Korean equities and US treasury yields

STOCK MARKET

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The tapering of quantitative easing continues in the U.S. as the Federal Reserve decided to reduce its monthly asset purchases by $10 billion to $65 billion at January's Federal Open Market Committee meeting.

The size of asset purchase would not matter much to investors, be it $65 billion or $85 billion.

What matters more is that January's tapering decision is sending a signal that QE days are numbered until the end of this year. If the Federal Reserve keeps up the pace — in other words, $10 billion monthly asset purchase reductions are implemented at each of the seven remaining FOMC meetings this year — QE will be over by the end of 2014.

The question is whether the Federal Reserve will skip an FOMC meeting without a tapering decision and whether it will stick with its plan to keep the federal funds target rate at 0.25 percent after the end of the bond-buying program.

The U.S. Treasury yields are a proxy indicator of the tapering decision impact on emerging stock markets. Will the Korean stock market find a stable footing and go higher? We think the answer lies in the sustainability of the U.S. Treasury yields.

The emerging market volatility touched off by January's FOMC signifies a money rotation into U.S. Treasury bonds.

Since December's tapering decision, global fund managers have been strengthening their short positions on U.S. Treasury bonds with considerable leverage. There are fundamental reasons why the U.S. Treasury yields have to rise.

First, the tapering effectively eliminates Treasury buying demand worth $45 billion a month. Also, an optimistic outlook on the U.S. growth (the U.S. economy is expected to grow 2.9 percent in 2014 and 3 percent in 2015) and expectations on the federal funds target rate (a rate hike is considered to be only a matter of time) support higher bond yields going forward.

December's non-farm payroll only increased by 75,000 in the wake of a cold wave. Treasury yields began to decline contrary to the market's expectations.

Leveraged short investors began running for cover and pulling money out of emerging market equities. The KOSPI felt the fallout, falling below the 1,900 mark in early February. We think the whole episode was only a blip.

Poor U.S. economic data in late 2013 and early 2014 were mostly weather-related. The decline in the U.S. Treasury yields will not likely form a trend, given the directions of U.S. inflation and economic growth.

The crisis in Ukraine is triggering flight to safe-haven assets again, pushing the 10-year U.S. Treasury yield back down to 2.6 percent.

We think this is just a temporary blip. Even if the crisis in Ukraine aggravates further, the subsequent rise in global energy prices and inflationary expectations will create upward pressure on the U.S. Treasury yield.

On the other hand, if the situation eases, the flight to safe-haven assets (U.S. Treasuries) will abate, sending interest rates higher.

The Ukrainian crisis gives some people a flashback to the Jasmine Revolution that swept through the Middle East and North Africa (MENA) in early 2011. At that time, the political uncertainty in the MENA region drove up global oil prices and sent global stock markets spiraling down.

The current crisis in Ukraine is different. Even if the situation deteriorates further, oil prices will not likely rise as they did in 2011 when the WTI shot up more than 20 percent on a year-on-year basis.

Back then, commodity prices rose faster because of QE2 amid worries of another global economic downturn. This time, however, such worries about the global economy or any aggressive tapering move by the U.S .Federal Reserve in March are not warranted because chances are slim that global inflation will pick up in the short run. Therefore, the KOSPI is more likely headed upward, rather than downward.

Every tapering event (FOMC statements and minutes releases) triggered emerging market crisis jitters. Back in the mid-1990s when early signs of the Asian financial crisis began emerging, emerging market equities' pullback coincided with the U.S. interest rate hike cycle.

What is ECB going to do?

GLOBAL ECONOMY

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The diagnosis is clear. The eurozone is the economic region in the world with the slowest growth and the highest unemployment rate.

At the same time, the rate of inflation is far below the level deemed necessary to ensure stability, credit is not growing and financial fragmentation persists. Given that the eurozone is one-fifth of the global economy and an important consumer market, the whole world is asking if one should expect any policy action to stimulate growth.

The possibility of a fiscal expansion is virtually zero, so the only hope lies with the European Central Bank (ECB), which could adopt some exceptional measures.

There is some good news: the GDP growth jumped to 0.3 percent during the fourth quarter of 2013, up from 0.1 percent in the third quarter, an increase above expectations.

France, Germany and the peripheral economies grew above the majority of forecasts, with Italy's economy starting to expand, Portugal growing at a pace of 0.5 percent and Spain at 0.3 percent.

The improvement could lessen the pressures on the ECB to find additional ways of stimulating the economy, but the reality is that they are not a guarantee of future growth, at least in sufficient quantity to reduce the two main imbalances afflicting most of the area's economies: high unemployment and high debt levels.

