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GLOVISTA INVESTMENTS

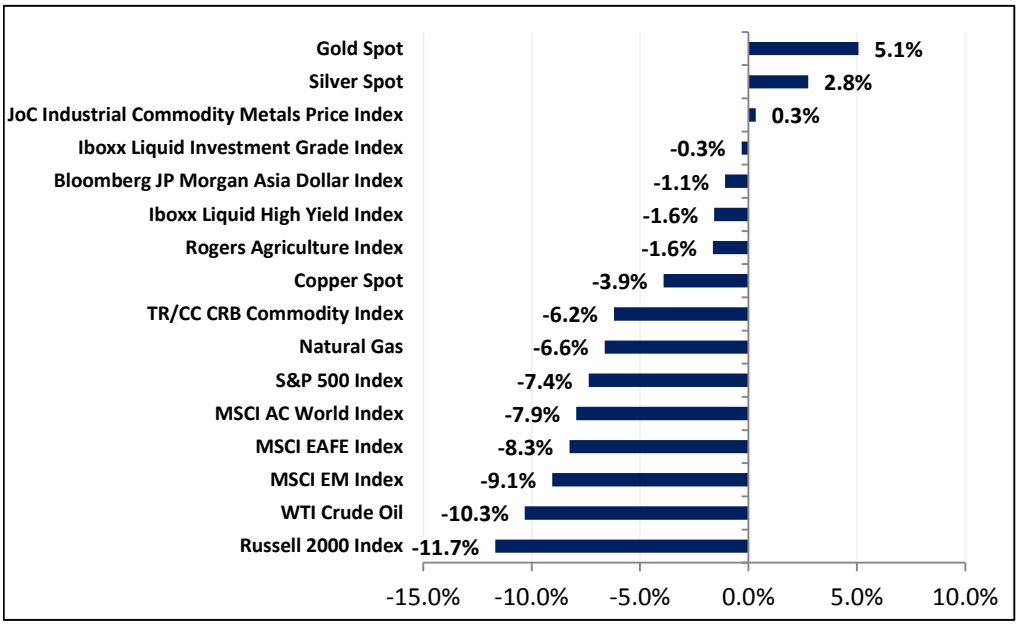
Glovista Global Perspectives

This Issue:

Risk Markets Record Sharp January Price Declines, Fueled by China Concerns, Renewed Oil Price Collapse and Softening Economic Calendar in USA and Europe. Glovista Maintains Defensive Portfolio Stance

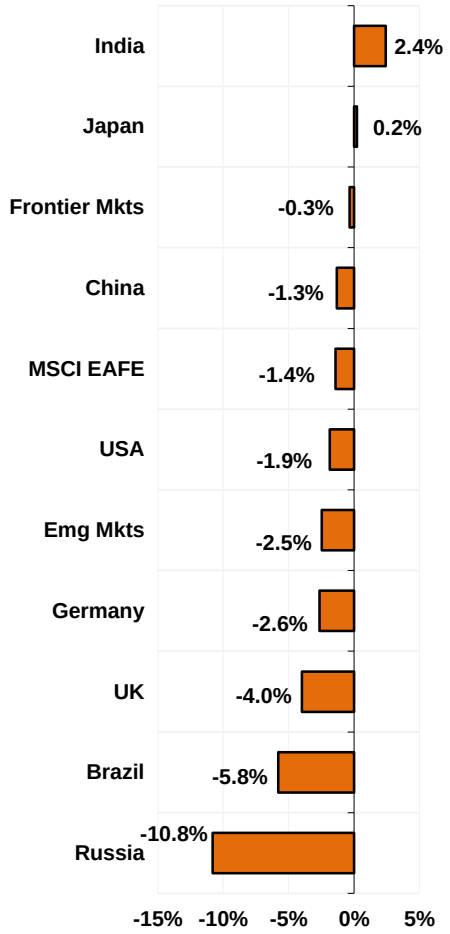
Thus far this month, risk markets have recorded among their worst January monthly price declines in history. Such outsized price declines come on the back of a succession of developments including weaker than expected economic releases out of the USA and Europe, disconcerting policy guidance out of senior China policy officials along with an ongoing crude oil price crash. Table 1 outlines the 2016 month-to-date (MTD) price declines recorded by a number of bellwether market indices in equities, credit and commodities.

