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Glovista Global Perspectives

This Issue:

Risk Markets Consolidate on Offsetting Macro, Earnings and Geopolitical Developments; Glovista Sustains Value Orientation to Non-US Equities and Intermediate Duration US High Grade Debt

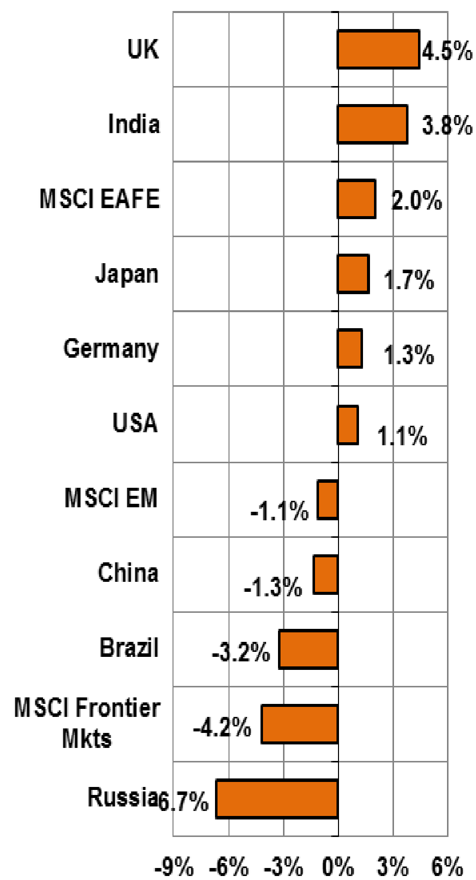
In April, risk asset markets' return performance has diverged significantly across asset groups, as illustrated in Figure 1. For example, global equity prices have bounced following sharp March price declines while bond prices have recorded significant price declines, across both the Developed-Emerging Market and corporate-government sector divides. In addition, the US Dollar has rallied 1.54% since the beginning of April 2018. We discuss below our assessment of the factors underlying the divergence in April monthly return performance across asset classes, followed by an update of our investment strategy views as we look ahead to the balance of the year.

In our view, the unusually broad dispersion in April monthly return performance across asset markets is the result of offsetting macro, earnings and geopolitical developments. Specifically, a number of said developments impacting various asset categories differentially during the month of April included:

- ***Soft Patch in Global Activity Momentum:*** As illustrated in Figure 2, the month of April witnessed an extension of the soft patch in the global macro calendar – especially in the Eurozone region – courtesy of weather and inventory factors along with the impact of adverse base effects tied to the timing of this year's Chinese New Year.

- ***Heightened US Inflation Concerns:*** Figure 3 illustrates the marked rise recorded in US inflation expectations during the month of April. Such rise comes on the back of supply sector-driven investor concerns impacting crude prices along with a steady upward momentum in US employment costs (Figure 4) and an unusually heavy US Treasury auction calendar these past several weeks.

Country-wise Monthly Performance in USD terms (April 2018)*



Source: MSCI & Bloomberg

**As of April 27th, 2018*

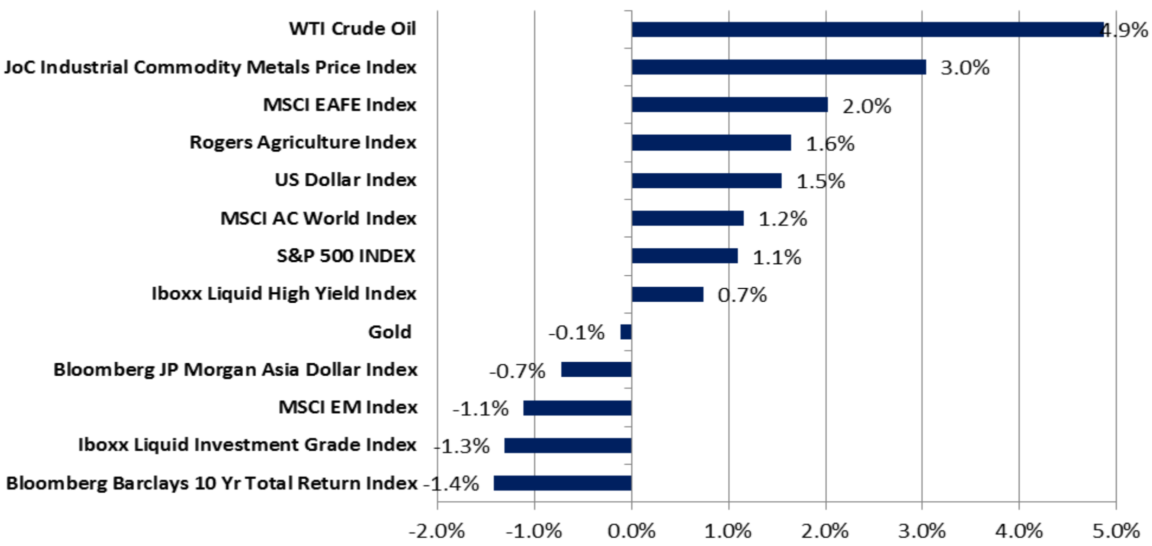
S&P500 Monthly Sector Performance – April MTD 2018*

