Issue
80
August/16

Monthly Market Newsletter

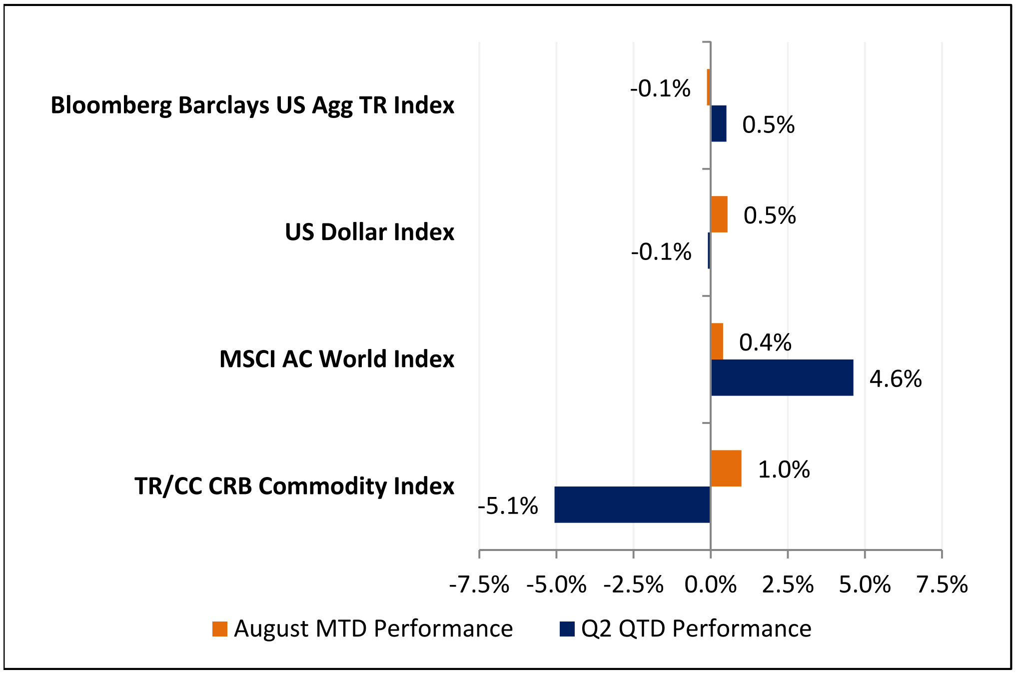
Glovista Global Perspectives

This Issue:

Glovista Sustains Overweight Credit Market Exposure on Valuation, Macro, Seasonal, Policy and Political Risk Considerations

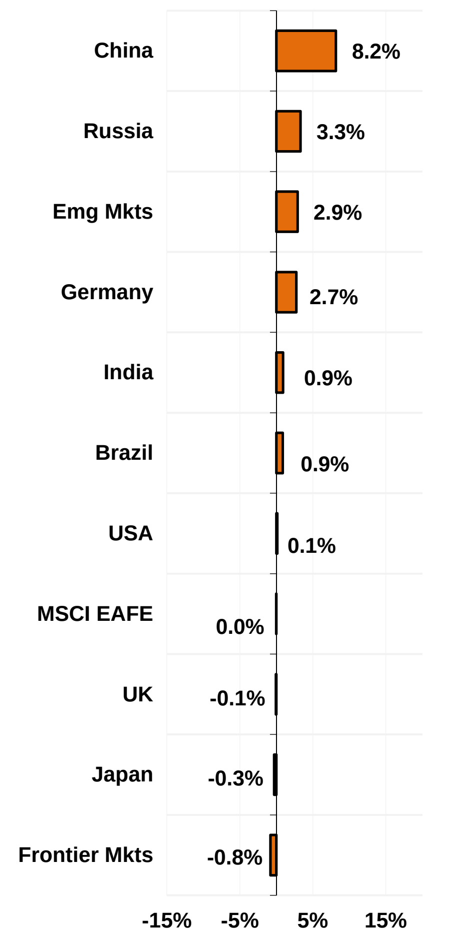
Over the past several weeks, risk markets globally have consolidated the strong price gains recorded throughout the year's second quarter. As illustrated in Figure 1, thus far in August, prices of bellwether equity, credit, currency and commodity indices have hovered within exceedingly tight ranges.

