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Glovista Global Perspectives

This Issue:

Equities Record Sharp Correction Early in February on Forced Deleveraging following Spike in Bond-Equity Correlations; Long-dated US$ Bonds Approach Fair Value Levels; Glovista Raises Duration Exposure via Real Estate

In early February, equity indices globally came under sudden and sharp selling pressure, resulting in a number of equity markets entering correction territory for the year (e.g. drawdowns in excess of 10 percent). Figure 1 illustrates the percentage pullback recorded by some of the world's major equity indices from their January 2018 high levels to the low levels reached early in February.

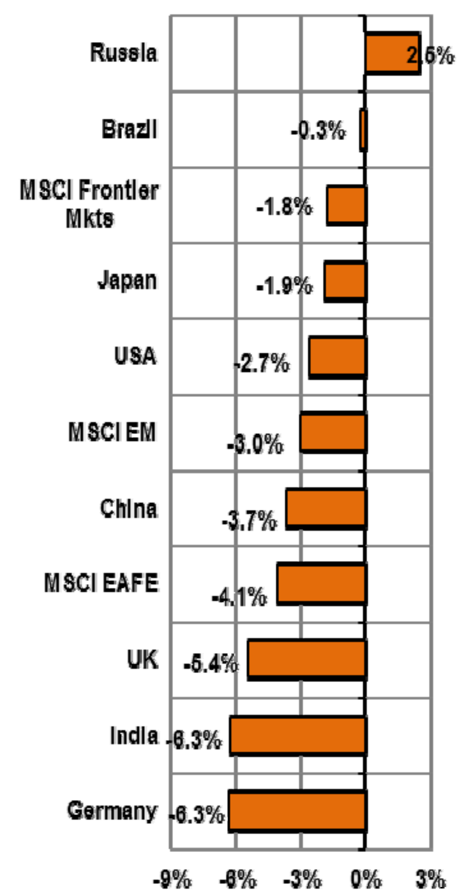
In our assessment, as well as that of a number of Wall Street strategists, the early February equity market correction had all signs of a technical and NOT fundamental correction. Such assessment reflects a number of considerations including the following:

- Spike in market volatility during the early February period was limited to equities, with credit, foreign exchange and bond market volatility levels remaining close to unchanged for the month (Figure 2).

- Equity market internals continued to flag a reflationary-expansionary drift to global markets, with cyclical stocks outperforming defensive stocks in Developed markets while Emerging Markets outperformed Developed market peers (Figure 3).

- Unprecedented spike in the volatility of equity index volatility, above 2008 high levels, consistent with equity volatility exposure imbalances as source of equity market correction (Figure 4). Specifically, at the beginning of February the net equity volatility exposure held by speculators, risk parity and short-volatility

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



Source: MSCI & Bloomberg

**As of February 23rd, 2018*

S&P500 Monthly Sector Performance – February MTD 2018*

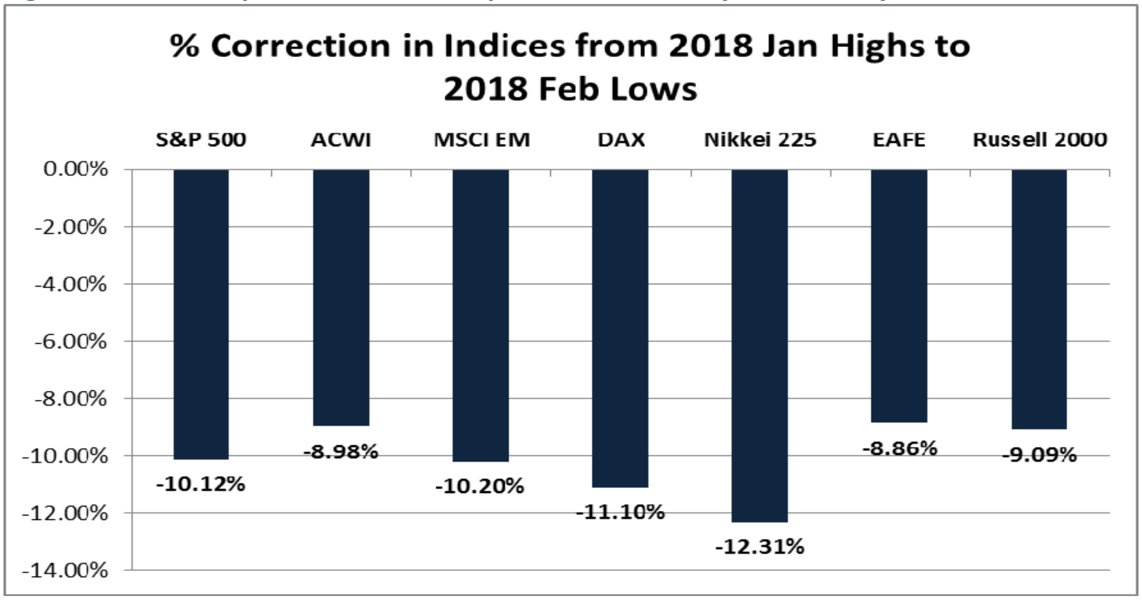
Sectors	% Change	FY1 PE Ratio
Energy	-8.65%	19.8
Materials	-2.77%	17.7
Industrials	-2.94%	18.3
Cons Disc	-1.84%	20.6
Cons Stap	-6.19%	18.4
Technology	-0.02%	19.0
Healthcare	-3.23%	16.3
Financials	-2.24%	14.0
Utilities	-1.80%	16.4
Telecom	-5.92%	10.8
Real Estate	-5.24%	37.7
S&P500	-2.71%	17.6

