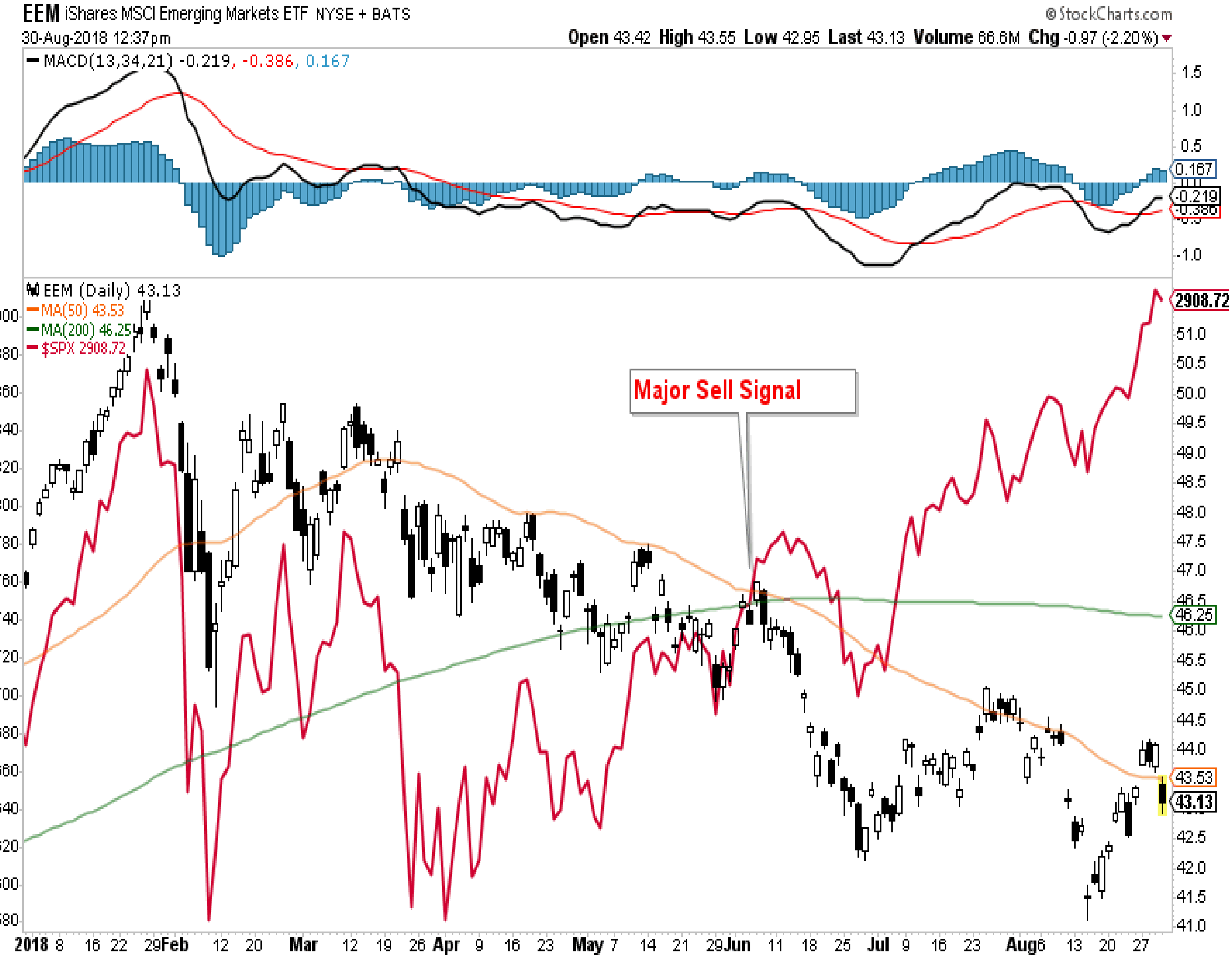
I have been, and remain, bearish on emerging markets for three reasons:

1. *As [discussed yesterday,] the U.S. is closer to the next economic downturn than not. When the U.S. enters a recession, emerging markets are hurt considerably more given their dependence on the U.S.•*
2. *International risks in countries like Turkey, Greece, Spain, France, Italy, etc.•*
3. *A strong dollar from flows into U.S. Treasury bonds for a "safe haven."•*

I recommended in January of this year to remove all international and emerging market exposure from portfolios and have been updating that position since each week•in the newsletter:

> ***"Emerging and International Markets****•were removed in January from portfolios on the basis that•?trade wars?•and•?rising rates?•were not good for these groups. With the addition of the•?Turkey Crisis,?•ongoing tariffs, and trade wars, there is simply no reason to add•?drag?•to a portfolio currently.•* ***These two markets are likely to get much worse before they get better. Put stops on all positions."***

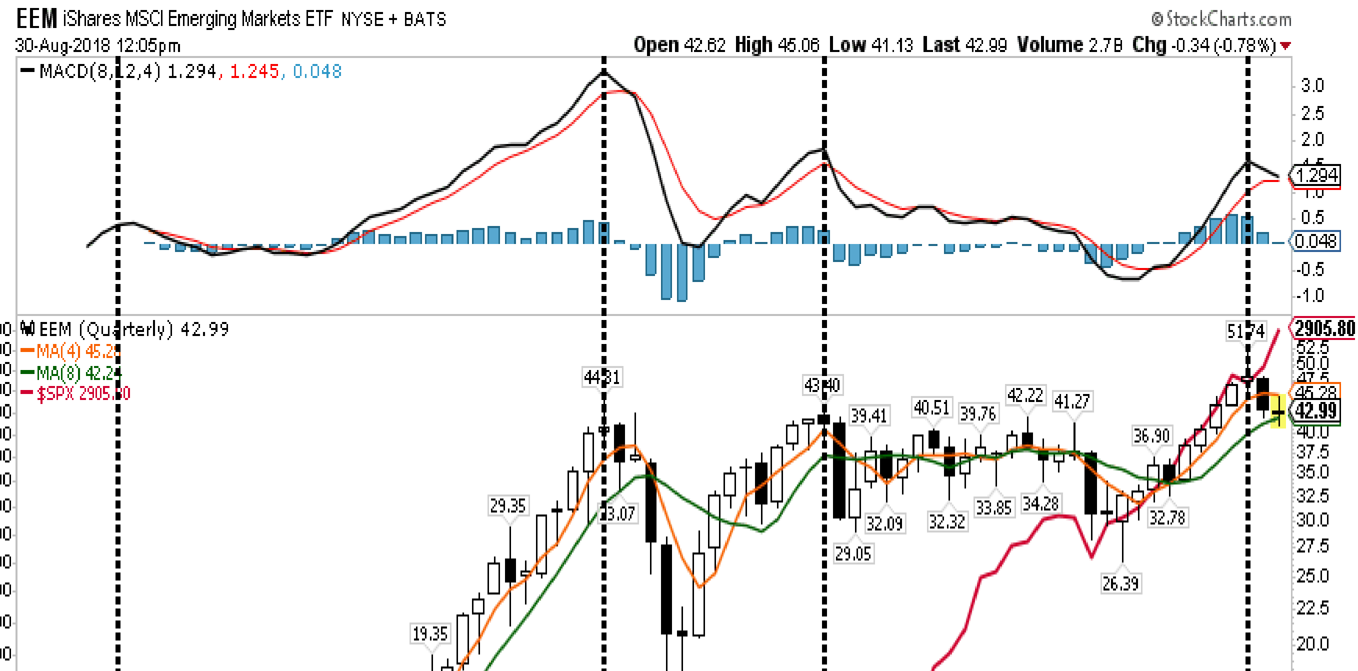
This has been the right call, despite the plethora of articles suggesting the opposite.