Figure 1. August Marks Consolidation in Price Indices across Asset Groups (As of August 30th, 2016)



Source: Bloomberg

Country-wise Monthly Performance in USD terms (August MTD 2016)*



Source: MSCI & Bloomberg

**As of August 30th, 2016*

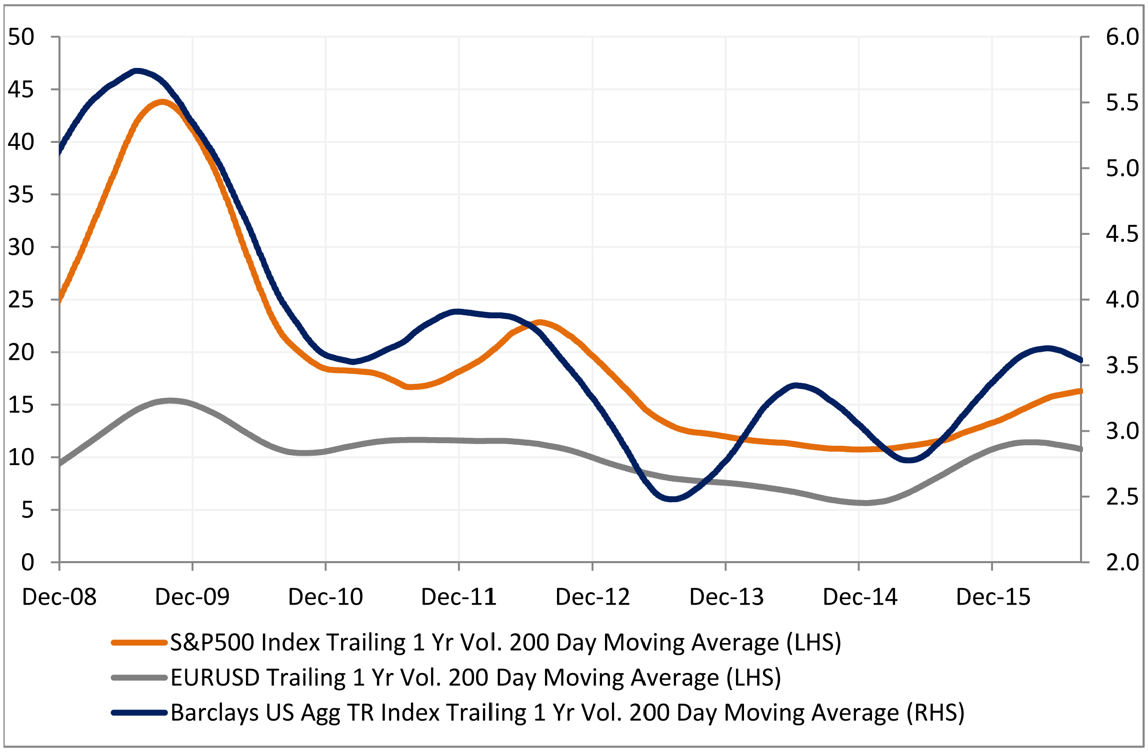
S&P500 Monthly Sector Performance – August MTD 2016*		
Sectors	% Change	FY1 PE Ratio
Energy	2.04%	101.6
Materials	0.63%	18.6
Industrials	0.98%	17.5
Cons Disc	-1.17%	18.6
Cons Stap	-0.80%	21.8
Technology	1.99%	17.8
Healthcare	-3.26%	16.8
Financials	3.48%	14.7
Utilities	-6.43%	18.8
Telecom	-5.65%	15.0
S&P500	0.12%	185

*As of August 30th, 2016

Source: S&P

While seasonal factors (summer period) likely have exerted a role in depressing realized market volatility, both the quantum and breadth of the realized volatility decline across asset markets during the past several weeks suggests the potential for a macro regime change over the medium-term (Figure 2). The remainder of this column aims at discussing such considerations at greater length, with an emphasis on portfolio strategy implications at the global level.