The ECB has two additional reasons for not being complacent: the danger of deflation and the continuing problems of monetary policy transmission, i.e. the fact that historically low long-term rates are not leading to better credit conditions for businesses.

We expect, along with many analysts, that the ECB will announce additional measures at the March meeting of its Governing Council.

Inflation expectations are falling from the current core measure of 0.7 percent, down from 0.8 percent in December 2013, which is the smallest rate since the monetary union was created.

The effects of declining prices on consumer decisions are well-known: purchases are postponed with negative consequences for aggregate demand and employment.

But the worst effect of deflation has to do with increasing the burden debt on the private and public sectors. The negative effect of declining prices on debt takes place when the rate of inflation is below the one expected when the debt was contracted. And the inflation rate now is significantly below the average of the last 10 years, close to the 2 percent target assumed by the ECB.

This deflationary dynamic will have devastating consequences in the peripheral economies, which have low inflation and a high level of both private and public debt.

The risks of a "Japanization" of the eurozone may be aggravated if credit growth in the Southern economies continues being anemic and if the divergence of interest rates is not reduced. For similar businesses and for homogeneous credit operations, Spanish and Italian companies pay more than 3.5 percent above comparable French or German companies.

All these elements should lead the ECB to avoid thinking it has already done its job. The ECB reacted to the severity of the crisis later than the Fed or the Bank of England, and in a less aggressive way.

Moreover, the problem of the tight coupling between sovereign debt and banking crisis has become a severe one. In fact, eurozone banks have to undergo several tests on the quality of its assets before the ECB itself assumes the task of bank supervision in the context of the newly created European Banking Union.

If these tests do not provide sufficiently favorable results we could witness again within the eurozone some episodes of financial stress that may delay the expected economic recovery even more.

INSIGHT

Open talent economy: People in borderless workplace

CONSULTING

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Each generation thinks it is living in an era of unprecedented change. They may all be right. What sets today apart is the pace and complexity of change.

Leaders see trends rushing by, and they're constantly making choices: Where should we invest? Which should we ignore? Even a moment's reflection can be enough to miss a critical inflection point.

When it comes to talent, however, few organizations take that dynamic view. They have traditionally treated it as an expense, a static item to be monitored on the debit and credit columns of a balance sheet.

Now, organizations are shedding this myopia. They're starting to treat talent as an investment that helps them realize business objectives.

An array of megatrends is driving this shift. Changes on a global scale have upended all those familiar patterns, and talent and employers now seek each other out, on more equal terms, from anywhere in the world.

The evolving workforce is a mixture of employees, contractors and freelancers, and increasingly people with no formal ties to your enterprise at all, otherwise known as "the crowd." Harvard Business Review estimates 1.3 billion people will work virtually in the next few years — almost one in five people living today.

Today, people move more freely than ever from role to role and across organizational and geographic boundaries. Global markets and products, driven by rapid innovation and post-digital disruption, demand a dynamic talent model that can be rapidly configured and reconfigured. Businesses expect agility, scale, and the right skills to be available faster than ever — even in real time.

Welcome to the open talent economy — a collaborative, transparent, technology-enabled, rapid-cycle way of doing business. What the open source model did for software, the open talent economy is doing for work.

Some sources of open talent can be free. Others involve accessing the crowd and paying for their ideas. What's important is that in this new economy, access to talent is more important than ownership of talent.

Instead of needing a good reason and signatures in triplicate to cross an internal barrier, an open talent organization needs a good reason to erect a barrier in the first place.

Barriers between organizations become permeable as well and give way to a borderless workplace. If today's employees occupy less sharply defined places in your structure, you may find some of tomorrow's employees on someone else's balance sheet, likely as not, their own balance sheets.

Because there are fewer ties to keep a person from walking out the door, organizations can't ever rest in recruiting, developing, or managing their talent and leadership. Once, barriers kept people in. Today, a sense of organizational magnetism has to draw people in.

The open talent economy is not a fad, nor is it a reaction to an era of change. It's part of the change. Personal mobility, connected markets, social media, mobile technology, and analytics are already the global forces that affect virtually everyone in every industry. Doing business as if these forces didn't exist would be like operating by gaslight.

This means it's time to reframe the way we think about talent once again. We can no longer view talent as a business expense. It's an asset and should be managed as a strategic investment that can help supercharge performance through the business ecosystem.

Like any investment, you must have a plan to engage and deploy. And, of course, you must measure the process. Only then can you determine the return you've earned. Only then can you adjust the course for continuous improvement.

The open talent economy needs leaders who can manage complex ecosystems in real time. It gives leaders the vision to see change coming when they can, roll with it when they can't, and never settle for just reacting to it.