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GLOVISTA INVESTMENTS

Glovista Global Perspectives

This Issue:

Global Perspectives P.1

Emerging Markets Perspectives P.7

Risk Markets Consolidate Q1 Gains on Weaker Growth Concerns and Positioning; Weaker US$ Trend Awaits Improved Eurozone Activity Outlook and Brexit Resolution

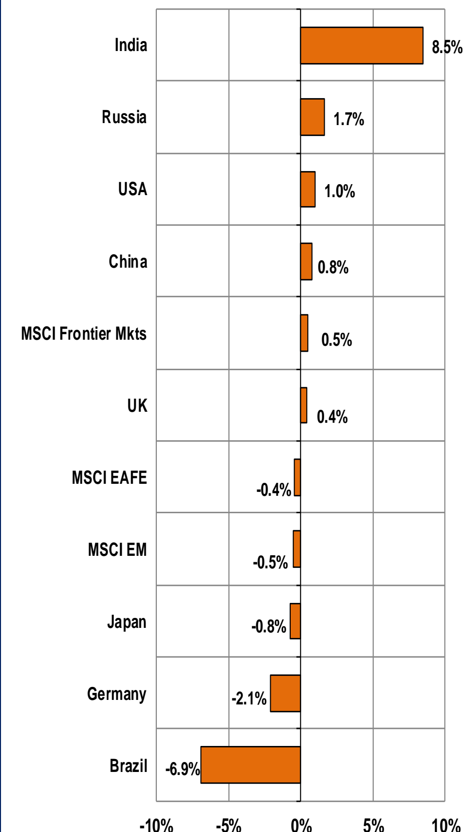
In March, global markets have consolidated this year's unusually strong first quarter price gains (Figure 1). We view the March return performance as a consolidation period likely to be followed by continued price gains in risk markets over the coming months. Specifically, we view the March price action in risk markets, including a considerable pullback in prices of key international equity indices and global financial stocks (including in the USA), as the result of investor concerns over the global economic outlook in the balance of the year following the first quarter's soft patch period as well as the role exerted by global risk indices' short-term overbought conditions.

We discuss immediately below a number of recent economic and policy developments fueling such concerns as well as our investment themes in the face of recent developments.

March Manufacturing Sector Data Underwhelms, Fueling World Economic Outlook Concerns: Role of Calendar Effects, US Government Shutdown, Brexit Definition Period and Unresolved Trade Frictions

In March, the global manufacturing sector calendar was uniformly weaker than expected by the consensus across most of the world's principal regions. Figure 2 illustrates the continued decline recorded by the global manufacturing sector in March. In our view, the March downturn in manufacturing sector momentum is the result of an unusual combination of adverse factors, including an unusually cold winter in the northern hemisphere, the longest US government shutdown period in history, business sentiment effects stemming from unresolved trade frictions between the US and Europe/China, as well as the undefined status of, the soon to be defined, Brexit.