Table 1. Risk Indices Record Outsized Price Declines thus far in 2016 (January 1st to January 28th, 2016)



Source: Bloomberg

Country-wise Monthly Performance in USD terms (December 2015)



Source: MSCI & Bloomberg

As noted above, Glovista's investment team believes this month's outsized price declines in risk indices respond to the simultaneous unfolding of three major developments

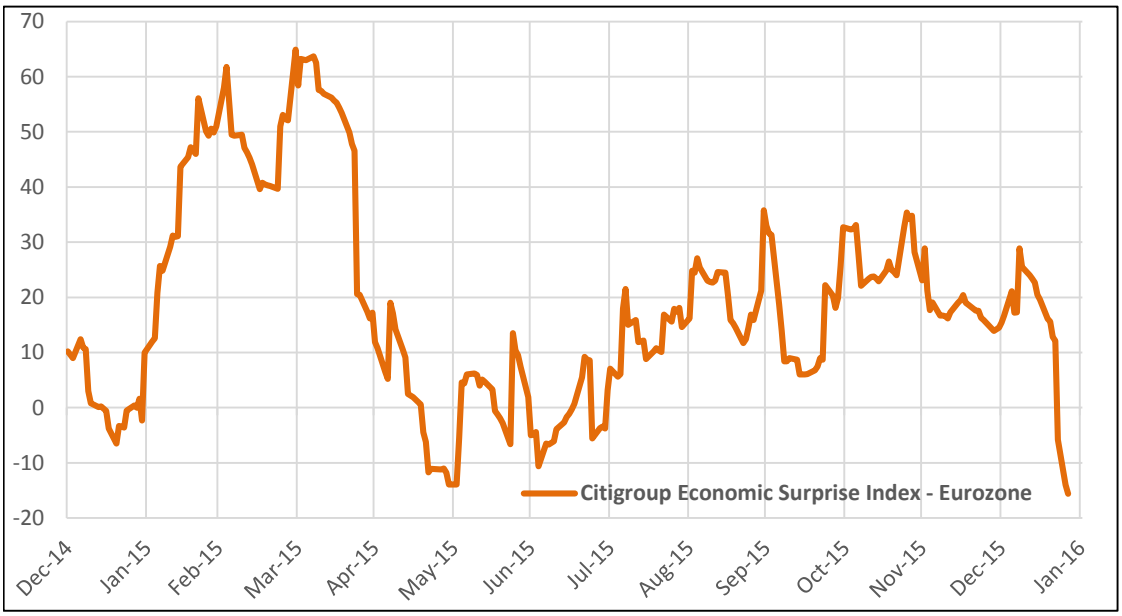
- ***Markedly weaker than expected economic releases for the month of January out of the world's major economic blocs, including the USA and Europe*** (Figure 1 and Figure 2). These include a number of below consensus economic releases for US retail sales, German retail sales, capital expenditure in Japan, USA and the Eurozone as well as softening of world trade momentum.

S&P500 Monthly Sector Performance – December 2015

Sectors	% Change	FY1 PE Ratio
Energy	-10.0%	25.5
Materials	-4.43%	17.0
Industrials	-2.21%	16.3
Cons Disc	-2.97%	20.1
Cons Stap	2.51%	21.1
Technology	-2.33%	17.0
Healthcare	1.61%	17.4
Financials	-2.35%	14.6
Utilities	1.85%	16.0
Telecom	1.72%	12.6
S&P500	-1.75%	17.4

