MARKET INSIGHTS

from Ziegler Capital Management

Unintended Consequences

WRITTEN BY

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ABOUT ZCM MARKET INSIGHTS

A series that provides a glimpse of our internal thought process through current topics effecting our clients and colleagues.

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With Federal Reserve (Fed) officials continuing to raise short-term interest rates, ostensibly to normalize credit market conditions and to prevent the U.S. economy from "overheating," struggles on the periphery could point to trouble for E.U. and U.S. economies.

Economists and pundits of all stripes have been arguing for years now about when and how our current expansionary period will end, especially as the bull market turns 10. With the global economy having grown increasingly synchronized throughout this most recent expansionary period, events outside of the U.S., perhaps accentuated by U.S. Federal Reserve policy, might point to turbulence ahead.

As the Fed has continued hiking rates, we have begun to witness the currency chaos that many feared would occur. Because of Fed policy, emerging market central banks (EMCB's) are beginning to unleash the nearly $6 trillion stockpile of foreign reserves they have been carefully amassing over the past decade as they try to ward off further domestic currency slides. In June alone, EMCB's ripped through roughly $54 billion and appear poised to increase that cash burn as conditions warrant. Case in point, earlier this year, Argentina blew through $10 billion in reserves during April and May in a desperate attempt to stave off a peso collapse. They were largely unsuccessful and required another $50 billion, via a credit line from the International Monetary Fund in June, to finally halt the slide. How did the currency fare? Despite such drastic action, the peso remains down roughly 34% on the year. When it comes to furiously churning through reserves, Argentina is not alone. Brazil has spent nearly $44 billion this year, and India has dumped another $17 billion. All of these moves are designed to stave off a corresponding currency collapse as the U.S. dollar continues to strengthen. Ultimately, the fate of these currencies is typically tied to the fate of the dollar, which derives its strength (in large part) from the state of the U.S. economy. If the U.S. economy continues to strengthen, especially in relation to global peers, these currencies could have further to fall.

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Despite all of the focus on Fed policy, our list of unintended consequences are not the only headwinds facing global markets. Other issues such as higher energy prices, potential labor shortages, and demographic shifts present their own unique challenges. When evaluating the state of the global economy, it is important to be cognizant of all of these factors. In light of all of these various challenges the question on many people's mind is, will global markets stabilize and continue to grind higher? Well, let me paraphrase something former Federal Reserve Vice Chairman Stanley Fischer said recently: it requires a lot of people to do the right thing at the right time and the right time is pretty soon, whether they like it or not.

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