As of February 23rd, 2018

Source: Bloomberg

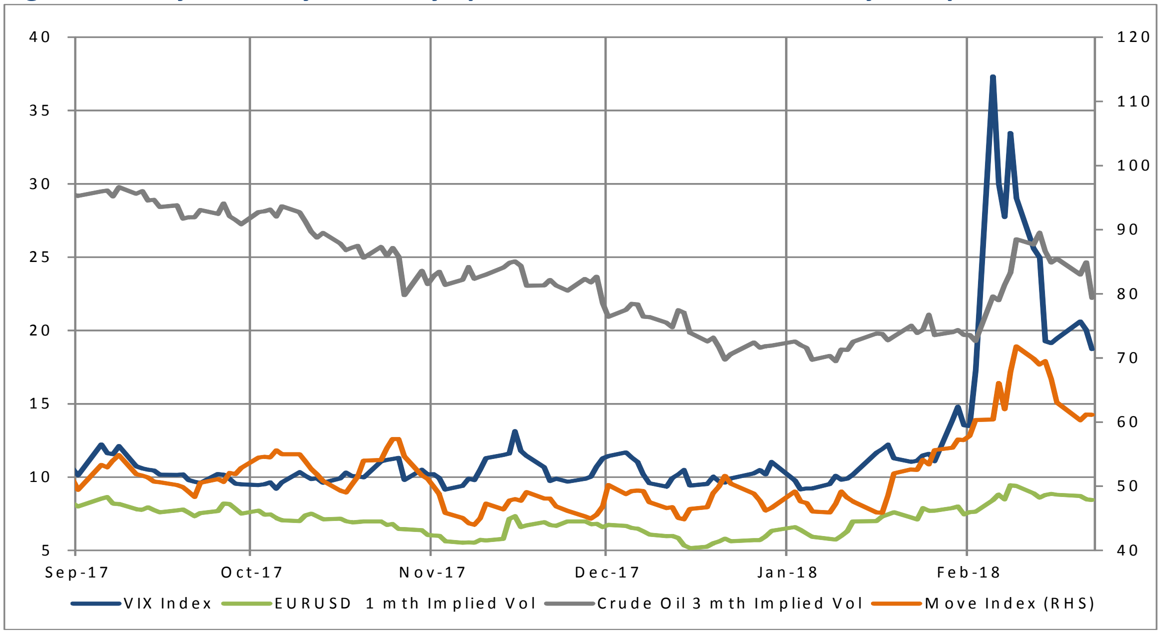
oriented funds was unusually elevated. In our view, the contemporaneous occurrence of such volatility positioning together with the reversal in bond-equity price correlations from negative to positive early in February helped set off the sudden demand for volatility from the Street (Figure 5). In the process, cash equity indices sold off in response to derivative market dynamics. Conversely, net bond market volatility positioning was a lot more even going into the beginning of February, resulting in relatively modest rise in bond market volatility later in the month.