Figure 2. Realized Volatility across Asset Groups at Historical Low Levels



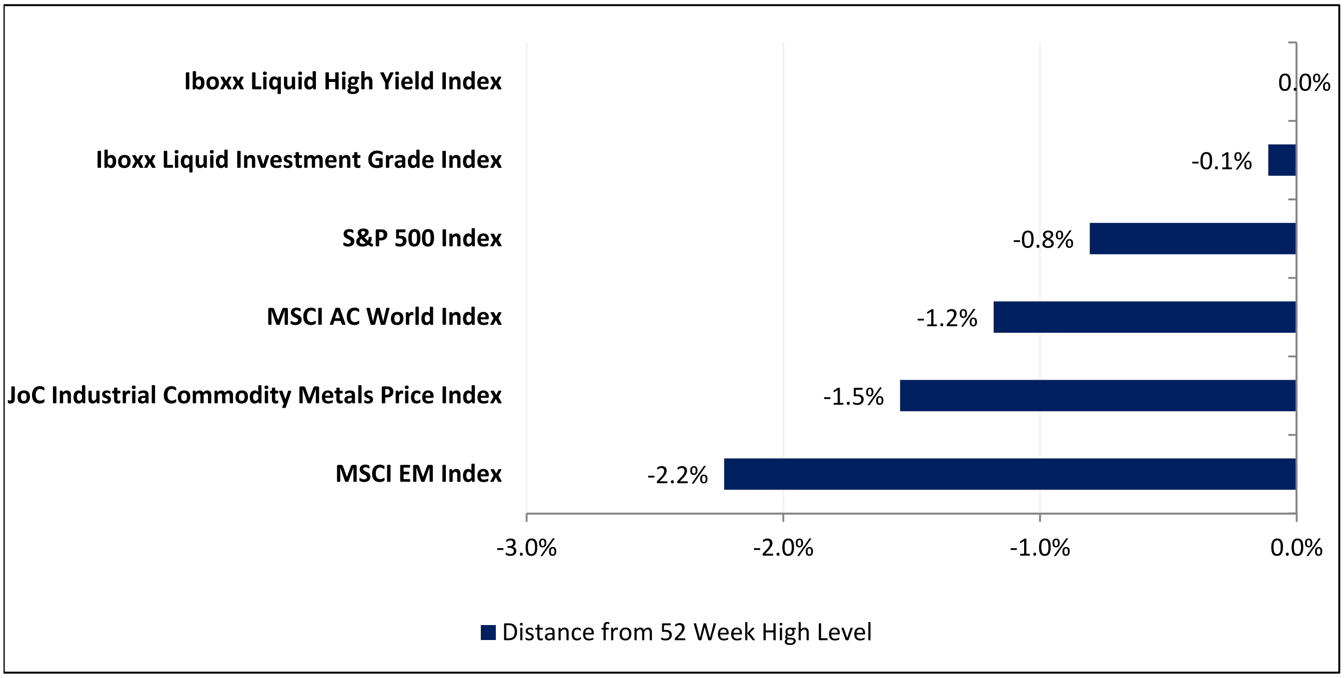
Source: Bloomberg and Glovista Calculations

Risk Markets Prove Resilient as Recession Risks Abate Given Firmer US & European Consumption; Outlook Conditioned by Risk Factors Spanning the Policy/Political/Profits/Capex Domains

Over the past several weeks, a number of bellwether risk indices – including equities, credit and commodities – have recorded considerable price momentum as illustrated in the number of indices posting 52-week high levels (Figure 3).

