GLOVISTA INVESTMENTS

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Monthly
Market
Newsletter

Glovista Global Perspectives

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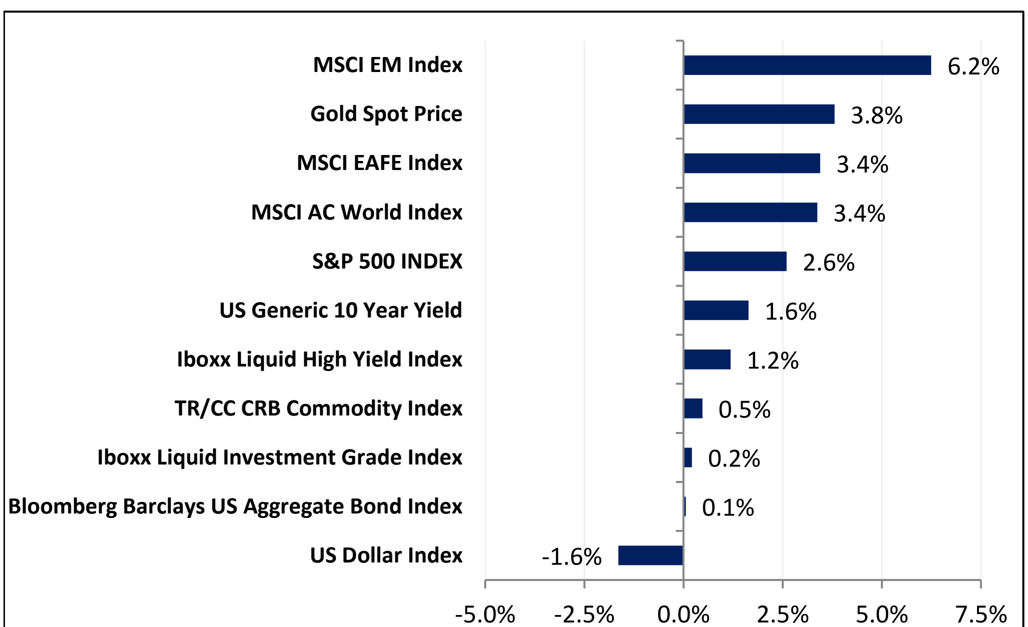
Risk Markets Edge Higher on Strengthened Activity Indicators; US$ Pulls Back, Impacted by Risks Tied to Trump's Economic Agenda; Non-US Markets Lead

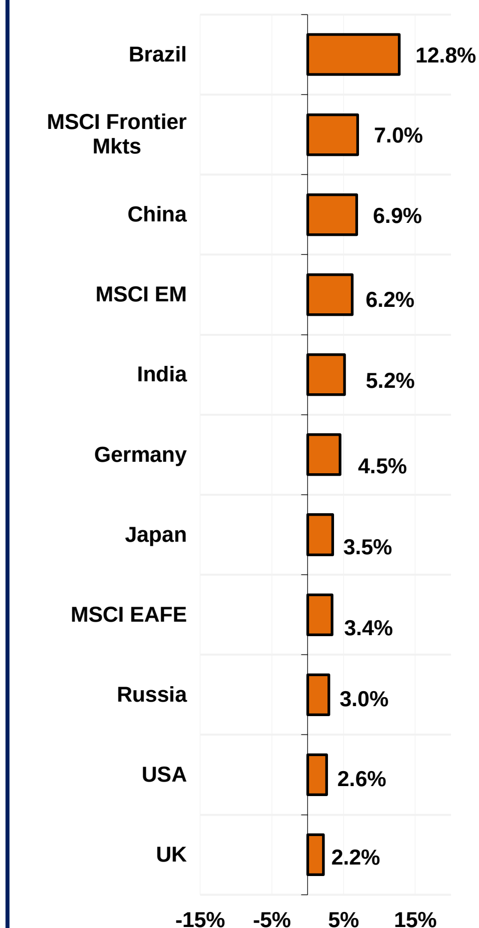
The month of January has witnessed a robust move higher in risk indices at a global level, as illustrated in Figure 1. In contrast to the rally in risk markets that unfolded immediately following the US November elections, the January month-to-date rally has not been led by US markets and value stocks. Non-US equity markets and commodity-linked asset markets have been behind the 2017 year-to-date rally, fueled by the meaningful pullback recorded by the US Dollar thus far in the month (Figure 2).