Country-wise Monthly Performance in USD terms (March 2019)*



Source: MSCI & Bloomberg

**As of March 28th, 2019*

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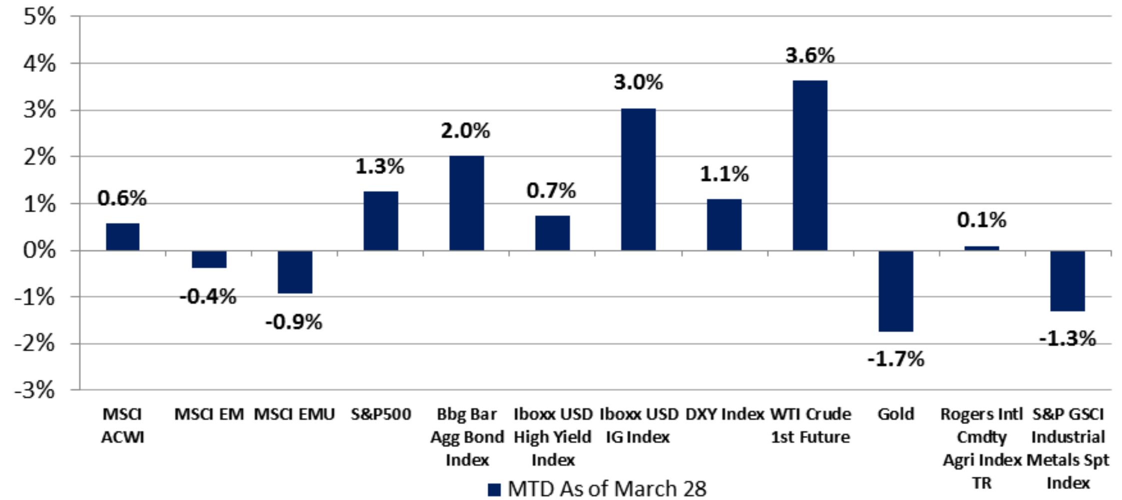
S&P500 Monthly Sector Performance – March MTD 2019*		
Sectors	% Change	FY1 PE Ratio
Energy	2.14%	18.9
Materials	0.18%	16.1
Industrials	-2.23%	16.0
Cons Disc	3.41%	20.7
Cons Stap	2.96%	19.1
Technology	3.74%	19.2
Healthcare	-0.82%	15.9
Financials	-3.06%	11.5
Utilities	2.03%	18.7
Telecom	2.10%	16.7
Real Estate	4.59%	42.8
S&P500	1.11%	16.9

*As of March 28th, 2019

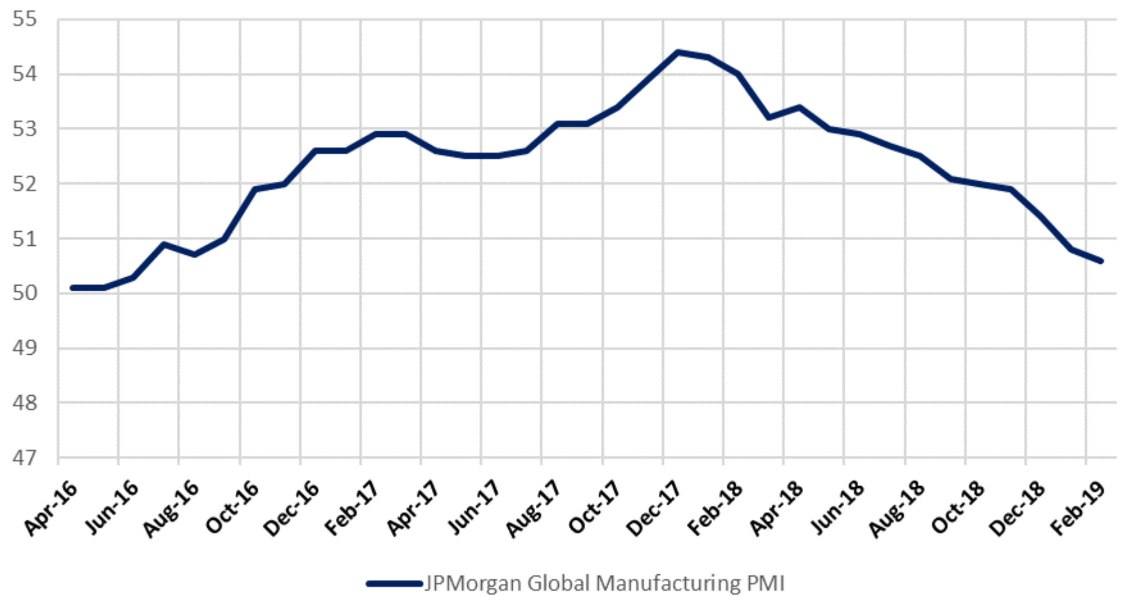
Source: Bloomberg

Figure 1. Global Markets Consolidate Return Performance in March, with Lagged Performance by International Markets