Sectors	% Change	FY1 PE Ratio
Energy	9.33%	20.7
Materials	1.42%	16.4
Industrials	-1.51%	17.1
Cons Disc	2.66%	20.1
Cons Stap	-3.96%	17.1
Technology	0.54%	17.9
Healthcare	2.73%	15.9
Financials	0.49%	13.3
Utilities	2.34%	16.7
Telecom	0.43%	10.6
Real Estate	-0.38%	38.7
S&P500	1.10%	17.0

**As of April 27th, 2018*

Source: Bloomberg

Figure 1. Risk Market Indices Record Diverging Return Performance in April (As of April 27th 2018)



Source: Bloomberg

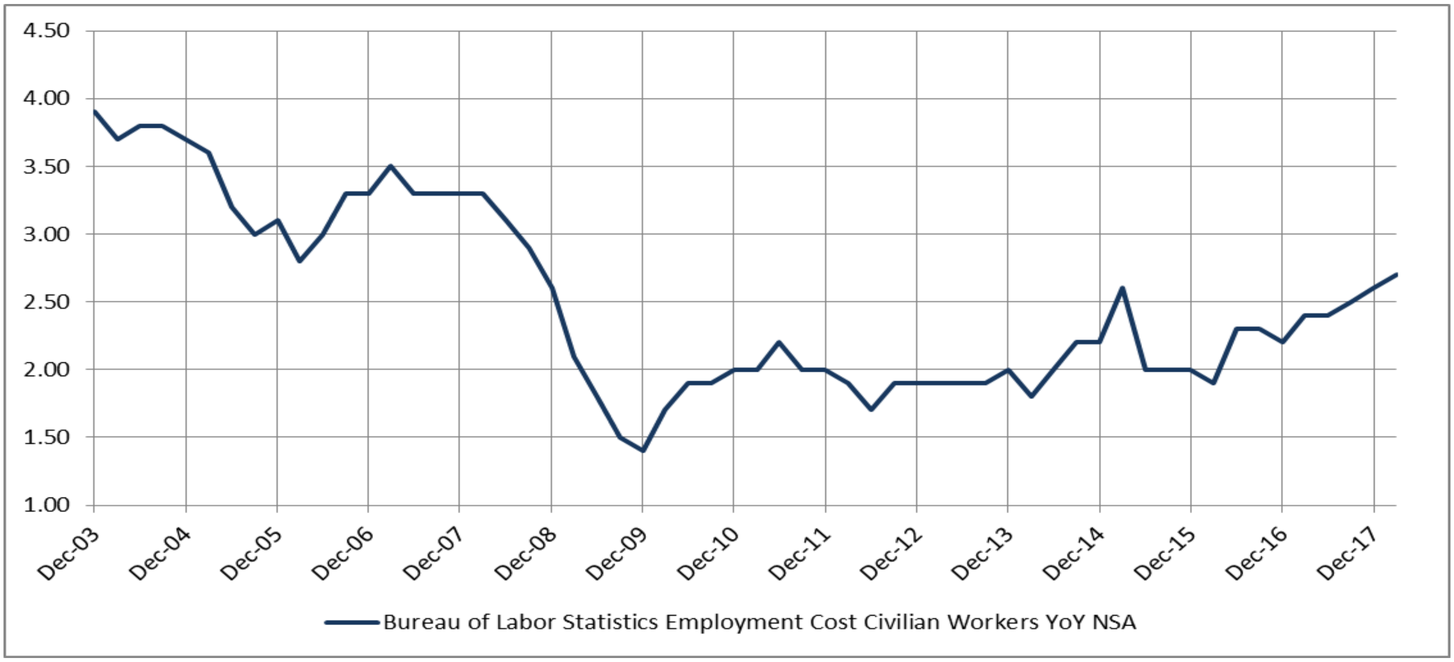
Figure 2. Soft Patch in Macro Calendar Extends in April owing to Transitory Factors

