

“The key to persuasion is teaching people something new through the lens of something they already understand” – Morgan Housel

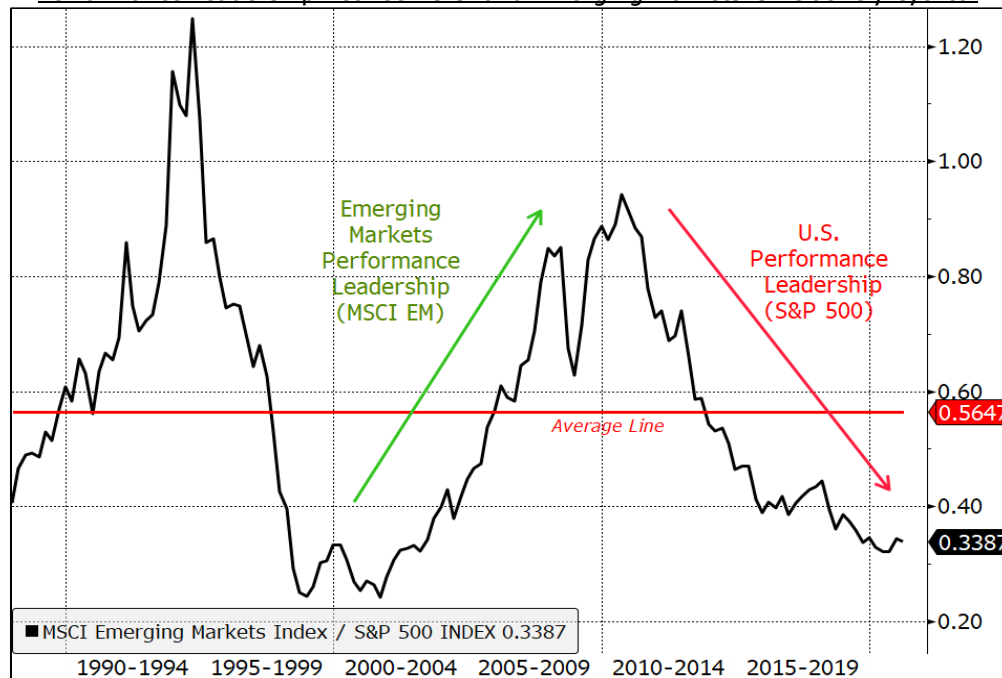
It doesn't take much to remind emerging markets investors how their risks differ from developed markets like the United States. Here, we comment on the political risks of this Democrat or that Republican being in office and how their political agenda will affect the overall health of the economy and we get concerned about inflation rising a tad bit above the arbitrary 2% inflation target due to current fiscal/monetary policy. What would our reaction be if we had upwards of 15% inflation and then decided to raise interest rates 2% in a single bound pushing rates to 19% to combat this inflation? Well that's exactly what Turkey did last week, and it cost the Turkish Central Bank Governor his job. That's the third central bank governor that Turkish President Erdogan has fired in less than two years. Turkey's New York Stock Exchange equivalent (Borsa Istanbul) sold off sharply and the Turkish currency (Lira) fell more than 10%, as global investors showed their disdain for the political move. This isn't a tiny country. Turkey is the 19th largest economy in the world and is a mostly open, industrial/service led economy. We have mentioned many times that the U.S. stock market doesn't care what party or what person sits in the Oval Office. Unfortunately for many emerging countries this is much less true, as governance is not as strongly beholden to a system of checks and balances on individual power. Political risks and currency risks are the price of admission for emerging markets, and the Turkey situation is not particularly noteworthy in the history of emerging markets investing (so far, at least). Why pay the price of unpredictable political risk to invest in emerging markets then? Because these risks are not the same across every emerging economy, yet they get treated the same. Investors allocate based on broad risks of an entire asset class, but professional investors can parse these risks better to avoid the worst. This bodes well for active management. Active emerging markets managers have a better track record of index outperformance than their developed market counterparts.

To oversimplify, emerging markets are countries that are transitioning from a low income, often pre-industrial economy towards a modern, industrialized global economy with a higher standard of living. For countries making progress on that transition, their economic growth rates (and ultimately their stock market performance) are higher than developed countries. It's common for the top performing stock market country in any given year to be an emerging market economy. As these emerging economies improve, the amount of investor assets that can flow into that economy are substantial compared to the size of their investment markets. For example, despite being the 19th largest economy in the world the value of Turkey's entire publicly traded stock market is roughly the equivalent size of Starbucks, the 60th largest company in the S&P 500 (see chart, top right). The long-term case for emerging markets is one of productivity enhancements and population growth amidst years of underperforming developed markets (see chart, bottom right). The shorter-term case to spark this cyclical reversal is broad commodity/metals price increases and a falling dollar, both of which bode well for forward looking returns in emerging markets. If you're worried about U.S. spending levels devaluing the dollar globally, then diversifying your risk exposures to include an asset class that benefits from a falling dollar seems reasonable despite the added cost of short-term political risks.

