a 3.4% annual rate in the third quarter. That is strong but nothing akin to the 6% seen in the fourth quarter of 1998 when the Russian debt crisis was in full swing. And if global woes are indeed starting to weigh on the job market—a possibility raised by September’s weak jobs report—the pace of spending may only diminish.

Similarly, while the housing market is showing improvement, it isn’t providing nearly as much oomph. One reason: after the housing bust, it doesn’t represent as great a share of the economy as it once did.

So although the U.S. may be dealing with a similar set of positives and negatives as in the late 1990s, it may be a mistake to think the economy and stock market can sidestep emerging-markets trouble as easily as in the late 1990s. While a recession probably isn’t in the cards, a slowdown that further diminishes corporate profits may be.

Questions:
1. Why did not Asian and Russian crisis affect US economy in the past?
2. Why US may be hit hard this time?
3. How much is US companies’ exposure to global markets?
4. How much of Apple’s and GE’s sales are from overseas?
5. What may be the effects of companies’ troubles overseas operations in the domestic market?
6. What was expected to create enthusiasm in consumer spending but we are not seeing it?
7. How is consumer spending nowadays compared to Russian crisis time period?
8. Do you think US can sidestep emerging market’s problems? Why? Why not?
Euro dives as traders bet on more ECB largesse

Jamie Chisholm, Global Markets Commentator

October 22, 2015

The European Central Bank prepared the groundwork for additional stimulus by the end of the year, bolstering equity and bond markets, while putting pressure on the single currency as Wall Street also gained momentum from upbeat earnings.

European bond yields and the euro fell sharply after the ECB’s monetary policy update which came during a busy session for company results.

The S&P 500 was up 1.3 per cent to 2,045.46 at midday in New York, recovering the 12 points lost on Wednesday and leaving the Wall Street benchmark just 4.2 per cent below its record high hit in May.

This followed a 2.1 per cent gain in the Eurofirst 300.

After holding interest rates at record lows, Mario Draghi, the ECB president, started his post-meeting press conference by warning that stress in emerging markets and possible repercussions from financial-market volatility posed downside risks to growth.

Given these concerns the central bank would examine its €60bn-a-month asset-purchase programme in December, Mr Draghi said — a pledge that traders have interpreted as raising the chances that the monetary guardian will boost its stimulus efforts in order to tackle deflationary pressures in the eurozone.

“The ECB will almost certainly be delivering an early Christmas present this year,” said Nick Kounis, head of macro and financial markets research at ABN Amro.

“This could include an adjustment of the QE programme but also further policy rate cuts, something which had been ruled out before.”

Analysts at Barclays said: “We do not rule out the possibility of a deposit rate cut in December, although this is not our baseline. The likely trigger for a deposit rate cut, in our view, would be a further material appreciation of the euro, possibly in a scenario where the Fed remains on hold for longer.”

The prospect of further easing pulled the rug from under the euro, which was down 1.7 per cent to $1.1153, a two-week low, and boosted eurozone government bonds.
The 10-year German Bund yield dropped 7 basis points to 0.49 per cent, while equivalent-maturity Italian and Spanish paper both fell 15bp to 1.45 per cent and 1.59 per cent respectively, according to Bloomberg data.

Meanwhile, the 10-year US Treasury yield was up 1bp to 2.03 per cent.

Investors parsed a flurry of corporate earnings. The results for McDonald’s and 3M were well received while Valeant Pharmaceuticals shares plunged a further 20 per cent over a controversy regarding its revenues.

Investors awaited results from Alphabet, the holding company for Google, and from Microsoft.

The dollar index, which measures the buck against a basket of its peers, jumped 0.9 per cent to 95.85 in response to the euro’s plunge.

That left it about 5 per cent shy of its 12-year high hit in March — a time when the market thought the Fed would by now have pushed interest rates to 0.75 per cent from the still record low of 0-0.25 per cent.

Sterling was also weaker against the greenback, trading 0.2 per cent lower at $1.5396 even after strong UK retail sales data.

The firmer dollar caused many commodities to pare session gains. Copper was up 1.1 per cent to $5,249 a tonne and Brent crude added 0.6 per cent to $48.13 per barrel, having popped above $48.50. Gold was flat at $1,167, after losing $3 an ounce at one point in the session.

Earlier in Asia bourses were on the back foot following Wall Street’s overnight dip.

Japan’s Nikkei 225 slid 0.6 per cent and Hong Kong’s Hang Seng returned from a day off to drop 0.6 per cent, partly in response to sharp falls on Wednesday in mainland China.

The Shanghai Composite recovered a bit of ground, however, with a fresh 1.5 per cent advance.

Poor results from two large industrial groups did damage to South Korea’s Kospi index, which lost 1 per cent.

Samsung Engineering plunged more than 20 per cent at one stage after reporting a surprise third-quarter loss instead of the forecast profit, and saying it would raise cash by selling Won1.2tn ($1.06bn) of new shares.

SK Hynix fell about 5 per cent after the semiconductor maker posted a fall in net income despite rising demand.
Questions:

1. What were the effects of ECB’s additional stimuli signal in the market?
2. What were the downside risks mentioned by ECB president, Draghi?
3. Why does Nick Kounis of ABN Amro think ECB will be delivering a Christmas present?
4. What are the views of analysts at Barclay regarding deposit rate cuts?
5. What were the effects of quantitative easing in other markets?
6. How does McDonald’s, 3M and Valeant look in terms of earnings?
7. How does dollar index and sterling look?
8. What was the effect of stronger US dollar on commodities?
9. How did Asian markets respond to ECB news?
10. How do Samsung and SK Hynix stock react?