Source: Citigroup

Figure 3. US Inflation Expectations Edge Higher in April on Resilient Energy Price Strength and Upward Labor Cost Momentum

Source: Bloomberg

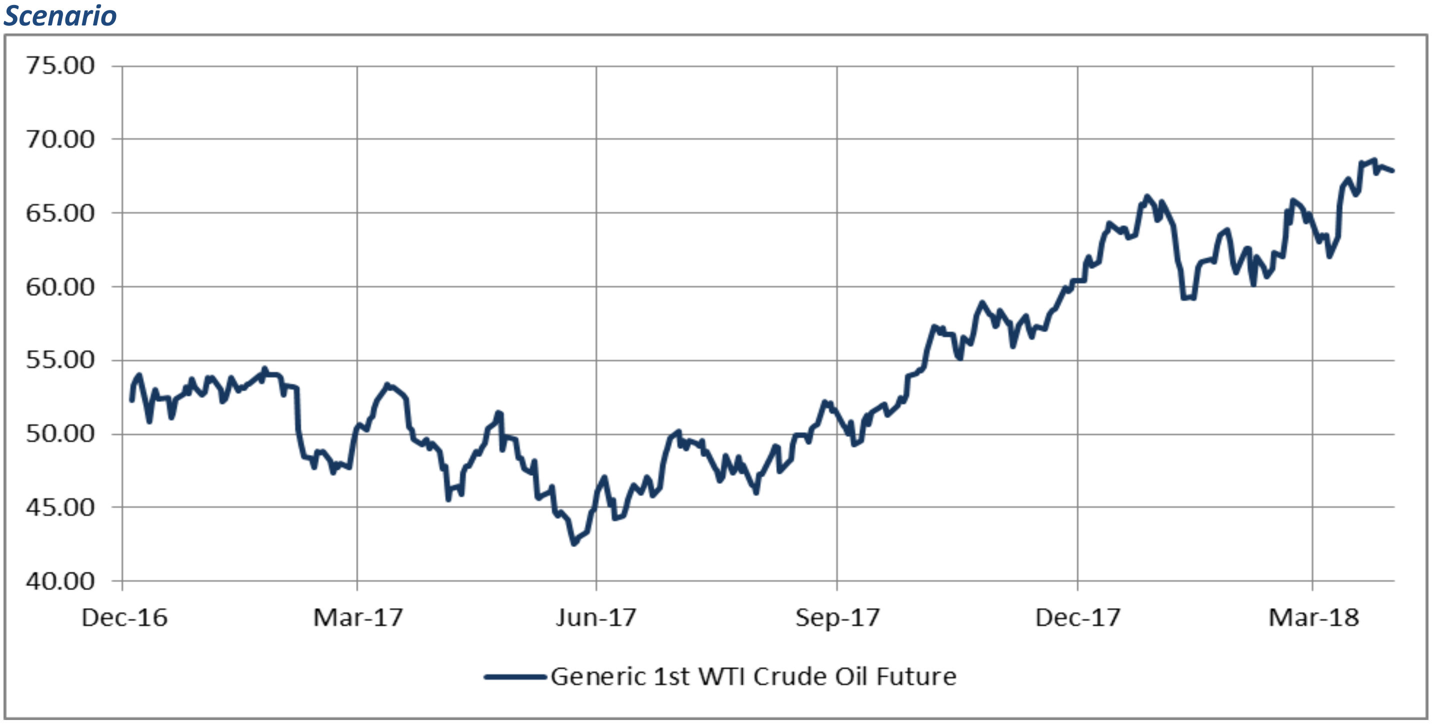
Figure 4. Upward Momentum in Civilian Employment Cost Indicator Stokes Increased Inflation Concerns



Source: Bureau of Labor Statistics

- ***Heightened Iran-US Geopolitical Risks:*** Over the past several weeks, investor concerns over the potential for a geopolitical crisis in the Middle East have escalated as the Trump administration increasingly telegraphs its intention to announce the US government's decertification of the Iran Deal at the upcoming May 12th deadline. Such investor concerns have led to continued upward crude price momentum during the month of April despite the US Dollar rise during the period (Figure 5).

