Take Your Eye off the Ball

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by David Dali

of Matthews Asia

Being a San Francisco-based firm, we are privileged here at Matthews Asia to watch the Golden State Warriors day in and day out (not in person mind you—ticket prices are extreme!). Of the dozen or so characteristics that make the Warriors so tough to beat, one that stands out is how adept the team is at moving without the ball. The next time you watch them play, take a few minutes to focus on what the Warriors do away from the ball. You will find a similar dynamic on the streets of New York if you come across a game of three-card monte or some other "shell game." This is not to say the Warriors are hustlers, of course. Their movement is extraordinary, and what happens away from the ball is arguably a key to their success.

As a strategist, I watch markets go up and down, and I often wonder about what catalysts exist to change the course of market direction. When markets are strong, I look for hiccups and pitfalls. And equally, when markets are in the doldrums (much like today for broader Asia and emerging markets) I look away from stock levels to try to find evidence of a change in sentiment or fundamental shifts in the supply-and-demand equation. I also look toward history as a guide. Essentially, I try to focus "away from the ball" (stock index levels) and toward anecdotal arguments for change.

When searching for arguments supporting the rationale for market stabilization, it is interesting to draw parallels with other periods of market stress. I find few comparisons in today's market environment with the Asian Financial Crisis of 1997 or the Global Financial Crisis (GFC) of 2008. But I see similar levels of stress with periods like 2003 to 2004, before the Federal Reserve rate hike, or to 2011 when there was a question over whether Greece would exit the European Union. Finally, I also see similarities between market stress now and in 2013, when we experienced a taper tantrum. These periods were worrisome and volatile with bouts of equity and currency weakness, widening spreads and flight to quality.

Today, I am being drawn back to 2004 before the Fed began to hike rates. The European Central Bank and the Bank of Japan were accommodative then as they are today. Oil prices were close to $35 a barrel back then and commodity index levels were close to 200, similar to today. Emerging market credit spreads spiked up to 500 basis points (5%) in mid-2004 and emerging market price-to-earnings ratios were close to 12X—just like today.

At Matthews Asia, we are long-term investors—believers in fundamental, bottom-up research. We like to connect dots. If we look away from the ball and focus on the dots of history, I am compelled to point out that if we discard the GFC, we have not, since 2004, seen the confluence of the start of a Fed rate hike cycle together with levels for oil, commodities, credit spreads and equity valuations similar to today. If history is a guide (remember that 2004 to 2007 was a very strong period for risk assets) it could mean that better markets are ahead—for Asia and emerging markets alike.

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