Comparing the Value of Top U.S. Companies to Entire Countries (circa 2014)



Performance Leadership Between U.S. and Emerging Markets is Relatively Cyclical



Market Rates & Returns

All returns are total returns and are annualized past 1-year. All rates are snapshots, as of the date noted. Source: Bloomberg LP

Data As Of: 3/19/2021

Asset Class	Sub-Asset Class	Index	YTD	1-Year	3-Year	5-Year	10-Year	2020
Equity	U.S. Large Cap Equities	S&P 500	4.54%	65.23%	15.13%	16.04%	13.97%	18.39%
Equity	U.S. Mid Cap Equities	S&P 400	13.63%	101.42%	12.68%	14.66%	12.23%	13.65%
Equity	U.S. Small Cap Equities	Russell 2000	16.04%	118.67%	14.85%	17.37%	12.42%	19.93%
Equity	Developed ex. U.S. Equities	MSCI ACWI ex U.S.	4.60%	70.77%	6.95%	10.65%	5.90%	11.23%
Equity	Emerging Markets Equities	MSCI Emerging Mkts	3.73%	78.71%	6.42%	13.06%	4.74%	18.79%
Fixed Income	Broad Aggregate	BB Aggregate	-3.61%	4.26%	4.75%	3.22%	3.38%	7.51%
Fixed Income	U.S. Treasury	BB U.S. Treasury	-4.34%	-1.72%	4.27%	2.39%	2.83%	8.00%
Fixed Income	U.S. Treasury Inflation Prot.	BB U.S. Inflation Linked	-2.33%	13.50%	5.89%	4.09%	3.43%	11.54%
Fixed Income	U.S. Investment Grade	BB U.S. Invest. Grade	-5.30%	15.66%	6.12%	5.02%	4.91%	9.89%
Fixed Income	U.S. High Yield	BB U.S. High Yield	-0.05%	29.94%	6.46%	7.75%	6.41%	7.11%
Fixed Income	U.S. Leveraged Loans	CS Leveraged Loan	1.97%	26.68%	4.13%	5.40%	4.45%	2.78%
Fixed Income	U.S. Municipals	BB Municipal Bond	-0.76%	10.18%	4.85%	3.51%	4.42%	5.21%
Fixed Income	Non-U.S. Gov't Bond	FTSE Non-U.S. WGBI	-5.31%	11.57%	1.39%	2.34%	1.09%	10.78%
Fixed Income	Emerging Markets Debt	JPMorgan EMBI	-4.29%	22.72%	4.22%	4.87%	5.44%	5.88%
Real Assets	Real Estate	FTSE NAREIT	7.42%	52.99%	9.11%	5.68%	8.63%	-8.00%
Real Assets	Master Limited Partnerships	Alerian MLP	23.19%	125.10%	-3.29%	-0.95%	-0.67%	-28.84%
Real Assets	Broad Commodities	Bloomberg Commodity	8.28%	37.59%	-0.78%	0.91%	-6.50%	-3.50%
Real Assets	Oil	WTI Crude	26.59%	143.54%	-0.34%	9.26%	-4.86%	-20.54%
Real Assets	Gold	Gold COMEX	-8.09%	17.74%	9.74%	6.79%	2.09%	24.42%

Key Market Interest Rates	Current Rate	1 Month Ago	2 Months Ago	3 Months Ago	4 Months Ago	6 Months Ago	1 Year Ago
Federal Funds Rate	0.07%	0.08%	0.09%	0.09%	0.08%	0.09%	0.20%
Secured Overnight Fin. Rate (SOFR)	0.01%	0.06%	0.08%	0.09%	0.06%	0.10%	0.06%
90-Day Treasury Rate	0.00%	0.03%	0.07%	0.08%	0.06%	0.08%	-0.02%
2-Year Treasury Rate	0.15%	0.10%	0.13%	0.12%	0.16%	0.14%	0.45%
5-Year Treasury Rate	0.88%	0.55%	0.45%	0.38%	0.37%	0.28%	0.69%
10-Year Treasury Rate	1.72%	1.27%	1.08%	0.95%	0.83%	0.69%	1.14%
30-Year Treasury Rate	2.43%	2.04%	1.83%	1.69%	1.55%	1.44%	1.78%
3-Mon/10-Yr Treasury Spread	1.72%	1.24%	1.01%	0.87%	0.77%	0.61%	1.16%
2-Yr /10-Yr Treasury Spread	1.57%	1.17%	0.95%	0.83%	0.67%	0.55%	0.69%
6-Month CD Rate	0.18%	0.20%	0.19%	0.27%	0.28%	0.31%	0.57%
1-Year CD Rate	0.33%	0.35%	0.34%	0.40%	0.41%	0.45%	0.83%
2-Year CD Rate	0.37%	0.38%	0.39%	0.44%	0.45%	0.48%	0.86%

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