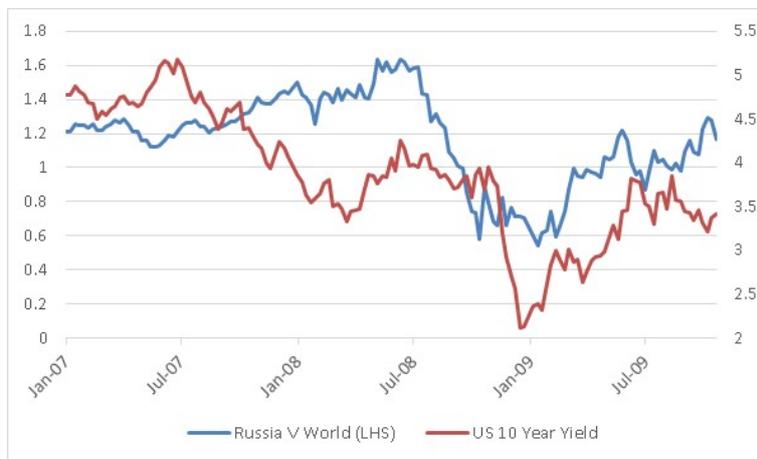


EMERGING MARKETS AND US BONDS



One of the most fascinating things about markets is how the relationship between different asset classes can vary over time. Does the steep fall in the long dated bond yields mean the Federal Reserve is going to remain accommodative for much longer than expected, which is bullish for emerging markets, or does it mean that global growth is slowing which is bearish for emerging markets?

As there are two possible interpretations, the market often initially interprets lower bonds yields as bullish, before changing its mind and crashing equities lower. A recent example was the Russian market which massively outperformed world markets in early 2008, before crashing lower in the second half of the year.



In my view this also occurred in 1997, when lower US bond yields drove a rally in Hong Kong shares before the property market crashed.



The above graph shows even more clearly that declining bond yields in 1995 and early 1997 were associated with rallies in the Hang Seng Index. As Hong Kong ran a fixed exchange rate with the US, lower bond yields were associated with looser monetary policy and was bullish for the property sector, which was the main driver of the economy.

Recent falls in US bond yields have again led to a substantial rally in emerging markets. This in my mind has created a similar pattern to how markets behaved in 1997.



However despite the move in US bond yields we have not seen any change in the Hibor/Libor relationship that I detailed in my note – [Hong Kong Property](#).



I produce below a magnified version for recent moves.



This seems to me that markets have interpreted lower bond yields as a good reason to buy cyclical assets, just when yields are signalling that an Asian led growth slowdown is coming. For investors with the ability to short, the risk reward of shorting Hong Kong Property looks good to me.

## INFORMATION

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