The StockCharts.com Market Message

Featuring our commentators, John Murphy and Arthur Hill

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WEAK DOLLAR HELPS BOOST EMERGING MARKETS -- EM CURRENCIES AND STOCKS ARE RISING TOGETHER -- THIS ISN'T A COMMODITY STORY -- IT'S A TECHNOLOGY ONE -- TECHNOLOGY STOCKS IN ASIA ARE DRIVING THE EM RALLY -- FALLING TREASURY YIELDS ARE ALSO HELPING -- THE EM RALLY MAY DEPEND ON DOLLAR AND TREASURY YIELDS STAYING DOWN

By John Murphy

FALLING DOLLAR BOOSTS EMERGING MARKET CURRENCIES... One of my recent messages explained that a weak dollar was contributing to money flows into foreign markets. That's because American investors get the dual benefit of rising foreign currencies as well as stocks. That's been especially true in emerging markets. A weak dollar is generally good for that asset class. Chart 1 compares the trend of the **U.S. Dollar Index** (green line) to the **WisdomTree Emerging Currency Fund (CEW)** over the last decade. It's clear that they trend in opposite directons. The dollar rally from 2011 through the end of 2015 resulted in lower EM currencies. The Dollar Index peaked at the end of 2016, while the CEW bottomed at the start of that year. [Weakness in European currencies kept the dollar up during 2016]. This year, however, a falling dollar has contributed to rising foreign currencies in both developed and emerging markets. While the Dollar Index has lost 7% during 2017, higher-yielding emerging currencies have gained 8% which is more than most developed market currencies. [The Mexican peso has gained 19%, while currencies in South Korea and Taiwan are EM leaders]. That's attracted funds into emerging market stocks.

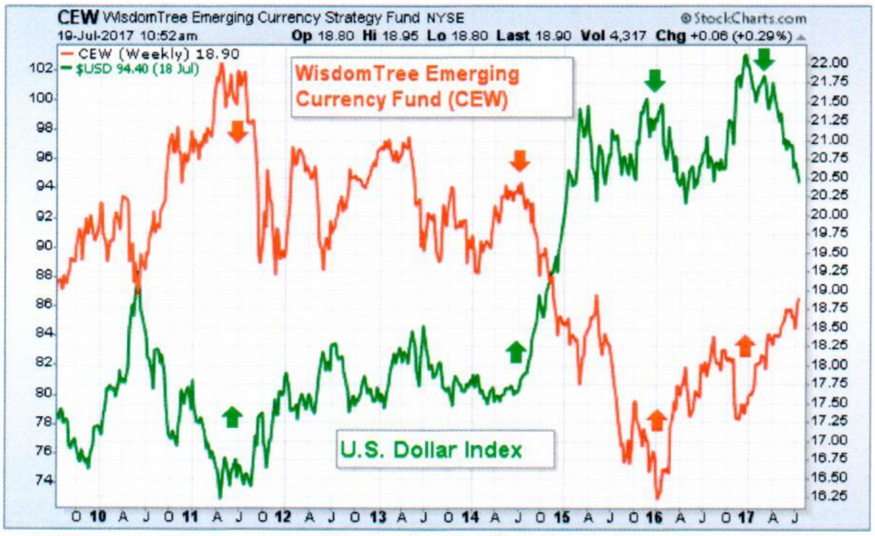

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Chart 1

EMERGING STOCKS AND CURRENCIES ARE RISING TOGETHER... Emerging currencies and stocks generally trend in the same direction. Chart 2 shows them bottoming together at the start of 2016 and rising together. Not only have emerging currencies outpaced G10 currencies since that bottom, EM stocks have done better than the rest of the world. The ratio on top of Chart 2 shows **Emerging Markets iShares (EEM)** outpacing the **FTSE All World Stock Index ($FAX)** since the start of 2016 by a better than two to one margin (38% versus 18%). The red bars also show the EEM clearing its 2014 peak to reach the highest level in six years. Another attraction of emerging market assets is that they pay much higher yields than the developed world. That's a big plus in a low-yield environment. In the past, emerging markets were largely driven by trends in commodity markets because many of them are commodity exporters. This time has been different. Weak commodity prices have not been the driving force behind the current emerging rally. Most of the credit goes to the boom in technology stocks. And that's partially tied to falling Treasury bond yields.