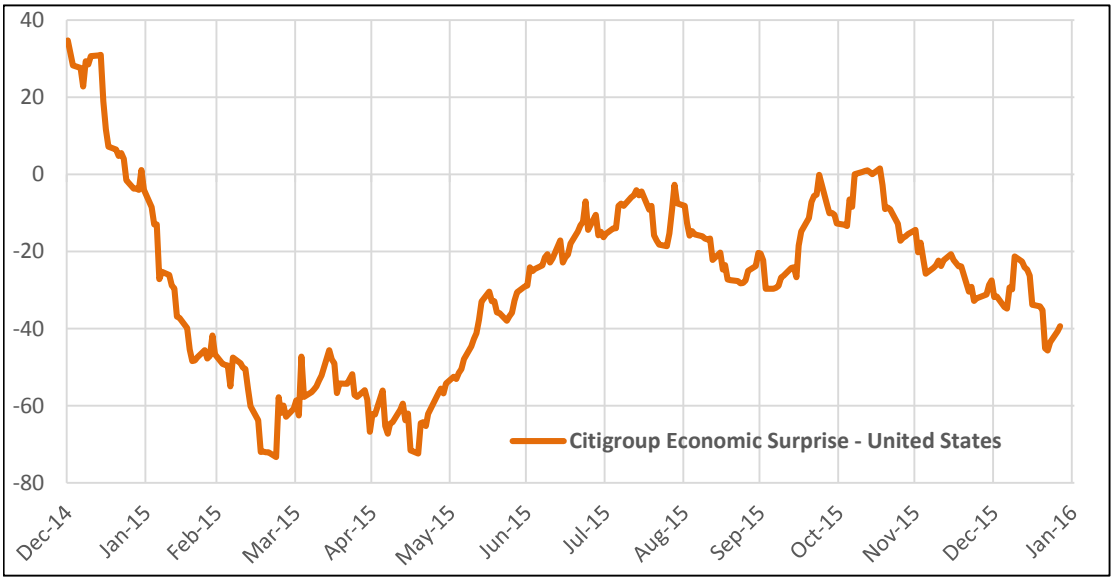
Source: S&P

Figure 1. Eurozone Economic Momentum Weakens Markedly Early in 2016



Source: Citigroup Global Markets

Figure 2. US Economic Momentum Softens Early in 2016



Source: Citigroup Global Markets & Glovista Calculations

- ***The release -early in the month of January- of China macro policy guidance for 2016 entailing disinflationary and decelerating implications for the global economy.*** Specifically, on January 4th a major China daily publication released an unusually informative interview of an unnamed senior macro policy strategist. The interviewee listed a number of major policy directives for 2016 including: the absence of a new round of major policy stimulus for the year; greater emphasis on supply-side reform, including an intensification of factory shutdown activities, and; the government's continued commitment to prevent disorderly deceleration of economic activity via the embracing of a more flexible policy stance which our investment takes to signify, among others, the likelihood of further weakening of the Renminbi versus the US Dollar.

- ***Extension of crude market crash early in 2016.*** The turn of the year has marked downside acceleration in the price of crude (Figure 3). That recent crude price declines appear to respond primarily to supply-side considerations - including the coming to market of Iranian oil production - normally would prove favorable for the world economic outlook and risk markets. However, millennials' frugal disposition, reflected in notably higher savings rate levels versus the pre-2007/2009 crisis period, together with the energy complex's central role in the global economy's CAPEX cycle these past several years account for the adverse effect collapsing crude prices is exerting on investors' expectations over the world economic outlook in 2016 and 2017.

Figure 3. Crude Market Crash Extends Further Early in 2016

Source: Bloomberg

	December 2015	December Change
Gold	1061.42	-0.3%
Silver	13.8582	-1.6%
Oil	37.04	-11.1%
EUR	1.0862	2.8%
JPY	120.22	2.3%
GBP	1.4736	-2.1%
CHF	1.0021	2.6%
CAD	1.3839	-3.6%
AUD	0.7286	0.8%
BRL	3.9608	-2.4%
MXN	17.2075	-3.8%

Source: Bloomberg

Rates	December 31st Level
1 Yr CD	0.62%
5 Yr CD	1.40%
30 Yr Jumbo Mortgage	4.44%
5/1 Jumbo Mortgage	3.67%
US Govt. 10 Year	2.27%
10 Yr Swap Spread	-0.0825%

Source: Bloomberg

Market Stabilization Likely Awaits Policy Clarity out of China, Strengthening US and European Domestic Expenditure Data, and Fed's Adjustment of Policy Rate Guidance

As noted in prior monthly columns, our investment team has maintained a cautious investment outlook towards US equities on the back of the market's extended valuations, declining earnings and profit margin dynamics together with a marked tightening of financial conditions. Moreover, the combination of declining profitability and rising debt cost of capital – courtesy of rising credit spreads – virtually guarantee a slowdown in the pace of stock repurchases by US corporates, a dynamic that has accounted for the single largest net purchase of US equities these past several years.