In our view, the recent strengthening of price momentum across a number of risk indices reflects global investors' increased comfort level surrounding the economic outlook: recent macro releases centered around the US and European consumer have been considerably stronger than expected by the consensus (Table 1). In turn, the diminution of downside economic tail risks along with the unusually low levels of interest rates and flat yield curves have been especially friendly towards equities over fixed income on volatility-adjusted yield considerations. In particular, as illustrated in Figure 4, equities' valuation allure versus government fixed income is particularly compelling on volatility-adjusted yield levels.

Figure 3. Price Momentum Extends Further Across Risk Markets as August Marks a Number of Indices Attaining 52 Week High Levels (As of August 30th, 2016)



Source: Bloomberg

Table 1. World Consumer Spending Firms Up thus Far in Q3

Latest Retail Sales MoM Growth (%)		
Country	**Actual**	**Estimate**
US*	0.0%	0.4%
Germany	1.7%	0.5%
United Kingdom	1.4%	0.1%
Japan	-0.5%	-1.5%
China**	10.2%	10.5%
Mexico	1.0%	-0.3%
Brazil	0.1%	-0.4%
Russia	4.2%	2.9%

**The MoM Retail Sales for prior month (June) were upwardly revised from 0.6% to 0.8%*
***Data available on a YoY basis*

Source: Bloomberg

	Aug 30th 2016	Aug MTD Change
Gold	1311.11	-3.0%
Silver	18.603	-8.5%
Oil	46.35	11.4%
EUR	1.1143	-0.3%
JPY	102.96	-0.9%
GBP	1.308	-1.1%
CHF	0.9839	-1.5%
CAD	1.3099	-0.5%
AUD	0.7509	-1.1%
BRL	3.2401	0.3%
MXN	18.8181	-0.3%

Source: Bloomberg

Rates	Aug 30th Level
1 Yr CD	0.57%
5 Yr CD	1.21%
30 Yr Jumbo Mortgage	3.81%
5/1 Jumbo Mortgage	2.95%
US Govt. 10 Year	1.5663%
10 Yr Swap Spread	-0.1388%

Source: Bloomberg

Figure 4. US Equities Trump Government Fixed Income on Yield Considerations: Volatility Adjusted US Corporate Earnings Yield to Debt Yield Ratio