Figure 5. Crude Price Rallies Further in April on Escalation of Investor Concerns over Iran Deal Decertification Scenario



Source: Bloomberg

	April 27th 2018	April MTD Change
Gold	1323.35	-0.2%
Silver	16.5125	0.8%
Oil	68.1	4.9%
EUR	1.213	-1.4%
JPY	109.05	2.5%
GBP	1.3781	-1.7%
CHF	0.9877	3.3%
CAD	1.2828	-0.4%
AUD	0.7581	-1.3%
BRL	3.4578	- 4.6%
MXN	18.6129	- 2.3%

Source: Bloomberg

Rates	April 27th Level
1 Yr CD	1.04%
5 Yr CD	1.67%
30 Yr Jumbo Mortgage	4.69%
5/1 Jumbo Mortgage	4.48%
US Govt. 10 Year	2.96%
10 Yr Swap Spread	0.03%

Source: Bloomberg

- ***Resilient Corporate Earnings Calendar:*** In the US, the past several days have marked the start of the Q1 corporate earnings season with approximately 40 percent of the S&P500 universe reporting. The percentage of corporate earnings beating consensus estimates hovers at around 80 percent versus 72 percent for the prior four earnings seasons. In absolute terms, US Q1 earnings are coming out around 5 percent above consensus estimates.

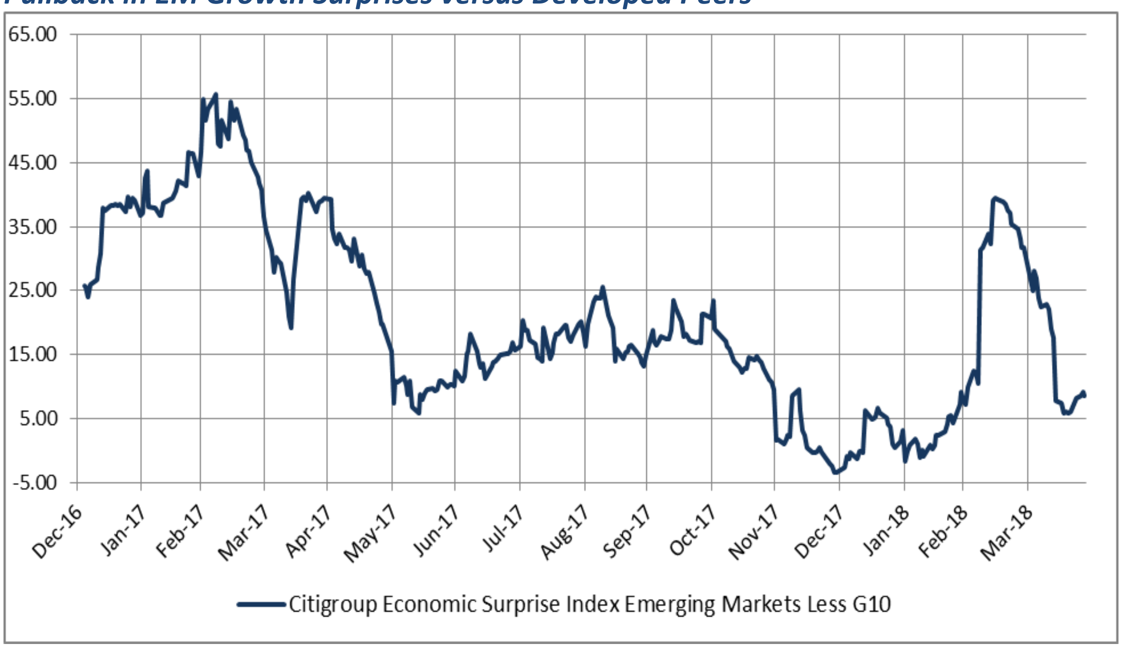
In examining the above mentioned developments that have unfolded these past several weeks, we can draw several conclusions regarding cross-asset market performance in April:

- Inflation hedges, especially equities, would perform favorably during the month of April given the modest uptick in inflation expectations along with resilient corporate earnings and revenue growth dynamics (in the USA and also internationally, though the timing of the international corporate earnings season lags that of the US);

- Within global equities, EAFE equities should have performed more favorably than US peers during the month of April given EAFE equities' considerably larger value-sector orientation at a juncture in which bond yields have been edging higher;

- EM equities would have lagged Developed peers during the month of April given (a) the recent pullback in EM currencies, following a long period of relative strength versus the US Dollar, (b) the recent pullback in large growth stocks globally, a number of which are Chinese (e.g. Tencent), and (c) the recent pullback in EM economies' relative growth surprise momentum versus Developed peers' following a stretch of outperformance going back to December 2017 (Figure 5).