Figure 1. Global Equities Record Sharp Corrections Early in February



Source: Bloomberg

Figure 2. Early February Volatility Spike Limited Almost Exclusively to Equities

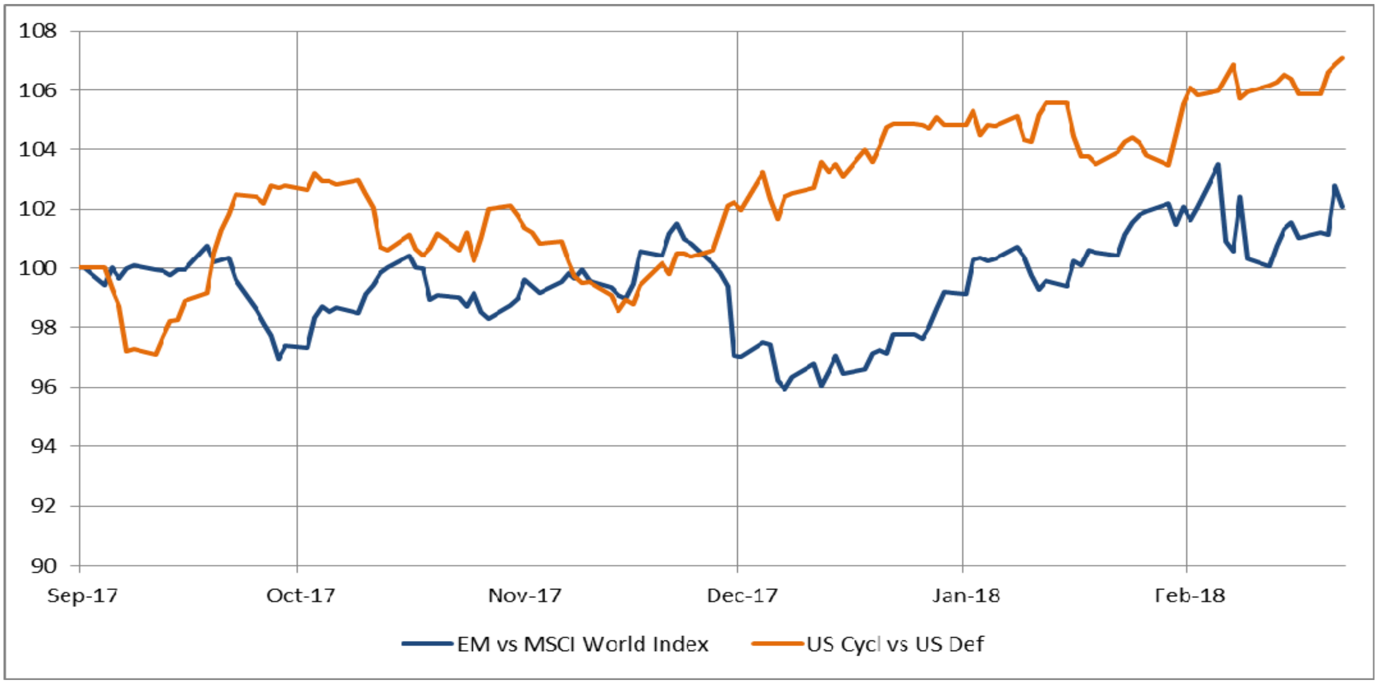


Source: Bloomberg

- Demand for safe haven assets during periods of market stress, such as gold and the Swiss Franc, remained unusually weak (Figure 6).