Source: MSCI, Bloomberg and Glovista Calculation

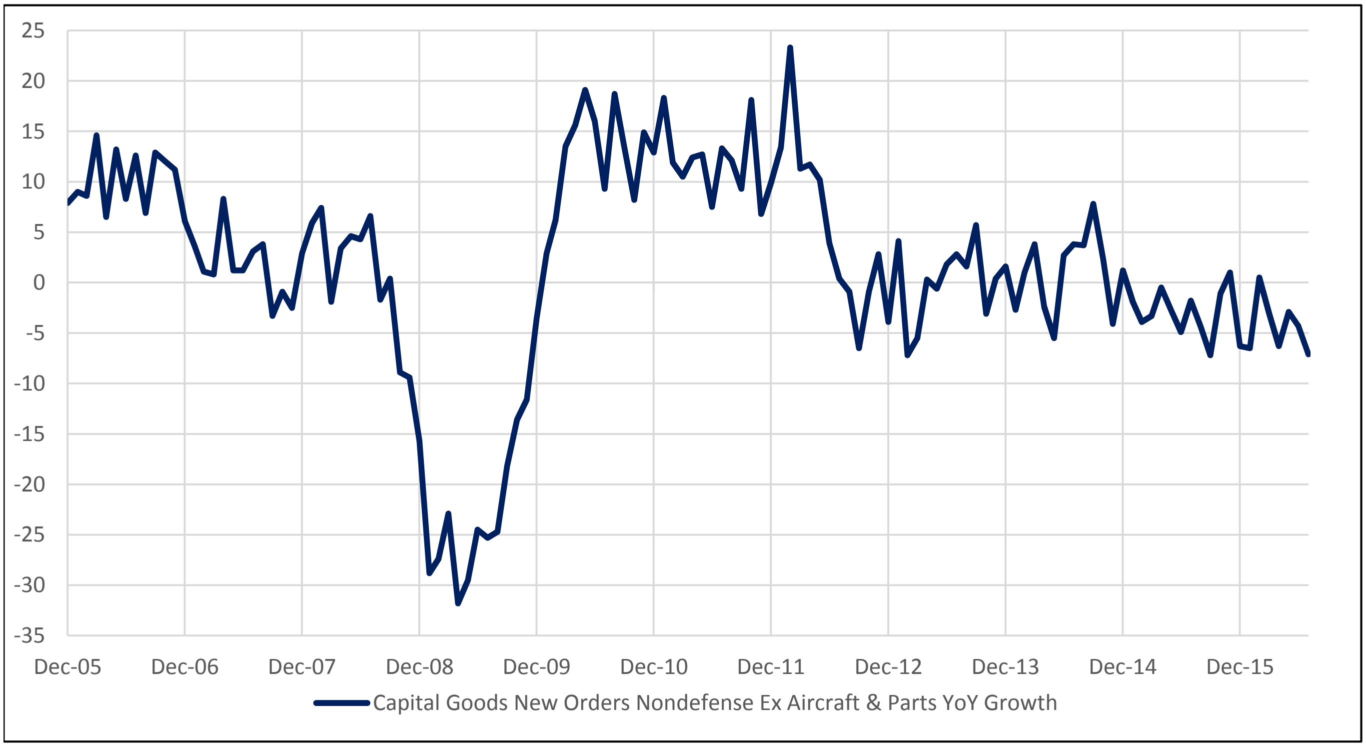
While it is straightforward to rationalize equities' valuation allure versus developed country fixed income, it is important to acknowledge the presence of a number of major mitigating factors from a medium-term perspective as well as a set of looming policy and political event risks, including the following:

- *Continued anemic momentum displayed by business investment spending*, as illustrated in Figure 5. A number of dynamics account for the ongoing softness in private sector investment spending including (a) the loss of momentum across the energy complex as crude prices continue to hover well below multi-year high levels; (b) policy uncertainty – discussed further below; (c) political uncertainty – discussed further below; (d) ageing of US business and profits cycle expansion as corporate profit margins are pressured by a tighter labor market and prospects of higher cost of debt capital.

- *Aging US corporate profits cycle as labor markets tighten and debt cost of capital bounces from multi-year low levels* as corporate balance sheets weaken following years of large net issuance for share buyback and dividend payout purposes. As illustrated by Figure 6, US corporate profits hover around -8 percent from multi-year cycle high levels reached on December 2013.