Figure 5. EM Equities Underperform Developed Peers in April on US Dollar Rally and Pullback in EM Growth Surprises versus Developed Peers



Source: Citigroup and Glovista Calculations

- Credit markets would have outperformed developed country government bond indices during the month of April as the rise in inflation expectations coincided with stabilization in global economic indicators.

In our view, the recent period of US Dollar strength (a scenario we had envisioned in recent monthly newsletter columns as a short-term potential given futures speculators' outsized short US Dollar positioning over the past several months) is likely to prove transitory given (a) the recent pullback in relative economic strength between the Eurozone and the US reflects primarily adverse weather and base factors impacting the Eurozone disproportionately (recent releases suggest these factors have begun to reverse themselves (Figure 6)) and (b) speculators' stretched short US Dollar positioning levels will work themselves over time.

Figure 6. April US Dollar Bounce Fueled Partly by Softening in Eurozone Relative Economic Momentum versus US Calendar

Source: Citigroup and Glovista Calculations

As we look ahead, the Glovista team reaffirms its constructive outlook towards (a) non-US equities, primarily Eurozone and Emerging Markets, and (b) US value sector stocks while maintaining (c) an underweight allocation to global fixed income. Our portfolio strategy reflects valuation, macro, earnings dynamics and fund of flows considerations summarized in the section immediately below.

Glovista Sustains Bullish Non-US Equities and US Value Sector Investment Outlook on Valuation, Macro, Earnings, Flow of Funds and Positioning Considerations

Glovista Team's portfolio strategy positioning outlined above reflects our 12 month forward macro baseline case, entailing the following views:

- **Exceedingly low probability of world economic recession:** such view reflects continued strength and breadth of trend conditions facing the household and corporate sectors (including sentiment, expenditure trends and financial conditions) along with low inflation adjusted borrowing costs as well as stimulative fiscal and monetary conditions In Europe and Asia. Similarly, corporate profit dynamics are being supported by reflationary conditions globally – including the sustained rise in commodity prices (statistically a strong leading indicator for corporate profit growth).

- **modest rise of inflation momentum** in the only major economy currently manifesting signs of diminished labor market slack, the United States. For example, Figure 7 illustrates the modest rise in US median wage growth as reflected by the Atlanta Fed wage growth tracker indicator (median laborer). Moreover, a decomposition of recent wage growth acceleration in the USA shows minimum wage adjustments have been a major contributory factor in the recent rise in aggregate wage growth indicators. That minimum wage adjustments are implemented, on average, once or less than once over a typical business cycle implies that such inflation momentum will wane over the coming quarters. Moreover, as capex dynamics accelerate over the coming months – courtesy in part to this year's passage of the Trump tax reform plan – productivity growth is likely to rise, thereby mitigating any inflationary effect derived from recent wage growth acceleration.

Figure 7. US Wage Growth Momentum Remains Moderate as Capex Accelerates

Source: Federal Reserve Bank of Atlanta

- **a sustained yet moderate withdrawal of G3 central bank liquidity** as the FED's stance remains gradual under new Fed Chair Powell while the Bank of Japan (BOJ) has recently extended the date by when to initiate a normalization of liquidity conditions following recent below target inflation releases. As for the European Central Bank (ECB), at this past week's Thursday meeting, President Draghi has signaled the institution's slow pace in normalizing liquidity conditions especially given the recent soft patch in Eurozone region macro conditions.

Against a macro baseline case as delineated above – minimal recession risks, moderate inflation pressures, low inflation adjusted borrowing costs facing the household and corporate sectors, supportive corporate profit margin dynamics – the Glovista team favors an overweight exposure to global equities – especially non-US and value-oriented sectors in the USA – along with underweight fixed income allocations. More generally, we view such portfolio stance as further supported by a number of considerations including the following:

- **Equities' attractive relative valuations versus fixed income.** Such assertion reflects both yield differentials between equities and bonds (e.g. non-US equities trading at close to 12x earnings -12 months forward- against 0.5 percent inflation adjusted 10 year US Treasury yields) as well as current equity risk premium levels considerably above historical average levels – e.g. market derived measures, using dividend discounted model implied equity returns versus US high grade corporate bond yields hover close to 300 basis points above trailing 40 year average levels, close to the highest levels during such period.

- **Non-US equities' considerably more attractive relative valuations versus US peers** – e.g. EM equities trade at close 13.7 times GAAP earnings against 30 times for US small caps and 60 times for US Micro caps!