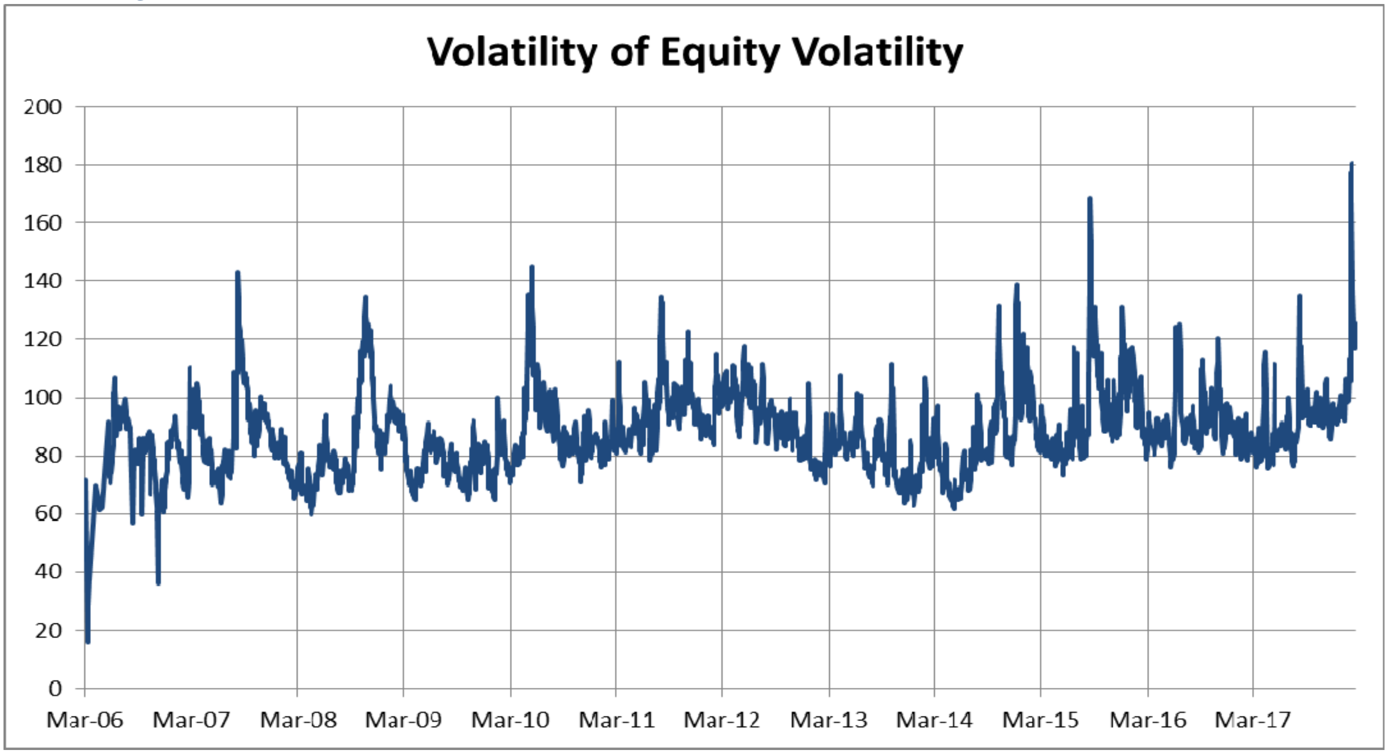
Against such backdrop, and notwithstanding the early February equity market correction's seeming technical footprints, it is sensible to reassess the equity and bond market outlook. We aim to do so in the section that follows immediately below.

Figure 3. Reflation-Expansion Themes Sustained Performance Leadership thru Early February Equity Price Correction: Consistent with Technical Correction



Source: Bloomberg and Glovista Calculations

Figure 4. Volatility of Equity Volatility Reaches Highest Levels in History in February as Stretched Volatility Positioning Rebalanced to Normal Levels



Source: Bloomberg

Rest of 2018 Outlook Remains Supportive of Equities on Broadening Economic Expansion, US$ Weakness, Relative Valuations versus Bonds, Limited UST Yield Upside from Current Levels and Flow of Funds Support from Buybacks, Sovereign Wealth and Pension Funds

As we look ahead to the balance of 2018, we continue to embrace a constructive outlook towards global equities along with an increasingly favorable disposition to US interest rate sensitive sectors, such as real estate. Our constructive outlook towards the global equities asset class is predicated on a number of considerations including the following:

- Equities' attractive relative valuations versus bonds (Figure 7);