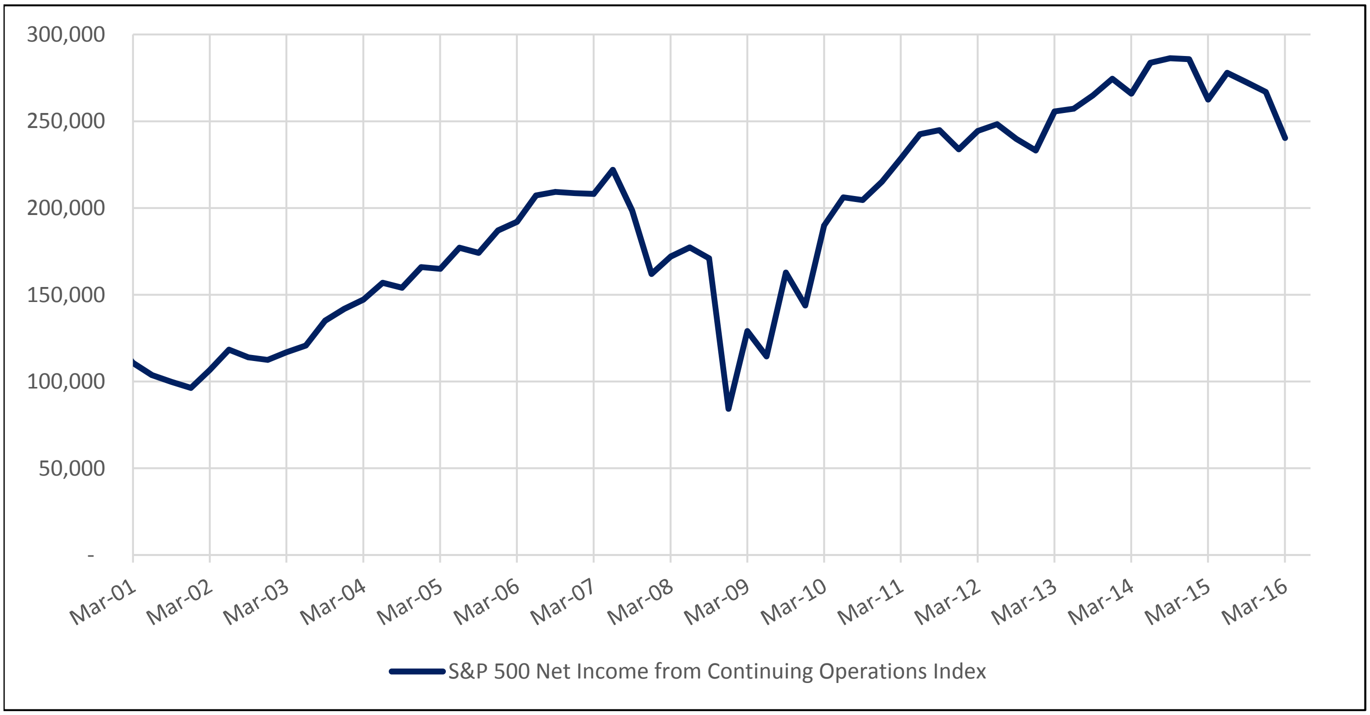
GLOVISTA
INVESTMENTS

Figure 5. US Business Investment Spending Continues to Underwhelm Consensus Estimates in 2016



Source: U.S. Census Bureau

Figure 6. US Corporate Profits Post Further Signs of Cycle Top



Source: Bloomberg

- *Potential back-up in risk premium levels*, thereby pressing market volatility higher, via the erosion of central bank credibility over the coming quarters as the Bank of Japan and other major central banks acknowledge the limitations of negative interest rate policy and enhanced quantitative easing. Said risk scenario carries the potential of impacting risk premium levels across the liquidity, term and credit domains. In this regard, the upcoming September and December central bank meetings are likely to prove highly consequential not only for the make-up of policy actions but also for the market response to the actions to be taken by central banks.

- *Political risk as the upcoming US presidential elections and Italy's constitutional referendum, both scheduled for the month of November, amount to binary events*. Specifically, in the US elections case, Mr. Trump's policy stance can be characterized as isolationist, anti-trade, anti-immigration and fiscally aggressive. As such, a Trump victory could result in an upward pressure on risk premium levels. Similarly, Mrs. Clinton's policy stance, while closer to the status-quo, can be characterized as fiscally active (including her proposed $275 billion infrastructure expenditure program, the multiplier effect of which on the broader US economy remains highly uncertain) and less enthusiastic on international trade than the status quo. On Italy's constitutional referendum, a NO vote may result in the failure of the incumbent government and its replacement with a coalition including the anti-Euro Five Star Party.

