
THE CHALLENGE FROM THE MIDTERM ELECTIONS AND EMERGING MARKETS

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Last week's podcast focused on the global [macro](#) environment and political dynamics with Guy Petcho, a global macro portfolio manager at Voya Investment Management, and Greg Valliere, chief global strategist at Horizon Investments.

This was a timely conversation with the emerging markets sell-off we've been experiencing, and, summarizing Petcho's views, he does not believe the challenging environment for emerging markets is over. Petcho generally is positioning for a stronger dollar environment versus emerging market currencies.

Petcho became more cautious a few months ago based on his modeling work, which suggests that Chinese exports will keep declining toward a 0% growth rate—this is from growth rates in exports that were more than 12% in June. China started slowing down late last year after some political transition points. In late 2015, President Xi clamped down on credit growth to 2013-14 levels which resulted in a sell-off in commodities, China, and the global economy.

Petcho also sees a slowdown in capital flows, which, compounded by rising rates in the U.S., are making emerging market debt and other opportunities less attractive on a relative basis. What is also creating challenges is how many of the emerging markets started cutting rates on low [inflation](#) in 2017, but then inflation started coming back in 2018. Now these countries are having trouble and need to [hike rates](#) while facing both inflation and pressures from a slowing global economy.

Petcho believes China has thrown everything at its problem besides credit growth—and he sees China needing to depreciate its currency, which would hit other emerging market currencies. He thinks a further depreciating Chinese yuan will ramp up political rhetoric, with the U.S. claiming that China is trying to support its exports in the trade spat.

A More Challenging Political Environment Forthcoming

The second half of our conversation focused on the political environment. Valliere discusses politics with his clients and tries to advise them to focus on the fundamentals—not the political noise. But after the midterm elections, if the Democrats take control of the House, as Valliere expects (the oddsmakers are currently setting odds around a 2-to-1 proposition), he believes there will be calls to impeach President Trump. Valliere, however, does not believe the Senate would get the 67 votes necessary to do so—and he believes the Republicans might even pick up a seat in the Senate. Nonetheless, the uncertainty surrounding impeachment could bring [volatility](#) to the market.

One other hot-button issue could be the [Federal Reserve \(Fed\)](#) and, more specifically, Jay Powell, who is in the hot seat. Valliere thinks as we get to December and get two more rate hikes with the unemployment rate ticking down and inflation pressures rising, Trump might start tweeting and attacking Powell for trying to slow down the economy. It will be interesting to see how Powell balances these potential pressures.

Overall, it was a fascinating conversation in which we discussed two of the hottest issues for the remainder of the year—the emerging market macro climate and the political environment with midterms looming. To listen to our full conversation, please listen below.

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DEFINITIONS

Macro: Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

Inflation: Characterized by rising price levels.

Rate Hike: refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Volatility: A measure of the dispersion of actual returns around a particular average level.

Federal Reserve: The Federal Reserve System is the central banking system of the United States.