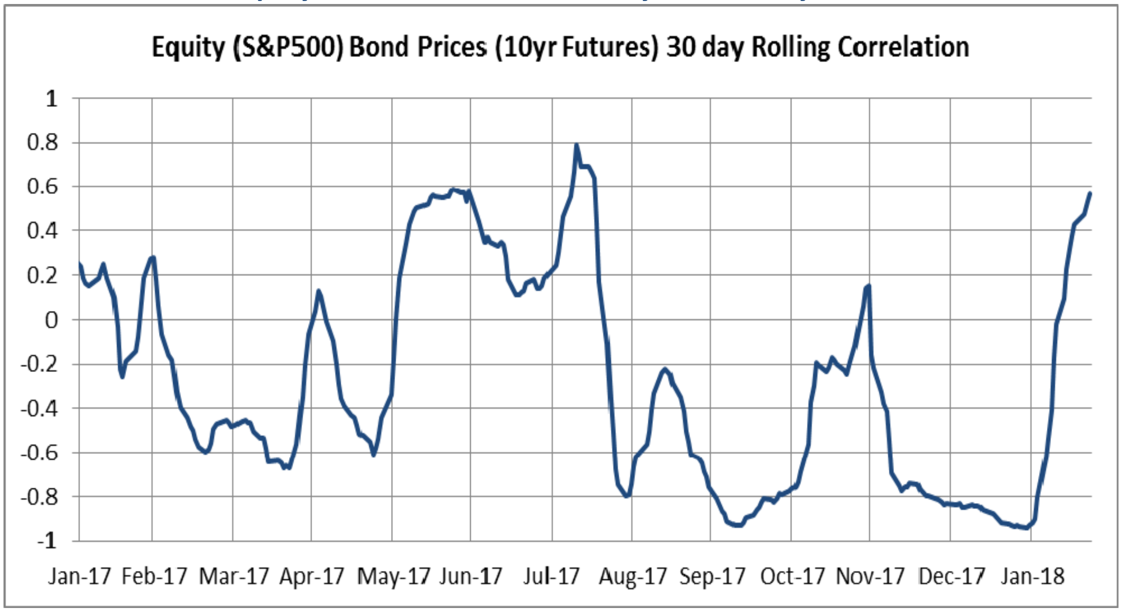
	February 23rd 2018	February MTD Change
Gold	1328.75	-1.2%
Silver	16.5275	-4.7%
Oil	63.55	-1.8%
EUR	1.2295	-1.0%
JPY	106.89	-2.1%
GBP	1.3971	-1.6%
CHF	0.9361	0.5%
CAD	1.2633	2.6%
AUD	0.7843	-2.6%
BRL	3.2389	1.6%
MXN	18.5545	-0.2%

Source:Bloomberg

Rates	February 23rd Level
1 Yr CD	0.91%
5 Yr CD	1.56%
30 Yr Jumbo Mortgage	4.62%
5/1 Jumbo Mortgage	4.24%
US Govt. 10 Year	2.866%
10 Yr Swap Spread	0.68%

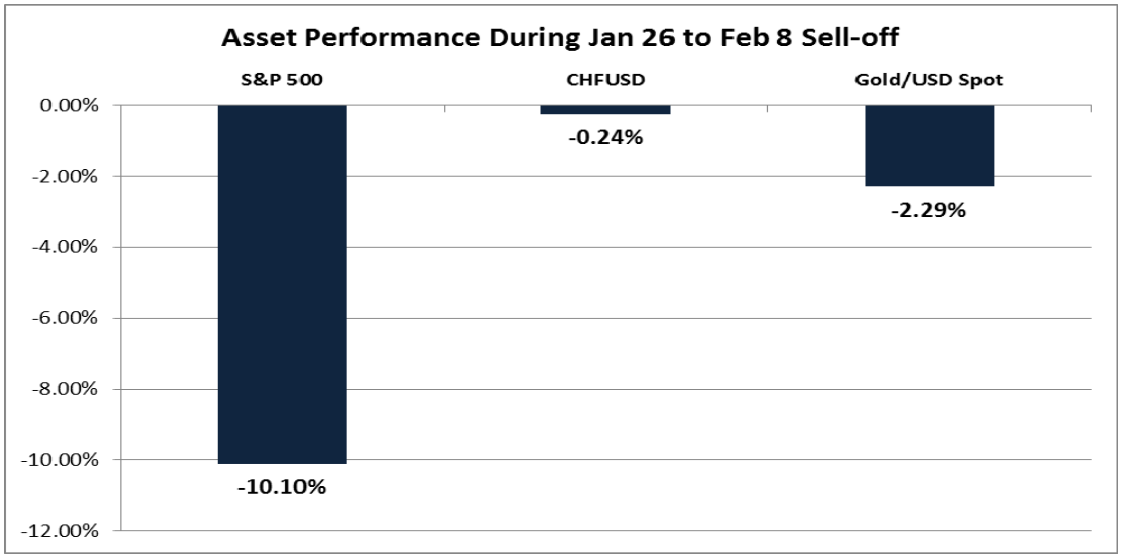
Source:Bloomberg

Figure 5. Late January Bond Price Declines Likely Planted the Seeds for Sharp Reversal in Bond-Equity Return Correlations Early in February