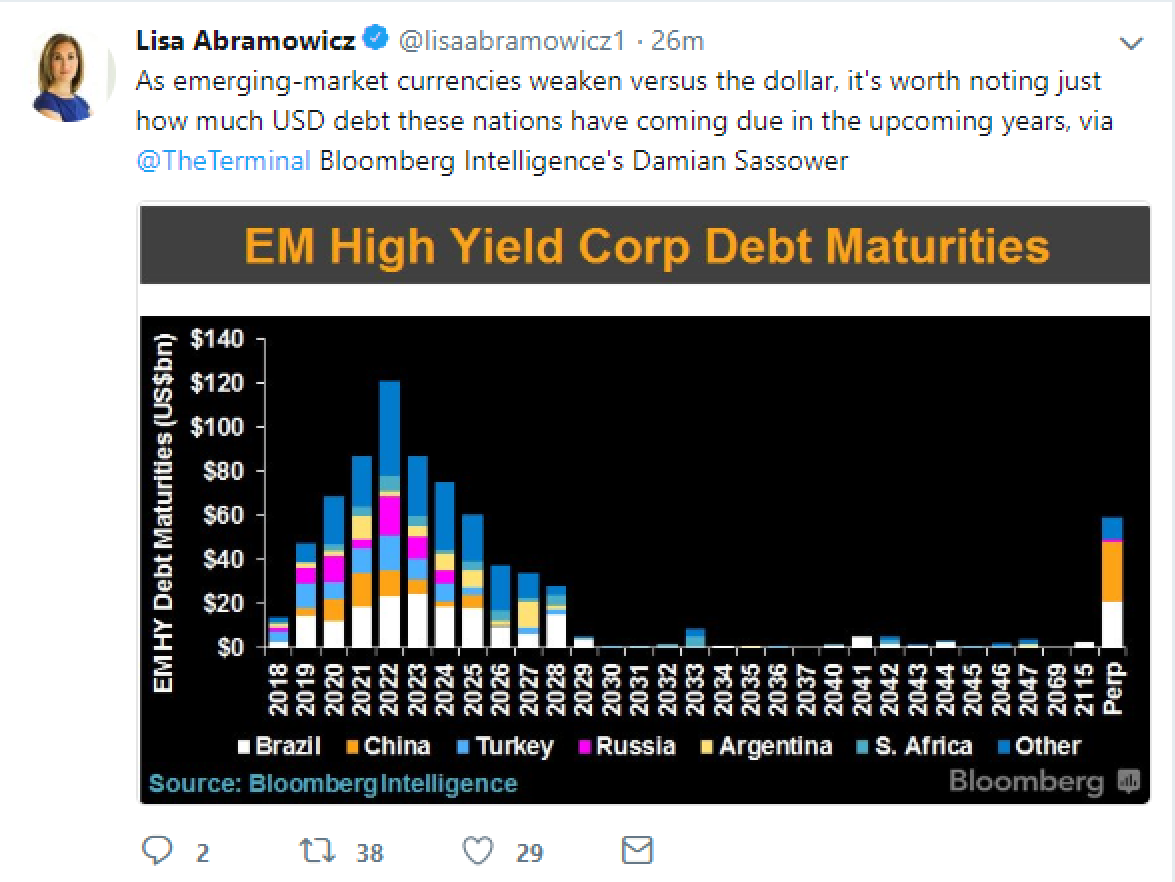
For example, in January, Rob Arnott [stated:](#)

> *"Look at value in emerging markets. In the U.S., value is trading about 25% cheap relative to the market. In emerging markets, it?s close to 40% cheap.•That?s pretty cool. If you can buy half the world?s GDP for nine times earnings or buy the U.S. for 32 times earnings, I know where I?m going to put my money."*

Now, I am not arguing Rob's point. But, my position is simply that the economic dependency of emerging markets on the U.S. is extremely high. Therefore, when the U.S. gets a "*cold,"* emerging markets get the *"flu."*•Over the last 25-years, this has remained a constant.



In 2000, 2007 and 2012, emerging markets warned of an impending recessionary drag in the U.S. *(While 2012 wasn't recognized as a recession, there were many economic similarities to one.)* Currently, emerging markets have once again diverged from the S&P 500 suggesting economic ...ly isn't ...ight with the ...efault risk in



While the markets are currently dismissing Turkey, Brazil, China and Russia as non-events, the problem is the issue of [funding needs](#) for these countries.

> *"The second, more salient point is that a key reason for the solid growth across emerging markets in recent years,* ***has been the constant inflow of foreign capital****, resulting in a significant external funding requirement for continued growth, especially for Turkey as [discussed previously](#).* ***But what happens if this outside capital inflow stops, or worse, reverses?*** *This is where things get dicey. To answer that question, Morgan Stanley has created its own calculation of Emerging Market external funding needs, and defined it as an 'external coverage ratio.' It is calculated be dividing a country's reserves by its 12-month external funding needs, which in turn are the sum of the i) current account, ii) short-term external debt and iii) the next 12 months amortizations from long-term external debt."*

Given the ongoing pressures of *"tariffs,"* trade wars and rising geopolitical tensions, the risk of something going *"wrong"*•has become increasingly elevated. Yet, market participants are ignoring the risk simply because prices are rising. As Doug Kass noted yesterday:

> *"There is nothing like stock price advances to change sentiment.•**Just like fear dominates politics these days, the opposite is occurring in the markets as greed has emerged as a byproduct of sharply rising prices** **(which have desensitized investors to risks, doubt, and fear).** Besides growing economic ambiguities, the most notable lack of criticism is the unusual nature of the last decade, in which interest rates sustained themselves around the world at generational low levels. To presume that foundation to be sound in the future **(particularly when a pivot of global monetary restraint has already started),** is to congratulate Lance Armstrong for his Tour de France wins without noting his use of illegal drugs. T.I.N.A. ('there is no alternative') is no longer a present condition as 1-month, 3-month, 6-month and 1-year Treasury yields are now at their highest levels in 10 years: There is now an alternative."*