As we look ahead, from the vantage point of lower equity price levels to the tune of 10 % from a month ago, it is reasonable to ponder if it is advisable to raise exposure to global equities. In our view, US equities, with selected exceptions including utilities and consumer sector stocks, are to be underweight at the global level while core Eurozone, Japanese and selected Emerging Asia equities are to be owned. Moreover, exposure to non-US equities should be, for the most part, implemented on a currency hedged-basis as the Glovista investment team continues to expect the US Dollar to rally further within the multi-year bull cycle that began in 2013.

Looking ahead, we expect to raise overall equities exposure in our managed global portfolios, at the expense of fixed income and cash instruments, once one or more of the following conditions unfold:

- ***Increased policy clarity out of China***, including guidance on how the country's central bank (the PBOC) will manage the interchange between interest rate and exchange rate policy as well as the extent of supply-side reforms implemented by Beijing over the course of the year.

- ***Stabilization in the pace of decline in domestic expenditure data in the USA and Eurozone***. Our cautious stance towards risk assets reflects our concerns surrounding the outlook for business investment spending in the USA and Europe at a juncture in which the energy sector complex, a major driver for overall CAPEX growth these past several years, undergoes first-order retrenchment in investment levels owing to impairments tied to the sharply lowered oil price levels.

- ***US Federal Reserve's adjustment of its staff's projections on future Fed Funds rate hikes*** expected later this year and in 2017 (so-called Fed dots). Specifically, we believe that recent economic releases out of the USA, China and Europe strongly suggest against the case for the US Federal Reserve's pursuit of a succession of rate hikes later this year and in 2017. Not only have supply-side and demand-side indicators come out on the weaker end of the range of consensus estimates but also the tightening of US financial conditions, on the back of a strong US Dollar, and the continued widening of credit spreads reinforce the case against additional Fed rate hikes.

Our investment team views the unfolding of the above listed conditions as likely triggers for a reversal in price momentum governing risk markets globally, especially equities and credit. Such expectation hinges on the following dynamics:

- the likely decline in risk premium levels globally that would obtain should greater China policy clarity be forthcoming over the coming months and also should the US and European economic calendar strengthen from current levels;

- the liquidity boost globally that would accompany the topping out of the US Dollar bull cycle, a likely result of a scenario in which the US Federal Reserve downwardly adjusts guidance on the future path of Fed Funds rate hikes.

Against the current volatile global macro environment, we intend to maintain the highly defensive portfolio stance we have held over the past several months. As one or more of the above mentioned macro developments unfold, we anticipate to dial up our managed portfolios' risk exposure levels. Until then, we will continue to hold overweight exposure to US Dollar-denominated predominantly investment grade fixed income instruments, including corporates, as well as modest exposure to defensive sector high quality stocks while preserving no exposure to commodity markets.