- EM and Eurozone equities remain among our most favored equity market groups owing not only to their attractive relative valuations versus US, Canadian and UK peers but also because of the **higher profit margin visibility** commanded by those markets, a result of those regional economies' higher levels of labor market slack.

- Eurozone equities, owing to the benchmark index's **heavier value-sector composition** versus US peers, are likely to benefit from the incremental normalization of government bond yields to higher levels .

- From a flow of funds perspective, we expect US corporates – by far, the largest net buyer of US equities over the past ten years – **to increase the magnitude of share repurchases over the balance of 2018** given the magnitude of profit repatriation by large US multinationals following recent congressional approval of Trump administration reform initiatives as well as the lower effective tax rates resulting in increased cash flow. A number of market analysts project US corporate share buybacks to reach a historic high level of 800 billion US Dollars in 2018.

- From an **investor positioning** perspective, over the past several weeks net equity beta exposure levels for hedge fund investors and balanced funds have retraced to markedly lower levels than those prevailing in January while the resilient strength of energy prices and the upcoming end of corporates' black out period in buying back their shares should prove supportive of net buying conditions for equities in the months ahead.

Glovista Emerging Markets Perspectives

EM Equities Pull Back Vs Developed Peers in April on US$ Rally, Russia Sanctions and Tech Sector Rout; Glovista Sustains Value-sector Tilts at Country Level

In April, Emerging Market equities have underperformed Developed peers by close to 268 basis points, as of the publication of this report on April 27. In our view, EM equities' April return underperformance versus Developed Market (DM) peers reflects three principal developments that unfolded during the month:

- the April cyclical bounce recorded by the US Dollar versus most of the world's currencies (as discussed above);

- the sharp de-rating experienced by tech sector companies during the month, particularly mega cap Chinese IT names as well as Taiwanese semiconductor stocks, fueled by several events and company developments discussed further below, and;

- the US government decision's to implement sanctions against a number of high profile individuals and corporations. As a result, the Russian equity market has sold off 6.70% during the month of April.

The de-rating of tech (social media and semi-conductor) stocks during the month of April responded to:

- Concerns over tech companies' discretionary spending on investment following recent company earnings releases;

- investor concerns over the upcoming release of Apple quarterly revenue and earnings data – as it pertains to the sales growth rate on iphones, and;

- rekindled investor concerns over privacy and increased government regulation facing social media companies (mainly covering US companies, such as Facebook and Google).

From a growth style perspective, we continue to view Emerging Asia tech stocks among the world's most attractive given their (a) cheap absolute and relative valuations versus US peers as well as (b) Emerging Asia tech companies' markedly higher visibility of revenue and earnings growth as compared to US and European peers given the Emerging Asia region's secular demand for IT services as well as the undisputed friendlier regulatory backdrop faced by the Emerging Asia tech companies when compared to those faced by their peers in the USA and Europe.

Against such recent developments, both sector/macro and geopolitical, the Glovista team has implemented a number of portfolio rebalancing actions during the month, including:

- Increase in Russia country weighting following the recent sharp sell-off since none of the sanctioned companies are part of the MSCI Russia benchmark. In addition, Russian energy stocks' valuations are trading at exceedingly cheap absolute and relative valuations versus international peers at a juncture in which payout ratios have increased steadily over the past several years. Moreover, the pullback in the Russian Ruble US Dollar exchange rate along with the continued rally in crude prices provide exceedingly positive tailwinds for Russian corporate earnings, especially in the Energy sector, over the coming quarters.

- Further increase in ASEAN regional allocations (particularly Thailand and Malaysia) given supportive relative valuations and earnings momentum.

- Increase in Turkey and Philippines country allocations following a period of strong relative underperformance for both country indices, as a result of which valuations have cheapened considerably. In the case of Turkey, we have raised country tilt from underweight to overweight on the back of compelling financial sector valuations along with the increased potential for Turkish Lira strength in the coming months as political risk premium levels diminish following the upcoming general elections scheduled for June 24th. We have funded the increased Turkey and Philippines country allocations via a further reduction in growth-sector oriented markets, especially Taiwan and Korea.

As we look ahead, we expect Emerging Market equities to further extend their multi-year return outperformance of Developed peers, primarily on the back of earnings outperformance (at the tune of around 10 percent in US Dollar terms). Admittedly, the potential for return outperformance accruing from a further compression in EM equities' valuation discount versus DM peers awaits a more sustained decline in equity risk premium levels globally. In turn, we believe the latter is likely to obtain during the second quarter as Developed country PMI indicators bounce from current low levels (e.g. especially German ZEW more so than the US ISM).

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