Glovista Sustains Overweight Credit Market Exposure as Equities' Valuation Allure Susceptible to Normalization of Macro Factors Anchoring Unusually Low Volatility Levels

As we look ahead to the balance of the year, Glovista's investment team continues to favor overweight allocations to the credit market versus global equities owing to principal considerations:

- the presence of near-term event risks permeating the policy (monetary, trade and fiscal) as well as political (US general elections and Italian constitutional referendum, both scheduled for November) domains, discussed above, and;

- the credit market's attractive valuation allure versus equities and government fixed income, on normalized volatility considerations, especially given our baseline case of a low US and Eurozone recession scenarios over the coming 12 months.

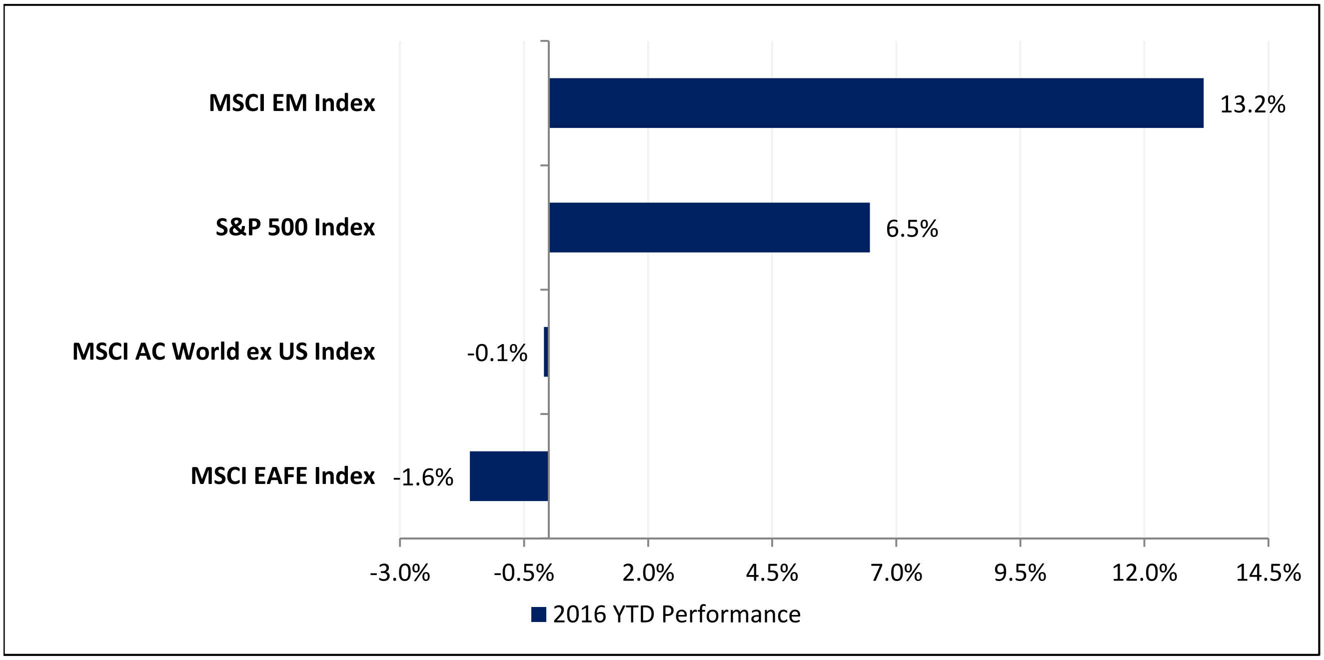
Within global equities, we continue to favor a number of Emerging Market equity indices as well as selective industries out of several Developed country indices tied to the energy, technology, health care and industrial sectors. Within the commodities space, we continue to favor tactical overweight exposures to precious metals and energy.

Glovista Emerging Markets Perspectives

August Marks Extension of EM Equities' YTD Outperformance of DM Peers; Glovista Raises China and Russia to Overweight, cutting Brazil to Underweight

In August, Emerging Market (EM) equities extended their 2016 year-to-date return outperformance of Developed Market (DM) peers, as illustrated in Figure 7. The Glovista investment team continues to embrace the standing thesis calling for a sustained return outperformance by EM equities of DM peers over the foreseeable future owing to: relative valuation attractiveness, upturn in relative economic performance, under-owned status, sustained reversal in EM central bank interest rate cycle away from hikes to rate cuts. The balance of this commentary lists a number of important country rebalancing actions implemented over the past several weeks in our EM equities strategy.

