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WEEK IN PERSPECTIVE

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Decoupling but not divorced

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Last week marked another round of poor economic news coming out of the U.S., as the Philly Fed announced that their business activity index showed unexpected weakness with a drop to negative 7.7, well below the positive 7.0 expected by economists. First-time jobless claims in the U.S. also rose to a ninth-month high of 500,000. This marks a third straight week of increases. Markets were fairly mixed during the week with the S&P 500 Index returning -0.7% and MSCI Emerging Market Index coming in at 0.8%. These two markets are decidedly different YTD as well, posting returns of -6.4% and -0.1%, respectively.

The arguments persist on the topic of decoupling between emerging and developed markets and/or economies, with both camps having strong arguments for their point of view. On one hand you have those that doubt that decoupling exists as we have a global economy that depends on each other for growth and on the other hand you have those that believe emerging markets are starting become self-sufficient.

The truth likely lies somewhere in between.

During the "Great Recession", it seemed that no stock market was insulated from the financial crisis and aftermath. However, some economies were less affected than others and turnarounds were quick once the dust settled. Many emerging market countries, including China (10.3%), Brazil (9.0%), India (8.6%), Malaysia (8.9%) and Singapore (18.8%), have experienced strong GDP growth over the last 12 months and many of these countries have already begun to tighten interest rates. Even if this growth slows, they will still offer attractive opportunities going forward in both equities and fixed income, when compared to developed economies that are offering slow to no growth.

Peter Mennie, Senior Portfolio Manager and lead manager for the Manulife Emerging Markets Fund comments, "Emerging Markets has the opposite problem to Developed Markets currently - EM is overheating somewhat, and several countries have raised rates. One of the advantages of this is that they have firepower in a slowdown - in the West we largely have Quantitative Easing problems ongoing, we have virtually zero interest rates, we have high budget deficits. In EM, we have many countries with significant sovereign wealth funds, and on average we have fairly high interest rates which gives the opportunity to reduce rates if we see any sign of slowing economies."

These strong growth numbers have also not come from the demand from developed markets either. There is more evidence of increasing interdependence among emerging economies and, in turn, less dependence on developed economies; trade flows between emerging market economies have increased, doubling in the past two decades, demand for commodities from large emerging markets like China and India has boosted growth in commodity exporters such as Brazil, Chile, and Russia and financial flows between emerging economies have increased. China gets nearly two thirds of its foreign direct investment from other Asian emerging countries. In turn, China has begun to undertake substantial investments in many commodity-producing countries, such as Brazil. All of this makes emerging markets as a group less dependent on financial flows from developed economies, as they once were.

Investing in emerging markets is not without risk, however, "We are concerned that as the early part of the value chain, EM will clearly hurt if there is a significant double dip recession, but we are reassured by strong underlying factors which gives EM significant macroeconomic flexibility to respond.", continues Peter.

Ultimately, we live in a global economy that is fairly intertwined but when broken down can be separated enough to identify pockets of investment opportunity. In addition to accessing emerging market equity exposure through the Manulife Emerging Markets Fund, emerging market debt can be found in the Manulife Strategic Income Fund. The Fund has been building up their weight in emerging market debt and now holds 11%, with a concentration in South East Asia.

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