Source: Bloomberg and Glovista Calculations

Figure 6. Safe Haven Asset Demand Remained Anemic during Early February Equity Market Correction



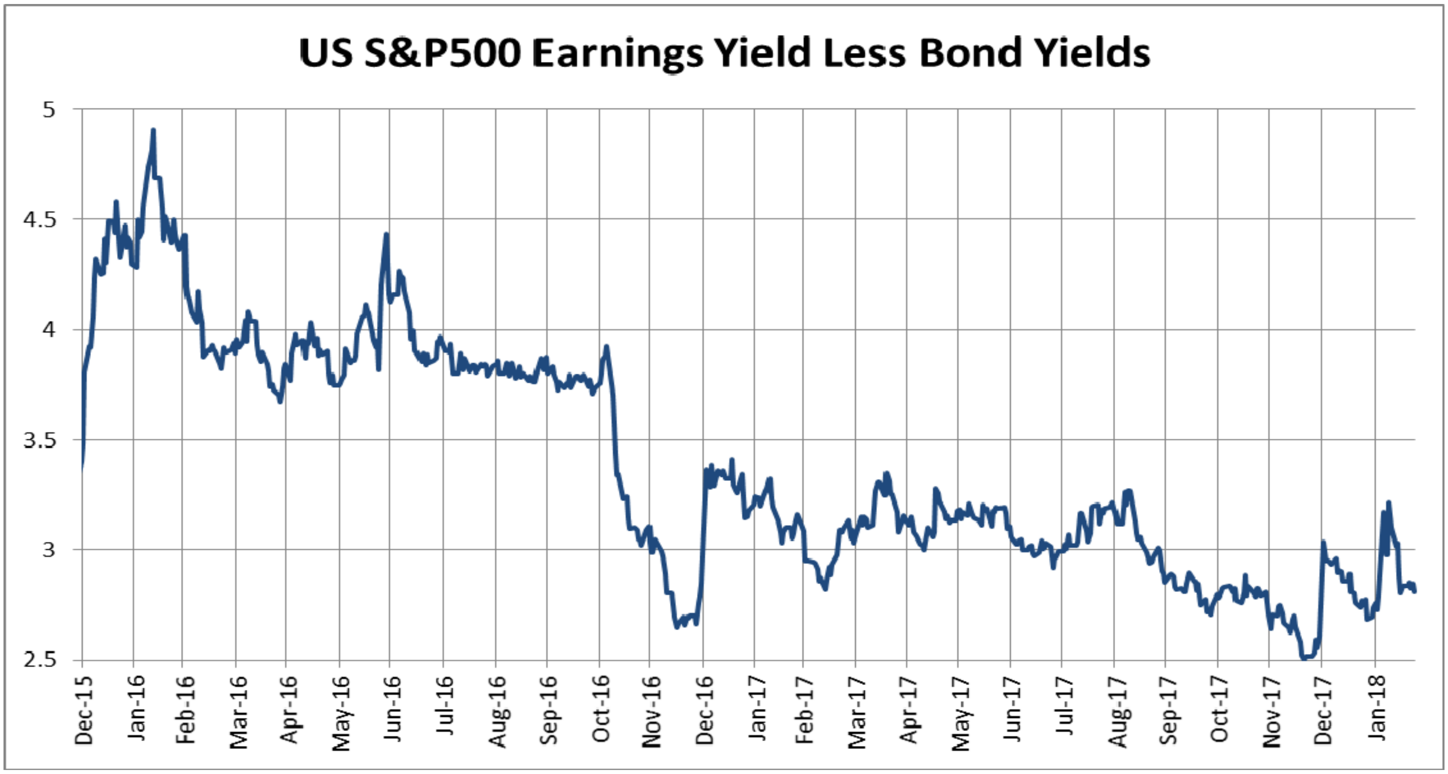
Source: Bloomberg

- Continued signs of global economic growth momentum and a broadening of such momentum across the world's principal regional blocs (Figure 8);

- Our assessment of limited additional upside to US long-term bond yields as the recent bond market sell-off period has pushed yields close to fair value levels. Specifically, we view fair value on 10 year US Treasury yields to fall within the 3-3.25