Emerging Markets Perspectives

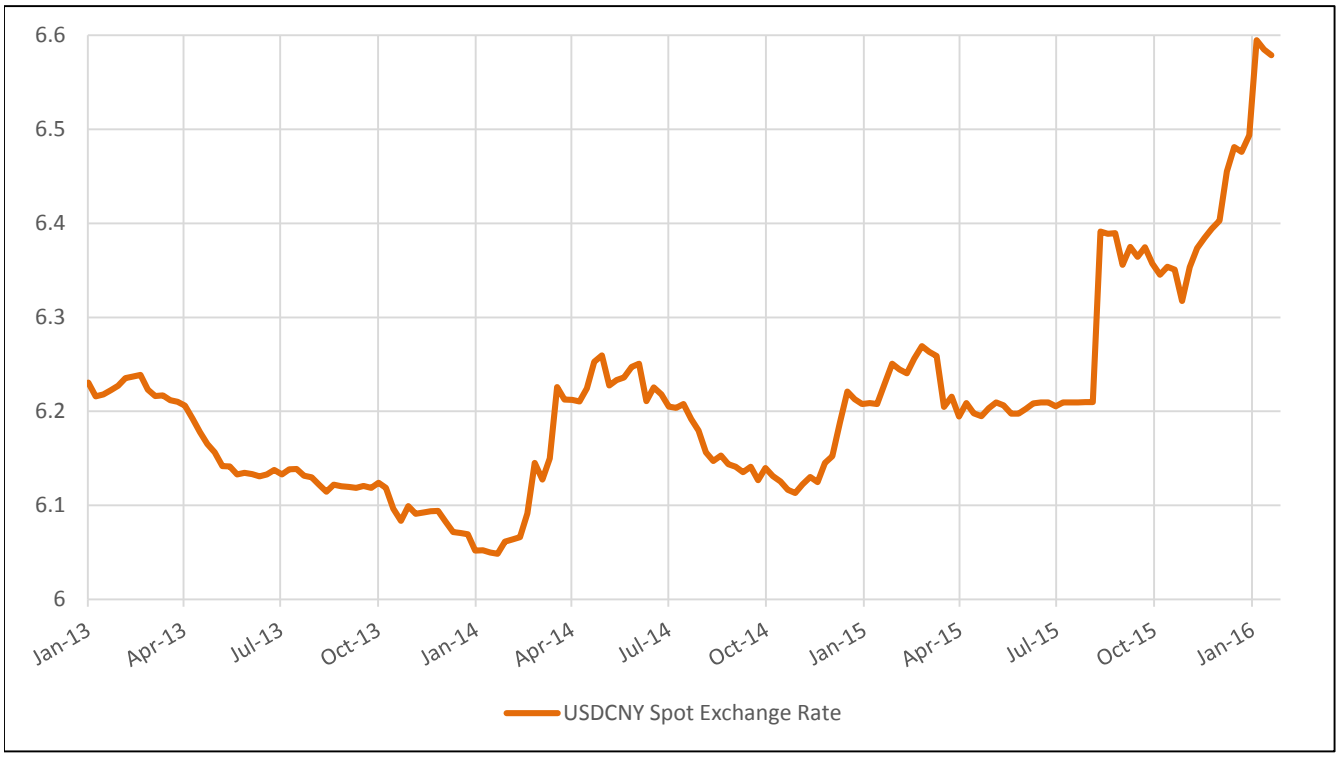
Energy Market Crash along with Concerns tied to China Policy and World Economic Outlook Reinforce Glovista's Standing EM Country and Sector Tilts

As discussed at length above, the month of January has witnessed thus far one of the sharpest monthly price declines in over four years across a number of risk asset classes globally. Recent asset price declines reflect growing investor concerns over several policy and economic developments, including: the potential for further downside economic acceleration in China following the release early in January of policy guidance for 2016; adverse global credit market implications derived from the ongoing energy market crash; unexpected softening of demand-side economic releases in the USA and Europe despite the boost factor resulting from lower energy prices and mild weather conditions in the northern hemisphere; and, the impact of further US Dollar strength on the pace of world economic growth throughout 2016.

We address below each of the above noted areas of investor concern in the context of Emerging Market equities which reinforce the standing country and sector tilts reflected in Glovista's managed Emerging Market equities portfolios.