Source: Bloomberg, Glovista Calculations

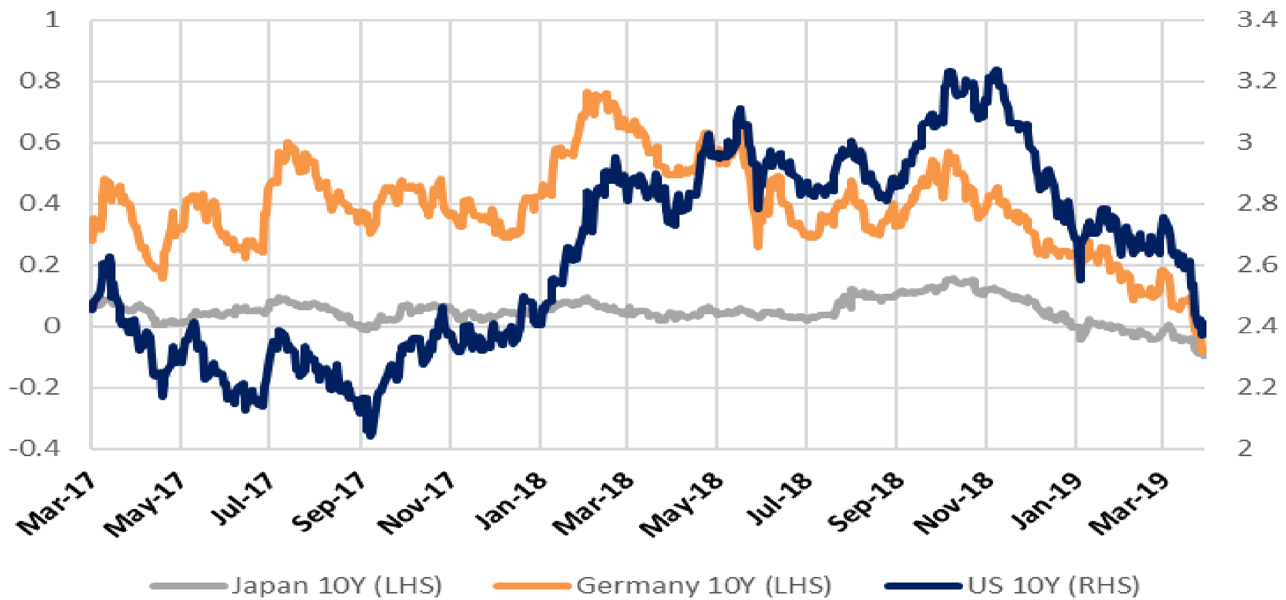
Figure 2. Global Manufacturing Sector Decelerates Further in March, Impacted by Calendar Effects, US Government Shutdown, Unresolved Trade Frictions