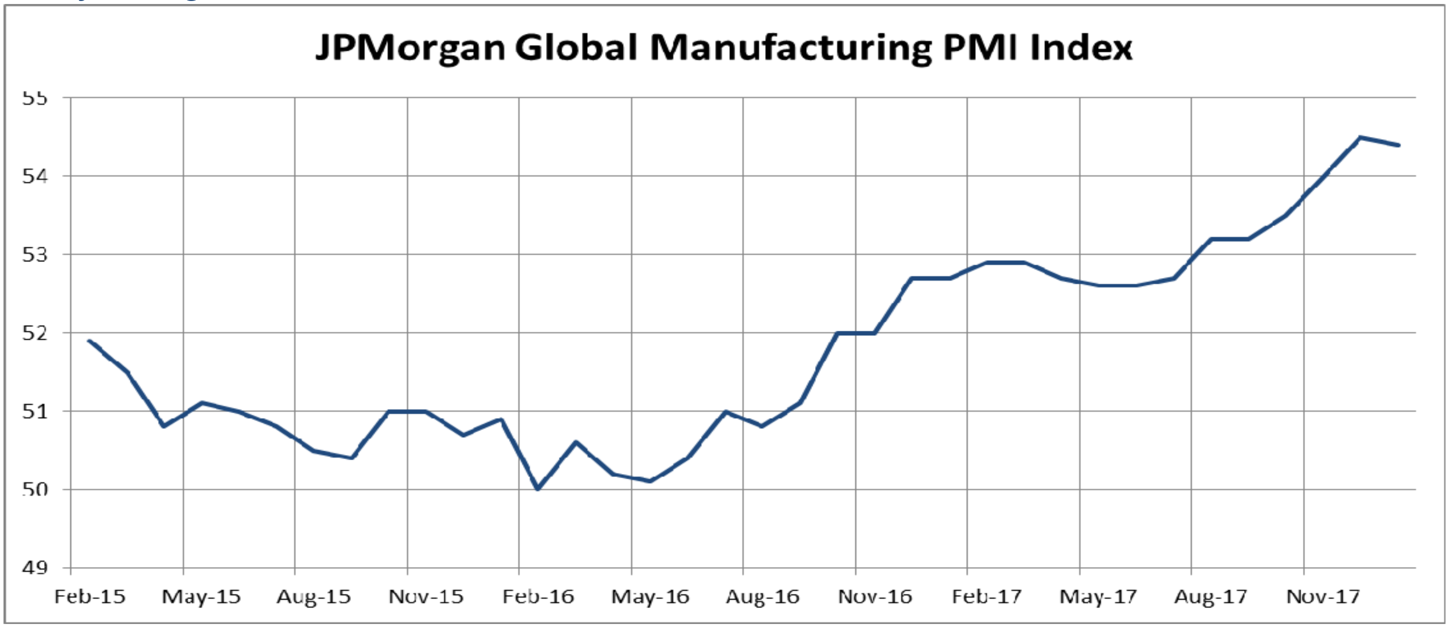
percent range. At present, 10 year US Treasury yields hover close to 2.9 percent. If we are correct in such assessment, in the months to come bond market volatility should prove a far less important source of downside equity volatility, leaving much of investors' focus on corporate earnings.

Figure 7. Global Equities' Earnings to Bond Yield Ratio Hovers at Multi-year High Levels, a Sign of Equities' Valuation Allure versus Bonds



Source: Bloomberg and Glovista Calculations

Figure 8. World Economic Growth Momentum Extends and Broadens, as Captured by JPMorgan Global Manufacturing Index



Source: JP Morgan

- Continued US Dollar weakness as our baseline case. We reaffirm our weak US Dollar thesis for 2018, laid out in our 2018 year-ahead outlook report published in December 2017. That the US Dollar has proved unable to strengthen versus the Euro and Emerging Market currencies these past several weeks despite a widening interest rate differential with the Euro and a spike in realized and implied equity volatility reveals much about global investors' medium-term growth outlook for the US economy versus international peers'. Under a continued weak US Dollar scenario, global equity prices should be major beneficiaries on account of the global reflationary effect stemming from a weak US Dollar.