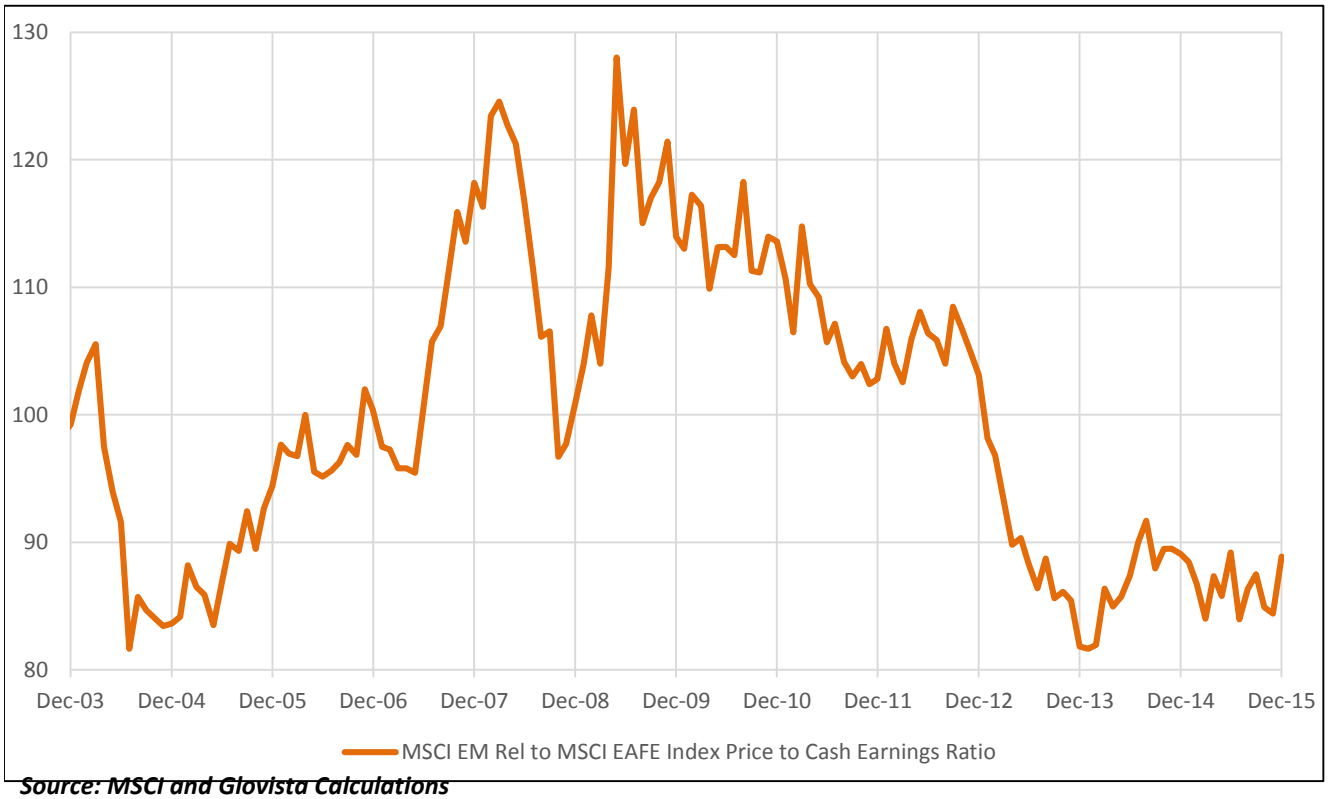
First, recent developments out of China, including the steady weakening of the Renminbi (Figure 4), together with the deterioration of the US and Eurozone economic calendar reinforce the case for maintaining underweight allocations to commodities-, materials- and industrials-sector exposures in our EM portfolios. This is because of the disinflationary/low economic growth implications derived from both of those dynamics. Furthermore, the ongoing transition of China's economic model away from the goods sector to the benefit of the services sectors reinforces our standing underweight China country allocation as well as our focus, within our China portfolio sleeve, towards service sector stocks and massive underweight allocation to 'old-China' plays.

Figure 4. Steady Weakening of the Renminbi versus US Dollar Amounts to a Disinflationary Shock to the Rest of the World



