Dying is easy; comedy is hard.
-- actor Edmund Kean on his deathbed (1833)

Remember when Microsoft was a growth stock? I know ... you've got to go back a loooong way for those heady days, but once upon a time investing in Microsoft was dominated by a growth Narrative. As was investing in Cisco and Oracle and every other tech stock that eventually grew up into mega-cap value adulthood.

Apple is the most recent casualty of this transition from a growth Narrative to a value Narrative. Two years ago the investment story around Apple was how fast they were expanding in China and the potential of the tablet and smartphone market. Today the story is around activist value investors and their pressure on Apple to return cash to shareholders. A transition to a value Narrative doesn't mean that Apple stock can't work, but it does mean that it is unlikely to ever work as well as it did under a growth Narrative. Why? Because being a cheap stock is easy. There are LOTS of cheap stocks out there, most of which are not tech stocks. So long as Apple is just another cheap stock and must depend on a critical mass of value investors speaking the same language to each other, most of whom are not particularly comfortable with tech stocks and tech company management in the first place ... well, good luck getting back to $700 on that. On the other hand, being a growth stock, particularly a large-cap growth stock ... now that's hard. And to be a mega-cap growth stock, like Apple used to be, is the rara-est avis of them all, which is why Apple dominated hedge fund portfolios and US index returns for so long.

For the past 20+ years, Emerging Markets have been the functional equivalent of large-cap growth stocks. We all know that Emerging Markets have been dreadful investments of late, but that's not what interests me. Stocks go up and stocks go down, and growth stocks tend to go up and down more than most. **What is very interesting to me, however, is the degree to which the core Narrative around Emerging Markets is shifting away from growth and towards value.**

The central tenet of Emerging Market investment beliefs for the past several decades - that there is an engine for superior growth rates within all of these countries relative to the Developed Markets – is being questioned publicly today to a degree that I've never seen before. Even in the depths of the various Emerging Market crises of the past, regardless of the epicenter or proximate cause, there was little or no public questioning of the core belief. Yes, Thailand or Mexico or Russia or [fill in the blank] might be having a hard time of it today, and yes, the contagion effects might be quite troubling in the short to medium term, but no one ever questioned the "fact" that there was an inherent growth STORY in all of these countries, and that with a little help from the West and a greater embrace of pro-market reforms each of these countries could resume that course of superior relative growth.

The alternative Narrative, which I see growing in power daily, is that Emerging Market growth rates are a function of Developed Market central bank liquidity measures and monetary policy. That all Emerging Markets are, to one degree or another, Greece-like in their creation of unsustainable growth rates on the back of 20 years of The Great Moderation (as Bernanke referred to the decline in macroeconomic volatility from accommodative monetary policy) and the last 4 years of ZIRP. That some Emerging Markets may still largely control their own economic growth destiny (and so are cheap from a relative value perspective), but that in some others - most notably India and Indonesia - the growth story is **broken**, and it is not within their power to fix it.

I don't pretend to know the "truth" here about the historical sources and future outcomes of Emerging Market growth rates. I'd **like** to believe that the Emerging Market growth Narrative is true. I'd **like** to believe that there's an arrow to human economic progress, and that it goes up and to the right. But I don't **know** that this is true. Frankly, I don't think anyone does. But I do know something about what happens to patterns of market behavior when long-held Narratives and Common Knowledge structures shift. If the Emerging Market growth Narrative breaks down, there will be an earthquake. Not an earthquake in terms of crashing markets (or at least not necessarily), but in terms of historical investment correlations tumbling, money flows and currency pairs going haywire, and wrong-footed portfolios being knocked to the ground.

I'll be watching the Emerging Market growth Narrative closely over the next several weeks and months for further signs of deterioration, and I expect the first resumed weekly Epsilon Theory note of September 8th to be a more fully-formed exposition of this email.

All the best,
Ben

****
W. Ben Hunt, Ph.D.

269 Newtown Turnpike
Redding, CT 06896
****