Turkish Turbulence Triggers Global Tremors

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- Trade tensions have ratcheted up, sending the post-2004 Turkish lira spiraling to a record low.
- Global risk assets, especially emerging markets, fell in sympathy.

Trade tensions ratcheted up after President Donald Trump authorized the doubling of steel and aluminum tariffs on Turkey as a consequence of a diplomatic impasse over an imprisoned U.S. citizen. Consequently, the new post-2004 Turkish lira spiralled downward, hitting a record low versus the U.S. dollar and most other currencies. The lira has since recovered somewhat. However, it remains down approximately 40% for the year, while bond yields have shot up (yields move inversely to prices) and foreign currency reserves have contracted—pushing Turkey closer to the brink of a financial crisis. Global risk assets fell in sympathy, with protracted declines in emerging markets. On Wednesday, August 15, 2018, Turkey retaliated, doubling import taxes on U.S. goods. On Thursday, the lira rallied after Qatar announced a $15 billion funding package for Turkey.

The situation in Turkey has rekindled concerns about the eurozone's financial sector, sparking a selloff in bank stocks due to their exposures to Turkish loans. Europe's biggest lenders have skin in the game, and regulators have warned that increased weakeness in the Turkish lira would lead to defaults on foreign loans. A weaker currency exacerbates conditions by making it more difficult for indebted Turkish companies to pay back loans denominated in foreign currencies. Turkish banks have to service roughly $7.6 billion in bonds by the end of next year.

Our View

Turkey represents only 1.5% of global gross domestic product and accounts for 0.8% of global equity-market capitalization (based on its representation in the MSCI ACWI Index). While Turkey's crisis may be rippling through global markets, we do not foresee a major lasting disruption.

Issues of this nature serve as valuable reminders of the importance of diversification. We believe that a diversified approach to portfolio construction can help limit the fallout from country- and region-specific shocks. It's therefore important that investors carefully consider all investment options and make selections that suit their individual needs and goals.

Background

Turkey's financial troubles predated the recent tariff threats; these were just the so-called straw that broke the camel's back, sending the Turkish government into crisis-management mode. President Recep Tayyip Erdogan won re-election in late June, enabling him to consolidate his grip on Turkish institutions with new policymaking powers due to a 2017 constitutional referendum. He has demonstrated a disinterest in central-bank independence and tended to favor policies that prioritize domestic investment over financial stability. As a result, Turkey faces a high level of foreign debt, a large current-account deficit, and rising borrowing costs—all of which threaten to undermine Turkey's financial system and economy.

U.S. banks' total risk exposure to Turkey (that is, claims, derivatives, guarantees and credit commitments) amounted to approximately $33 billion at the end of the first quarter of 2018, according to the Bank for International Settlements. U.S. banks have about 0.5% of their total foreign claims at risk in Turkey.

Our Portfolios[1]

SEI's Emerging Markets Debt Fund held small overweights to Turkish debt and underweights to the Turkish lira.

The SGIF Global Select Equity, SGMF European (Ex-U.K.) Equity Funds held small off-benchmark positions in Turkey.

As for benchmark exposure, a 50/50 blend of the JP Morgan EMBI Global Diversified and JP Morgan GBI-EM Global Diversified Indexes held just over 4% in Turkish debt including 2.5% lira exposure as of July 31, 2018. Turkish companies made up roughly 0.70% of the MSCI Emerging Markets Index and 0.08% of the MSCI World Index.

Fund Name	**Fund Exposure to Turkey (%)**	**Benchmark Name**	**Benchmark Exposure to Turkey (%)**
SGIF Global Select Equity	0.32	MSCI World Index	-
SGMF Emerging Markets Debt	5.51	50/50 JPM EMBI Global Div & JPM GBI EM Global Div	4.21
SGMF Emerging Markets Equity	1.16	MSCI Emerging Markets Index	0.69
SGMF European Ex- UK Equity	0.79	MSCI Europe ex UK Index	-

[1] Fund and benchmark exposures as of 31/07/2018.
Source: SEI Data Portal, Bloomberg

Index Definitions:

MSCI ACWI Index: The MSCI ACWI Index is a market-capitalization-weighted index composed of over 2,000 companies, and is representative of the market structure of 48 developed and emerging-market countries in North and South America, Europe, Africa and the Pacific Rim. The index is calculated with net dividends reinvested in U.S. dollars.

MSCI Emerging Markets Equity Index: The MSCI Emerging Markets Index is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging-market equities.

MSCI World Index: The MSCI World Index is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index consists of 24 developed-market country indexes.

JP Morgan EMBI Global Diversified Index: The JP Morgan EMBI Global Diversified Index is a total return, unmanaged trade-weighted index for U.S. dollar-denominated emerging-market bonds, including sovereign debt, quasi-sovereign debt, Brady bonds, loans and Eurobonds.

JP Morgan GBI-EM Global Diversified Index: The JP Morgan GBI-EM Global Diversified Index tracks the performance of external debt instruments (including U.S.-dollar-denominated and other external-currency-denominated Brady bonds, loans, Eurobonds and local-market instruments) in the emerging markets.

Important Information

Data refers to past performance. Past performance is not a reliable indicator of future results.

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