Source: Bloomberg

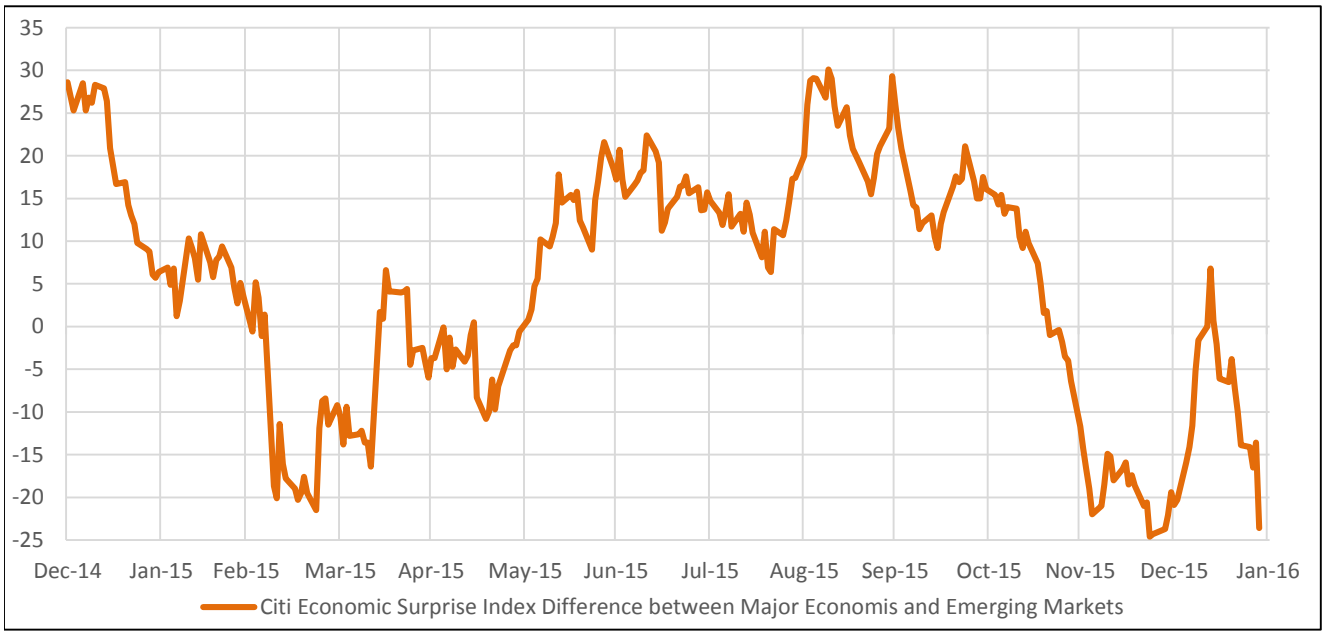
Figure 5. EM Price to Cash Earnings Relative Valuations versus EAFE Peers Hovers at Close to Historical Low Levels



Source: MSCI and Glovista Calculations

Second, a careful review of recent economic releases, out of both Emerging and Developed country blocs, should caution investors against drawing conclusions commonly highlighted in the financial media. Specifically, in contrast to widely held views, recent economic releases evidence a sharper downside acceleration in economic activity these past several weeks in Developed economies versus their Emerging Market peers (Figure 6). Such observation is consequential to investors as they tend to associate global economic softness with Emerging Market equities' relative underperformance of Developed Market peers. As Emerging Market equity valuations versus Developed Market peers hover at significant discount levels to the historical average (Figure 5), that relative economic momentum is no longer weakening for a number of major Emerging Market economies may provide an impetus for a number of EM country indices to extend relative return outperformance versus Developed peers, such as the case of Indian equities, Won-hedged Korean stocks and IT sector Chinese stocks that hover well above 52 week-low levels versus EAFE and NYSE Composite index levels, having touched trough levels in relative terms several months ago, and in some cases well over a year ago. In short, there is an ongoing relative outperformance cycle for a selected number of large capitalization EM country and sector indices versus Developed peers, that has been in place for months in some cases and well over a year in a smaller number of cases.

Figure 6. At Start of 2016, Developed Countries' Economic Calendar Underwhelms versus EM Countries'



Source: Citigroup Global Markets and Glovista Calculations

Third, recent 2016 China macro policy guidance suggests the PBOC stands ready to accommodate a faster pace of Renminbi currency devaluation versus the US Dollar. Such new stance is evident from the government's commitment to prevent a more significant pace of economic deceleration resulting from the country's leadership decision not to initiate a new round of fiscal stimulus this year as well as their disposition to speed up the shutdown of factories in sectors of the economy displaying excess capacity. In turn, a backdrop of weaker Renminbi exchange rate versus the US Dollar reinforces the Glovista team's standing view to hold an overweight exposure to Korean equities on a Korean Won hedged basis.

Besides the likely impact a weakening Chinese Renminbi is to have on other Emerging Market currencies, such development is likely to result in renewed pressure on credit spreads of highly indebted Emerging Market corporate and sovereign issues. In fact, some of the worst performing Emerging Markets YTD include indices of countries displaying stretched leverage levels either at the corporate or sovereign levels, such as Russia, South Africa and Brazil. Put differently, we believe stronger credit issuers, both at the company and sovereign level, are more likely to outperform Emerging Market company and country index peers in the balance of the year. In that regard, our EM portfolios' strong overweight allocation to Taiwan, 'new China' (debt-free sector plays) and Korea while underweighting country exposures to Brazil and South Africa are consistent with such baseline investment thesis.

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