Figure 1. Risk Indices Rally Early in 2017, Led by Emerging Market Equities (January 1st, 2017 to January 27th, 2017)



Source: Bloomberg

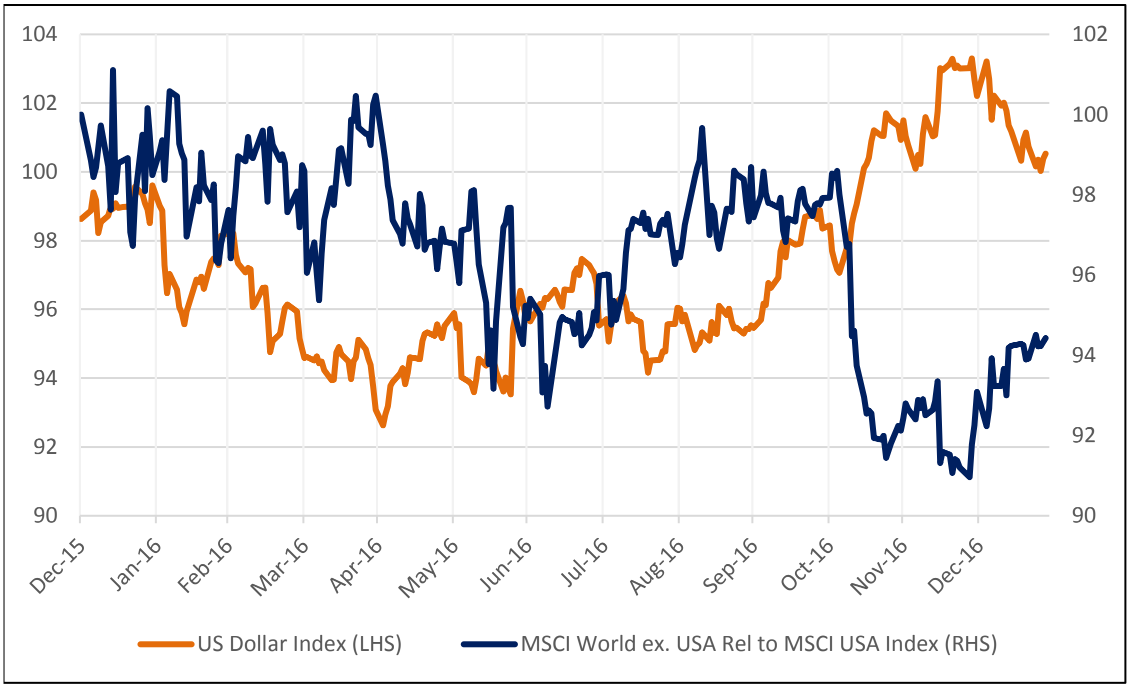
Country-wise Monthly Performance in USD terms (Jan MTD 2017)*



Source: MSCI & Bloomberg

**As of January 27th, 2017*

Figure 2. *US Dollar Index Pulls Back Early in 2017, Anchoring the MTD Commodities-linked and Non-US Market Performance Leadership*



Source: MSCI, Bloomberg and Glovista Calculation

S&P500 Monthly Sector Performance – Jan MTD 2017*

Sectors	% Change	FY1 PE Ratio
Energy	-1.82%	144.4
Materials	6.37%	19.7
Industrials	3.11%	18.7
Cons Disc	4.56%	19.3
Cons Stap	1.04%	20.5
Technology	5.85%	17.4
Healthcare	1.15%	15.5
Financials	1.53%	15.6
Utilities	-0.44%	17.0
Telecom	-3.18%	14.6
Real Estate	-0.42%	37.0
S&P500	2.50%	18.9