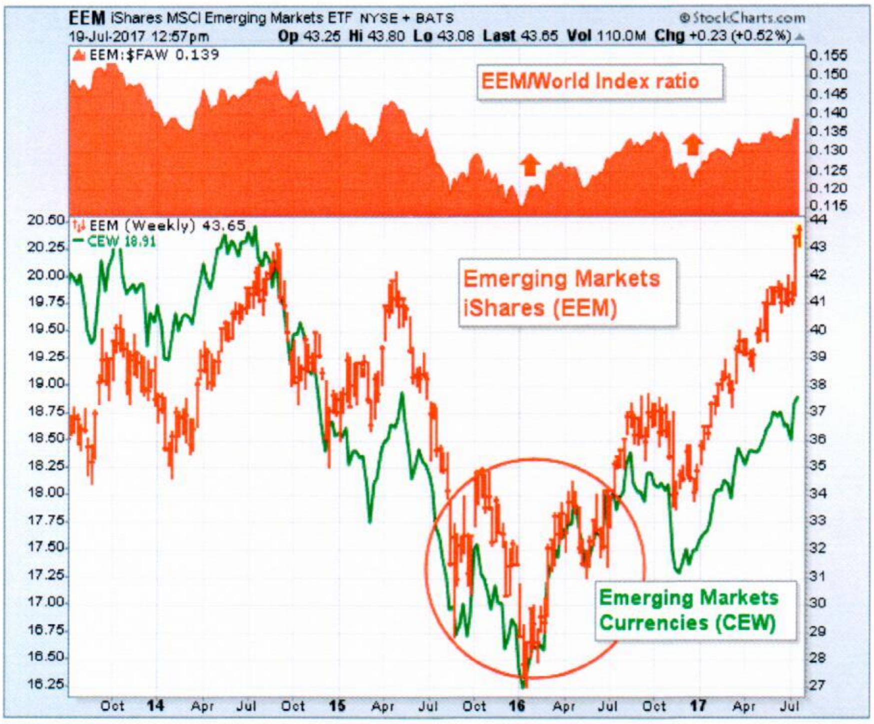

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Chart 2

EMERGING MARKETS ARE BEING DRIVEN BY TECHNOLOGY... Chart 3 shows a close correlation between **Emerging Markets iShares** (red line) and a relative strength ratio of **technology stocks divided by the S&P 500** (histogram bars). After rising together during 2016, they pulled back together after last year's presidential election before resuming their uptrend during 2017 (more on that shortly). More than half of the EEM (55%) comes from three Asian countries -- China (mostly Hong Kong) 27%, South Korea (15%), and Taiwan (12%). And that's where the biggest stocks in the EEM are located. The four biggest EEM holdings are **Samsung Electronics (South Korea), Tencent Holdings and Alibaba (Hong Kong), and Taiwan Semiconductor**. Six of the top ten EEM are in technology. So it's little wonder that technology is a main driver in emerging markets, and Asia in particular.

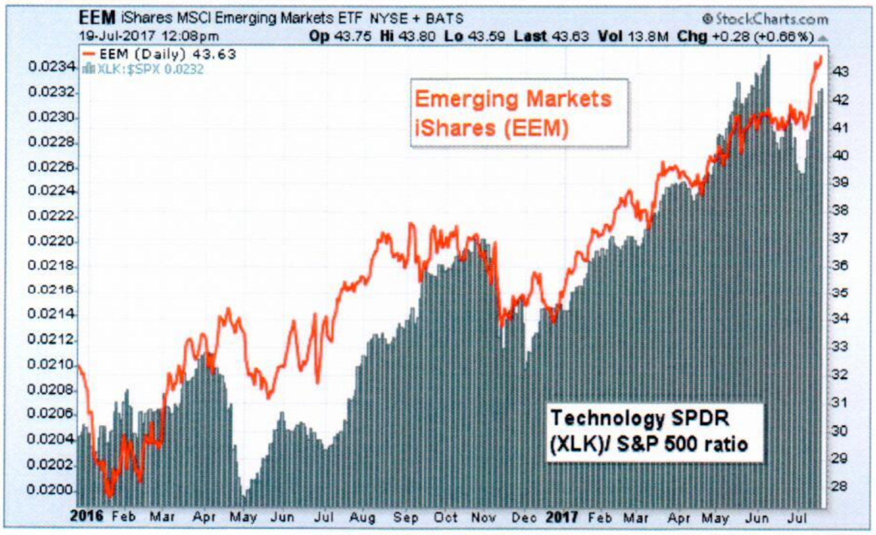

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Chart 3

LOWER TREASURY YIELDS ARE ALSO HELPING... My message from last Friday (July 14) showed that technology stocks have tended to show relative strength when Treasury yields drop, and relative weakness when yields rise. Chart 4 again demonstrates that over the last year by comparing the **10-Year Treasury yield** (green bars) to a **relative strength ratio of technology stocks (black line)**. The thin read line represents the EEM. The chart shows that the last two spikes in the TNX last November and this June caused profit-taking in technology stocks (a falling ratio). It also caused a November slide in the EEM and a June consolidation. This week's pullback in bond yields has helped lift technology performance. And that in turn helped push emerging markets to new highs. So here's the dual message. A falling dollar is helping drive global funds into emerging markets. Low Treasury yields are helping support technology stocks which, in turn, are also boosting Asian emerging markets. All of which suggests that the rally in emerging markets may depend on the dollar and Treasury yields staying down and tech stocks up. At least until commodity markets start rising.

(click to view a live version of this chart)

Chart 4

QQQ HITS NEW HIGH... Chart 5 shows the **PowerShares QQQ** hitting a new record high to resume its uptrend. The QQQ/SPX ratio on top of the chart shows the QQQ showing leadership again. That's coming mainly from big technology stocks. MACD lines (below chart) have turned positive. Small cap stocks are also hitting new records as is the S&P 500. The July rally continues.

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Chart 5

Books and Instructional Videos by John Murphy