> *"The magnitude of the market's rise in the month of August is almost certainly borrowing from future returns.•In the extreme, a more durable and significant top may be forming."*

Higher borrowing costs on the short-end reduces consumption and the demand for imported goods. Emerging markets are likely already signaling there is an issue from the Federal Reserve's actions, and the consequence historically has not been good. But, as I quoted yesterday:

> *"Unfortunately, Powell left the unsettling feeling that monetary policy can be summarized as•**?We plan to keep hiking until something breaks.?"-** Tim Duy*

Just something to think about as you catch up on your weekend reading list.

Economy & Fed

- **A New Path For Powell** by Tate Lacey via Alt-M
- **Trumps Exasperating Ignorance On Trade** by Caroline Baum via MarketWatch
- **US Overdue For Another Economic Disaster** by George Will via National Review

- **If Fed "Paused" It Would Be A Good Thing** by Conor Sen via Bloomberg
- **CBO's Long-Term View Is Dire** by Maya McGuinness via CNN
- **NAFTA - The No Deal, Deal** by Macromon via Global Macro Monitor
- **Tax Cuts And The Electoral Impact** by Vanessa Williamson via Brookings
- **Keep Hiking Until It Breaks** by Tim Duy via Fed Watch
- **The Fed Is About To Make A Mistake** by Jim Bianco and Ben Breitholtz via Bloomberg
- **My Family Escaped Socialism, Now Dems Want It** by Giancarlo Sopo via USA Today
- **The Depth Of The Next Recession** by Jeffrey Frankel via Project Syndicate
- **High Prices & Stagnant Wages Workers Turn To Debt** by Patrick Hill via The Progressive Ensign

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Markets

- **Emerging Market Crisis Is Growing** by Tyler Durden via Zerohedge
- **The Trend Divergence Between S&P 500 And The VIX** by Sue Chang via MarketWatch
- **If Market Reporters Were *"Totally Honest?"*** by Shawn Langlois via MarketWatch
- **Has The Market Reached Its *"Now What"* Moment** by Michael Santoli via CNBC
- **Bears Punished In August** by Mark DeCambre via MarketWatch
- **Mid-caps Breaking Out?** by Dana Lyons via The Lyons Share
- **What's Next For The Market** by Martin Feldstein via Project Syndicate
- **Uncertainty Surrounds Aramco Deal** by Simon Constable via Middle East Eye
- **GS: Powell Not As Dovish As Markets Believe** by Greg Robb via MarketWatch
- **Excessive Optimism A Reason To Be Cautious** by Ryan Vlastelica via MarketWatch
- **"Tug Of War" In The Bond Market Could Sends Yields Tumbling** by Sunny Oh via MarketWatch
- **How Does This Bull Market End?** by Gillian White via The Atlantic

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Most Read On RIA

- **Should You Ignore John C. Bogle** by Lance Roberts
- **Running On Empty** by Michael Lebowitz
- **The Bull Market Resumes...For Now** by Lance Roberts
- **Why U.S. Stocks Hit A Record** by Jesse Colombo
- **Don't Worry About Trump, Worry About Earnings** by John Coumarianos
- **As Good As It Gets** by Lance Roberts

Research•/ Interesting•Reads

- **One Policy To Boost Your Currency & Weaken Exports** by Paul Kasriel via The Econotrarian
- **Top Market Predictions From Camp Kotok** by John Mauldin via The Market Oracle
- **Don't Believe That GDP Number** by Justin Fox via Bloomberg
- **10-Reasons It's Hard To Be An Intelligent Investor** by Justin Carbonneau via Validea.com
- **Was The Financial Crisis Wasted?** by Howard Davies via Project Syndicate
- **How An Investment Legend Is Trying To Beat Yale** by Amy Whyte via Institutional Investor
- **What Does The Slope Of The Yield Curve Tell Us?** by Raphael Bostic via Fed Reserve Bank of Atlanta

- **Protectionism Enables Cronyism & Corruption** by Dan Mitchell via International Liberty
- **Student Debt Is Worse Than Imagined** by Ben Miller via NYT
- **More Fraud In China's "Cooked" Economic Data** by Tyler Durden via ZeroHedge
- **Proof Negative - The Advisor's Real Job** by Robert Seawright via Above The Market

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"Stay humble...or the market will do it for you." - Anonymous

Questions, comments, suggestions ? please email me.