Source: JP Morgan

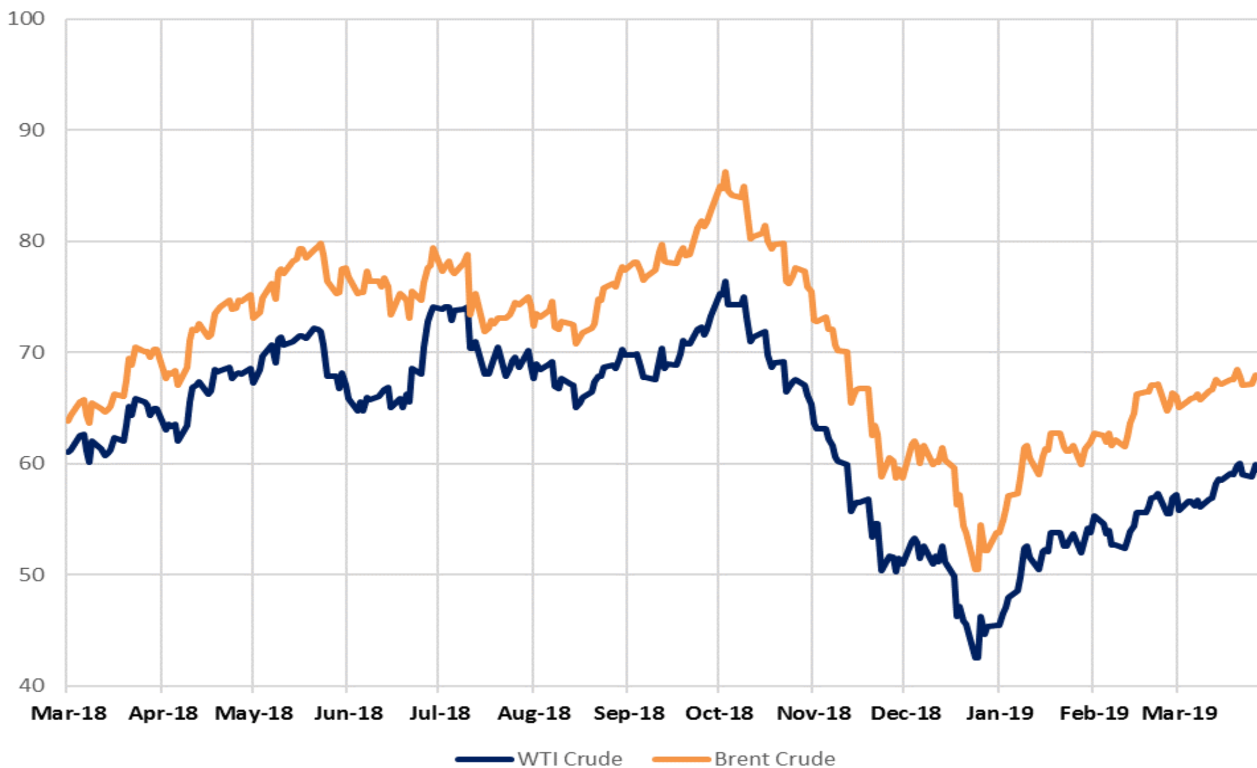
The release of weak March manufacturing sector activity figures unfolded around the same time of key scheduled G3 central bank meetings in which those institutions put forth downward economic growth revisions for 2019 and 2020. Such events included central bank meetings in the US, the Eurozone, Japan, Australia and New Zealand. In the U.S., the March 20th FOMC meeting proved especially momentous for global bond markets because at said meeting the US Federal Reserve affirmed its new "average inflation" targeting approach whereby a larger tolerance to short- and medium-term inflation overshoots will be in effect. In the process, the FED also signaled to markets their decision not to hike its Federal Funds policy rate in the remainder of the year.

Figure 3. Developed Global Bond Markets Post Sharp Rally in March on the Back of Dovish Central Bank Meetings and Soft Manufacturing Sector Calendar



Source: Bloomberg

Figure 4. In March, Crude Prices Extend Year-to-date Rally, Fueled by Bullish Supply Data Releases



Source: Bloomberg

The soft March manufacturing sector economic calendar along with dovish central bank meetings combined to fuel a large rally in global bond markets during the month of March, as illustrated in Figure 3. Of interest, the sharp decline in government bond yields was not accompanied by a proportionate decline in inflation expectations – possibly impacted by

resilient energy market price performance during the month, courtesy of bullish supply-demand data releases (Figure 4). As a result, implied real (inflation adjusted) long-term interest rates have declined to the lowest levels since 2017 (Figure 5).

	March 28th 2019	March MTD Change
Gold	1290.41	-1.7%
Silver	15.0145	-3.8%
Oil	59.3	3.6%
EUR	1.1221	-1.3%
JPY	110.63	-0.7%
GBP	1.3044	-1.7%
CHF	0.9956	-0.3%
CAD	1.3438	2.0%
AUD	0.7074	-0.3%
BRL	3.902	3.9%
MXN	19.3395	0.3%

Source: Bloomberg

Rates	March 28th Level
1 Yr CD	1.49%
5 Yr CD	2.02%
30 Yr Jumbo Mortgage	4.18%
5/1 Jumbo Mortgage	3. 66%
US Govt. 10 Year	2.3946%
10 Yr Swap Spread	-0.5%

Source: Bloomberg

Figure 5. US 10 Year, Inflation-adjusted Government Interest Rates Declined to Two-Year Low Levels

Source: Bloomberg

The decline in developed country long-term bond yields, fueled by (a) the FED's re-direction of its inflation mandate to an "average inflation" modality along with (b) the suppression of inflation term premium levels in Europe courtesy of the Eurozone region's unresolved political dynamics (e.g. Spain April elections, May Euro area parliamentary elections, Brexit end-stage process, Italy political developments in the year's second half), have brought about an inversion in the widely monitored 3 month to 10 year segment of the US Treasury curve, for the first time since 2006 (Figure 6).