Figure 7. August Marks Extension of EM Equities' Strong YTD Outperformance versus EAFE, US Equities and ACWI ex-US (As of August 30th, 2016)



Source: MSCI

Over the past several weeks, we have implemented a number of meaningful country-level rebalancing actions, including a marked upgrade of China's country exposure from underweight to overweight; upgrade of Russia country exposure from approximately neutral to strong overweight; downgrade of Brazil country exposure from overweight to underweight.

The above listed country- and sector-level rebalancing actions are predicated on the following considerations:

(A) Chinese equities' improved relative valuations and attractive currency valuation following the year-to-date cheapening versus other EM peers; strengthening of top and bottom-line performance for information technology companies in China;

(B) Russian equities' beneficiary status from a stabilization in crude prices, cheap valuations and attractive 'carry' considerations (Bond Yield and Dividend Yield);

(C) Brazilian currency valuation's diminished allure versus other EM peers and unattractive equity valuations.

From a longer term perspective, we believe the EM equities' outlook has been solidified these past several weeks especially following US FED Chair Yellen's Jackson Hole speech at which she reaffirmed the FED's gradual approach towards normalizing policy rates as well as the permanent inclusion of quantitative easing policy tools in the FED's policy toolkit. These dynamics are positive the EM market outlook owing to their reflationary effects on the global economy. In particular, we believe the FED Chair's medium-term guidance is likely to result in further US Dollar weakening versus EM currencies, a positive for the overriding majority of EM country indices.

Finally, the upcoming event risks looming on the horizon, including the November US presidential elections and Italy's constitutional referendum, are combining to fuel a rebalancing into EM countries given the greater visibility found in EM countries' economic growth and policy outlook. That earnings and bond yield differentials between EM and DM remain outsized provides additional impetus to the pace of portfolio rebalancing actions by global asset allocators into EM.

Disclaimers:

1. *This newsletter from Glovista is for information purposes only and this document should not be construed as an offer to sell or solicitation to buy, purchase or subscribe to any securities.*
2. *This document is for general information of Glovista clients. However, Glovista will not treat every recipient as client by virtue of their receiving this report.*
3. *This newsletter does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. The securities discussed in this document may not be suitable for all investors.*
4. *The price and value of investments referred to in this newsletter and the income arising from them are subject to market risks. Past performance is not a guide for future performance*
5. *Certain transactions including those involving futures, options, and other derivatives as well as non-investment grade securities give rise to substantial risk and are not suitable for all investors. Please ensure that you have read and understood the current risk disclosure documents before entering into any derivative transactions.*
6. *This newsletter has been prepared by Glovista based upon publicly available information and sources, believed to be reliable. Though utmost care has been taken to ensure its accuracy, no representation or warranty, express or implied, is made that it is accurate or complete.*
7. *The opinions expressed in this newsletter are subject to change without notice and Glovista is under no obligation to inform the clients when opinions or information in this report changes.*
8. *This newsletter or information contained herein does not constitute or purport to constitute investment advice and should not be reproduced, transmitted or published by the recipient. This document is for the use and consumption of the recipient only. This newsletter or any portion thereof may not be printed, sold or circulated or distributed without the written consent of Glovista.*
9. *Forward-looking statements in this newsletter are not predictions and may be subject to change without notice. Neither Glovista nor any of its directors, employees, agents or representatives shall be liable for any damages whether direct or indirect, incidental, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information included in this newsletter.*

GLOVISTA INVESTMENTS
1 Evertrust Plaza Suite 1102
Jersey City NJ 07302
Tel: 212-336-1540
Website: www.glovista.net