

Quantitative Easing, focus on EM currencies and commodities

Lmf international

ECB QE has put downward pressure on EUR/USD. And dollar strength is particularly negative for emerging markets and commodities. Investment strategy according the main asset managers

European Central Bank (ECB) Quantitative Easing (QE) has put tremendous downward pressure on EUR/USD. And the USDollar strength is particularly negative for emerging markets (EM) and commodities.

Which is the impact of this move?

"The easy trade of simply being short EM currencies versus the US dollar is over, we believe. A more nuanced view is appropriate going forward", **Collin Crownover, Head of Currency Management, State Street Global Advisors**, said.

"EM currencies are already affected by anticipated rise in the Fed interest rate and depreciated in aggregate to levels significantly weaker against the USD than what we have seen during the Lehman crisis", **Ronald Schneider, bond manager of Raiffeisen Capital Management**, added.

"Bond yields in EM are correcting higher as a result of the sharp reversal seen in US Treasury yields. Wider spreads too mean investors have started to discriminate EM bonds more according to their credit profile. In sum, both the higher level of US interest rates and wider spreads make it harder for EM to sustain domestic spending growth", **Viktor Nossek, Head of research of WisdomTree Europe** explained.

According to **Paul Jackson, Head of Multi-Asset Research, Source**, "Emerging market currencies are suffering on the whole: either because of reliance on commodity exports or because it is believed there is too much exposure to USD financing, which becomes more expensive when US rates and the USD rise".

But the situation of emerging countries is very diversified. Risks coming from the exposure to some emerging markets may arise from higher debt servicing cost of external debt in USD and weaker commodity prices. "Commodity exporters, countries with high external debt levels and weak balance of payments position like **Brazil, South Africa** and **Turkey** are likely to be negatively affected - Schneider explained - The recent EUR/USD move has cushioned the drop of EM currencies against the EUR but in aggregate they already trade on historically weak levels. ?In the medium term we would see value in **Mexico**, which should benefit from good economic growth in the US, **India**, where the new government has an ambitious reform agenda and **Russia**, once and if the geopolitical situation improves".

Also Nossek is focused on Russia. "The Russian rouble may have the potential to continue to appreciate if Putin's government is able to limit the damage economic activity and trade - Nossek said - Probably too much negativity on Russia was priced in last year. As a beaten down currency, the rouble is likely to have more upside, especially as the oil price stabilises".

Other asset managers have different views. "We don't like emerging markets forex with the exception of the **Turkish Lira**", **Andrea Cuturi, Chief Investment Officer**,

Anthilia Capital Partners sgr, declared. Instead, Crownover continued saying: "We would avoid currencies with heavy exposure to commodities as the knock-on effect to the economy of the decline in commodity prices is still being felt. We favor EM currencies that have low commodity exports, and are better levered to a US expansion, such as the **Korean won**".

And what happens to the commodities?

"Commodities generally suffer when the dollar is strong and vice versa. This correlation has been apparent in the last couple of years and especially so since mid 2014. Since then the dollar has increased aggressively and commodities have sold off. Thus a further strengthening of the greenback will still be of bad influence for commodities", **Kurt Schappelwein, Head team Multi-asset Strategies of Raiffeisen Capital Managment** answered. "In our opinion, commodities are still in the process of eliminating the "super-cycle" bubble and have plenty of downside. Rising US rates and an appreciating dollar may add to the downward pressure but are not a necessary condition", Jackson continued.

"**Copper** in particular has been in a downtrend over the last 5 years and the weak Chinese housing market is adding to the price pressure in base metals - Nossek explained - **Crude oil** is affected by a rebalancing Chinese economy on the one hand and by the rise of US shale output and OPEC refusing to cut production on the other". Then Nossek stated that these trends unfolded well before the dollar started to strengthen. "Hence I do not believe that any further strengthening in the dollar would coincide with weaker commodity prices. It is likely that commodity prices will merely stay weak and not move a lot in either direction this year, even as the dollar may climb higher", he concluded.