Figure 6. U.S. Treasury Yield Curve Inverts in 3 Month-10 Year Segment for First Time since 2006, Fueling Recession Risk Concerns Among Investor Community

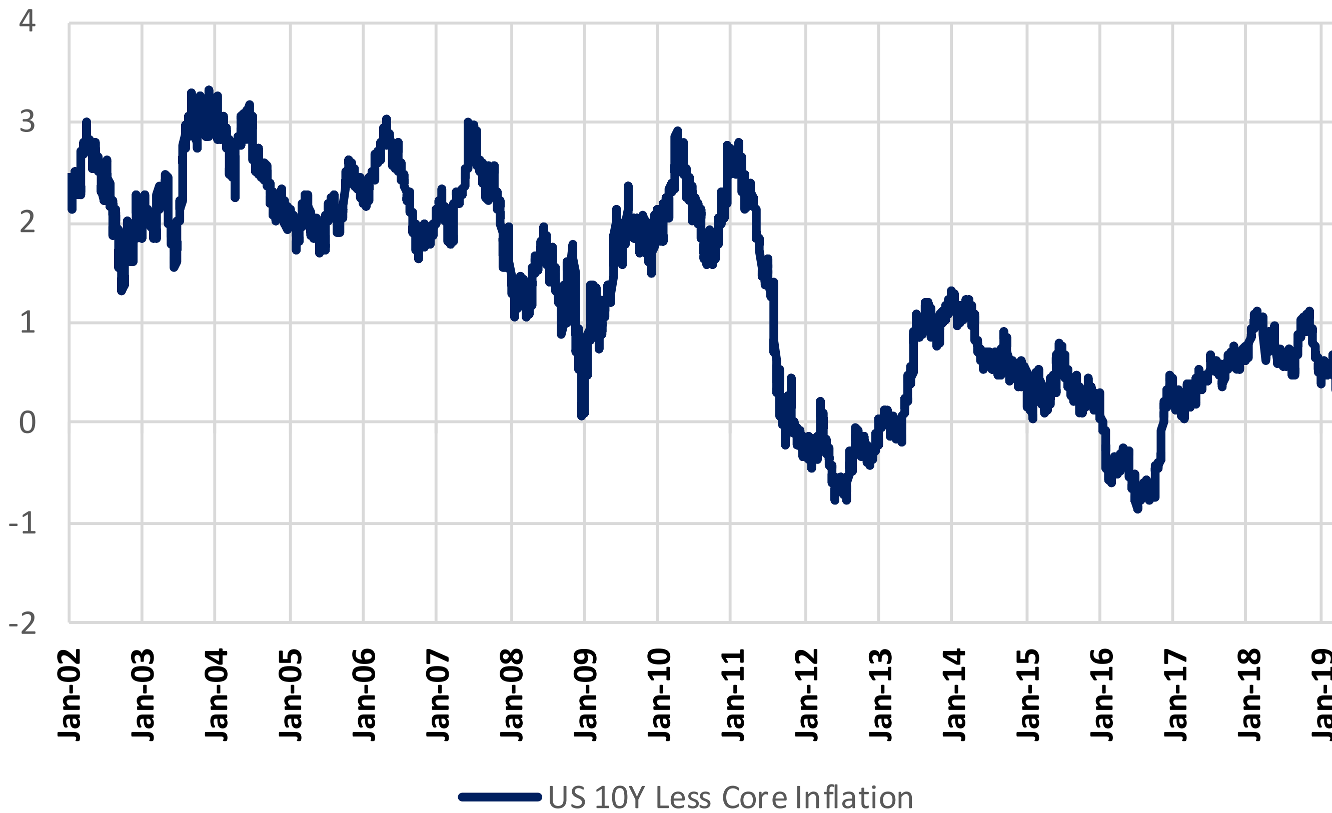
Source: Bloomberg

The Glovista investment team firmly believes global investor concerns over the world economic outlook tied to the recent US Treasury curve inversion are both extemporaneous as well as misguided. We hold such view on the back of several considerations, including the following:

- Historically, the timing of the US yield curve inversion with that of economic cycle and market cycle peaks is one that exhibits a lag of between three and six quarters;

- During the US post-war period, episodes of US yield curve inversion have been associated with periods of excessive tightening of financial conditions as well as large rises in US inflation-adjusted short-term interest rates. Neither of those conditions is present at the current juncture, likely a reflection of the unusual length and nature of the post-2007-2009 economic expansion cycle (Figure 7).

Figure 7. US Real (Inflation Adjusted) Interest Rates Hover at Markedly Lower Levels than in Prior Periods of Yield Curve Inversion

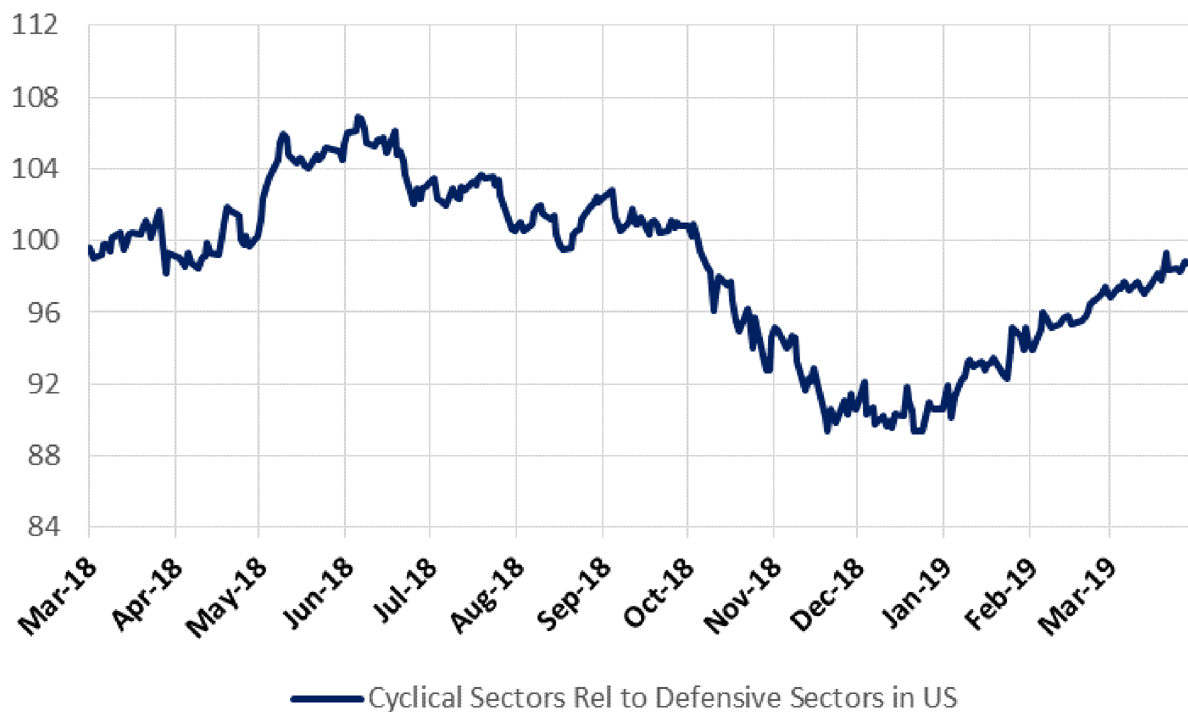


Source: Bloomberg

Besides the two above mentioned considerations, we also find validation of our assessment in the US equity market's internal dynamics. For example, Figure 8 illustrates the US market's continued bullish orientation towards cyclical sector stocks over defensive sector peers.