- Favorable fund of flows backdrop facing global equities. Specifically, we believe the fund of flows backdrop should prove supportive of global equities, especially international equities in the months to come. For example, the sustained crude price recovery these past several months should help bring about an end to the drought in sovereign wealth funds' purchases of global equities. Likewise, the sharp declines recorded by short-term corporate interest rates in Europe over the past sixteen months should help set off an accelerating M&A momentum in the months to come. Finally, the sharp sell-off in bond prices these past several months have proved beneficial to US and European defined benefit pension systems and insurance companies, from a balance sheet perspective. Historical precedent suggests that such balance sheet strengthening episodes often trigger increased equity purchase levels by such institutions in the ensuing quarters.

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Of course, the investment outlook is not bereft of downside risks. These include geopolitical tensions in the Middle East (e.g. Israel and Iran), North Asia (North Korea and the USA/South Korea/Japan), among others. Likewise, as we have discussed in prior monthly columns, the US household's financial position remains fragile on a long-term basis. For example, the normalization of US interest rates has begun to impact the housing market, especially first-time homebuyers.

Glovista Sustains Overweight Value and International Tilts, Lowering EAFE Exposure on Risk Management Considerations and Raising Duration via US Real Estate on Value Considerations

As noted in the above sections, the Glovista investment team views the early February equity price declines as reflecting predominantly technical considerations. Consequently, we have maintained our overall portfolio positioning largely unchanged, with several exceptions reflecting risk management considerations as well as new value opportunities emerging from the recent sell-off period. We address each of these mentioned portfolio rebalancing actions immediately below.

As discussed in the section immediately above, we believe the recent sell-off in US Treasuries has resulted in the unearthing of duration value in the US government debt curve. Specifically, we believe fair value levels on the US Treasury 10 year note hovers in the 3 to 3.25 percent range, exceedingly close to current levels. We hold such view on the basis of our assessment of the US economy's long-term economic growth potential along with standing core inflation target levels by the US Federal Reserve.

Given our valuation assessments on the US Treasury market, we have taken advantage of the recent sell-off in US interest rate sensitive equities, especially real estate, to take on exposure to the space for the first time in several years. Moreover, the bottom-up conditions surrounding the US real estate (excluding commercial) space have become attractive both on yield, balance sheet and credit access considerations. We have funded the purchase of US real estate sector exposure via a cut in our EAFE value exposure. We have chosen to cut exposure to that space on account of underwhelming earnings reports emanating from bellwether energy sector companies in Europe as well as global financial institutions, such as HSBC. We continue to like exposure to the space on top-down considerations but will await improving bottom-up momentum prior to reestablishing high exposure levels.

Global Emerging Markets Perspectives

EM Equities Extend Outperformance versus DM Peers thru February Global Equities Rout; EM Value Extends Outperformance versus Growth; Glovista Sustains Tilts

In February, Emerging Market (EM) equities extended their two-year long period of return outperformance versus Developed Market (DM) peers despite the monumental escalation in equity volatility recorded early in the month, discussed in the adjoining *Glovista Global Perspectives* column. We view EM equities' strong February relative performance versus DM peers as a testimony of the asset class' (a) exceedingly strong balance sheet and economic growth fundamentals, (b) compelling relative equity valuations versus DM peers, (c) beneficiary status from a broadening global economic growth backdrop and US Dollar weakness, and (d) under-owned status on the part of the global investor community.

The month of February marked an ongoing extension of the nascent return performance leadership by EM value sector-oriented markets versus growth-sector oriented peers, a dynamic conforming to Glovista's investment thesis for the EM asset class in 2018. Specifically, EMEA and Latin America regional stocks posted strong February relative return outperformance versus EM Asia peers. We credit such relative return performance dynamic both to relative valuation considerations as well as the broadening economic growth momentum across the EM universe.

The Glovista investment team continues to favor overweight country exposures to value-oriented markets, including Russia, Brazil, Chile and underweight country exposures to growth-oriented markets, including Taiwan and South Korea. Within the value-sector oriented EM domain we recently upgraded Turkey from underweight to moderate overweight on resilient financial sector earnings performance as well as increasingly compelling currency valuations. We maintain an underweight Mexico country allocation given underwhelming relative valuations and earnings momentum. In the Asia Pacific region, we have maintained and modestly raised overweight country allocations to a number of ASEAN markets, particularly to those hosting attractively valued financial sector stocks, improving business cycle expansion dynamics and compelling currency valuations. Finally, we have chosen to maintain an underweight South Africa country allocation given unattractive relative stock valuations despite recent improvements in country risk following this month's change in government leadership.

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