In the international sphere, it is also instructive to note the continued strengthening of economic growth expectations for the German economy, the one most adversely impacted by last year's crude price collapse (impacting its trading partners in the Middle East), as well as the impact exerted by US-China trade frictions on trade with China, and the adverse impact of Brexit on the German industrial sector's export activities with the UK. Figure 9 illustrates the ZEW Germany expectation of economic growth indicator. Such indicator reinforces our expectation of a medium-term recovery in economic conditions following the soft patch of Q4 2018 and Q1 2019.

Figure 8. US Cyclical Sector Stocks Sustain Outperformance versus Defensive Sector Peers Throughout Recent Period of Growth Concerns among Investor Community



Source: Bloomberg

Figure 9. German Economic Growth Expectations Strengthen in February and March

Source: ZEW

Notwithstanding our constructive medium-term economic outlook, we believe the current stage of the macro cycle is late stage, particularly for the US. In that context, the equity market implications are straightforward, to be discussed in the section immediately below.

Glovista Sustains Bullish US, Emerging Market Equities Barbell Approach along with Short-term US Corporate Debt Exposures

Against the global macro and financial backdrop delineated above, the Glovista investment team sustains its standing global portfolio tilts. Specifically, we continue to favor a barbell approach within global equities, comprised of exposures centered around US and Emerging Market equities. Such index groups carry considerably lower financial sector exposures versus International Developed whose outlook is considerably constrained by the excessive flattening of the government bond curves. In fixed income markets, we continue to favor exposure to short-term maturities owing to valuation considerations while on the credit spectrum, we maintain a balanced exposure between US high yield, senior loans and high-grade debt paper.

Emerging Markets Perspectives

EM Asia Stocks Strongly Outperform Developed and EM Peers in March; LatAm & EMEA Stocks Impacted by Brazil & Turkey Politics; EM Outperformance to Extend in 2019

In March, Emerging Market equities underperformed Developed Market peers, driven by a small number of country specific market unfriendly political developments, impacting Brazil and Turkey. It is particularly impressive that emerging Asia equities outperformed both US and international developed equity peers during the month despite the strengthening US Dollar and weaker than expected global economic calendar released during the period, discussed above.

Figure 10. Emerging Market Currencies Prove Resilient to the US $ Strengthening Period in March

Source: Bloomberg

It is especially impressive and favorable to the Emerging Market equities' return performance outlook for the balance of the year, in both absolute and relative terms, that Emerging Market currencies did not weaken during the month of March despite the adverse global economic and financial environment (Figure 10). We view such resilience as a testimony to the asset class' strengthening fundamental and technical outlook.

As we look back at Emerging Market economies' year-to-date economic calendar, we identify strong signs of stabilization to strengthening momentum in both absolute and relative terms versus developed economy peers. For example, Q1 China economic growth estimates have been raised by the Street on the back of stronger year-to-date industrial production, fixed asset investment expenditure growth momentum as well as signs of bottoming in the country's international trade accounts. In India, composite PMI indicators have come out above consensus estimates these past two months while the monthly trade deficit has narrowed sharply from Q4 2018 levels, all of this despite the higher level of economic volatility associated with pre-election periods. In Brazil, a country undergoing continued high levels of political volatility, retail sales figures have come out above consensus estimates while in Russia, retail sales growth momentum has surprised positively, a sign of domestic demand expenditure strength.

A stronger economic growth momentum for the Emerging Market economies, combined with a sustained decline in asset risk premium levels courtesy of the much-improved tone of US-China trade discussions at the highest level, reinforce our bullish outlook for the asset class in the balance of the year, both in absolute and relative terms versus developed country peers. As we approach the May India election period, we are looking to raise our India country overweight exposure while maintaining overweight allocations to Taiwan and China on the back of cheap valuations and under-ownership status as well as the positive impetus to result from a finalized trade discussion between the US and China.

In Latin America, we recently cut our Chile country exposure to underweight on both profit-taking considerations as well as unimpressive bottom-up company releases. We continue to hold an overweight Russia country allocation on valuation grounds along with an underweight allocation to the Central European and Gulf regions. In the South East Asia region, we favor Indonesia country exposure versus its regional peers, primarily on valuation and ownership level considerations.

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