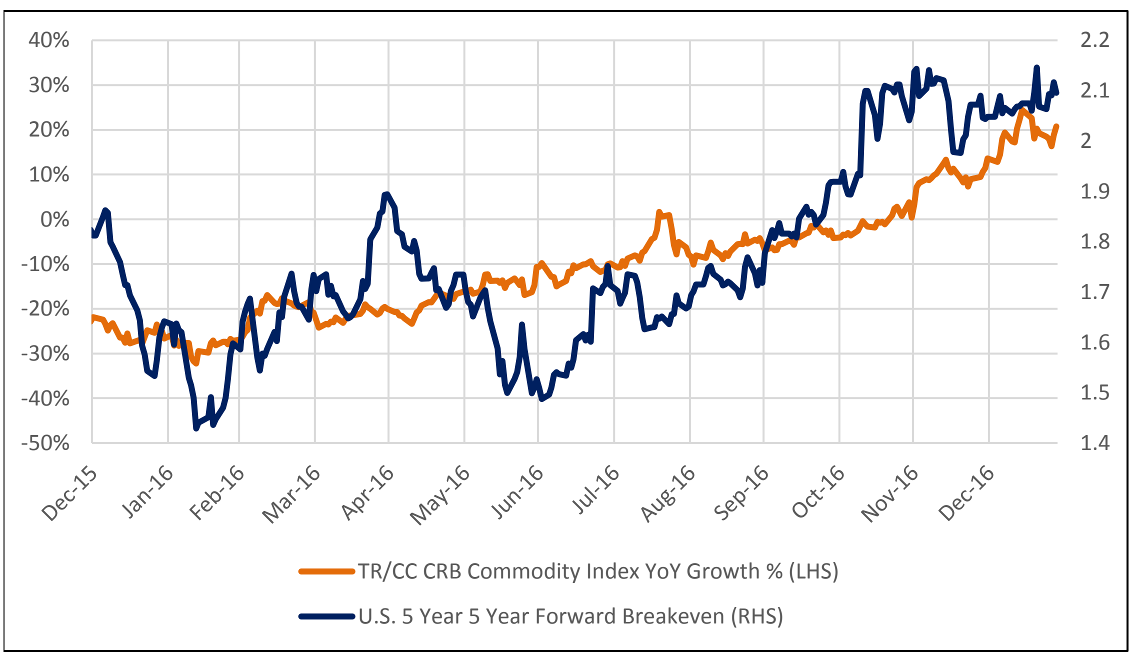
**As of January 27th, 2017*

Source: S&P

We attribute the January rally in risk markets to two principal factors:

- The global reflationary effect derived from the weakening US Dollar thus far this year, including but not limited to increased commodity price momentum (Figure 3);

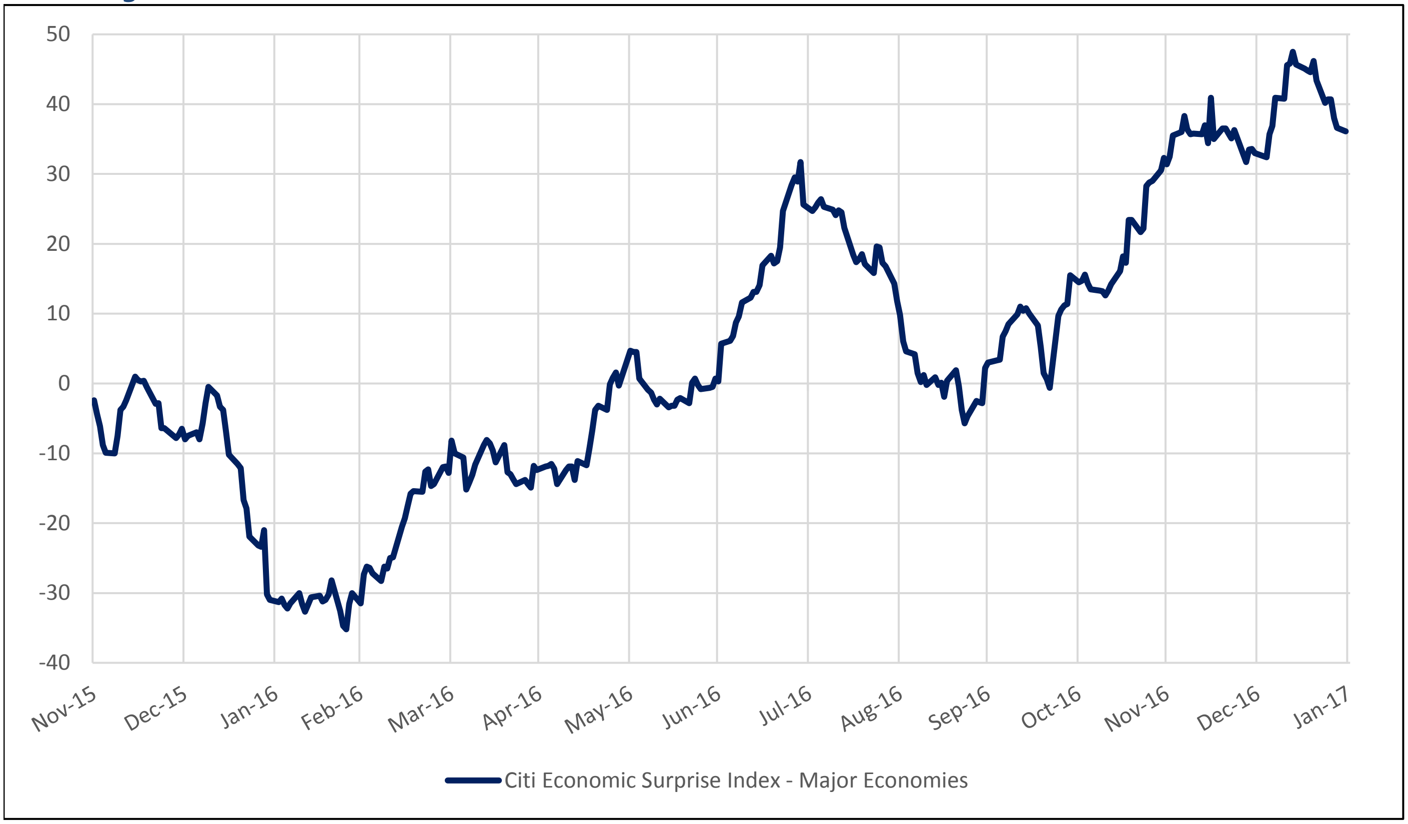
Figure 3. *2017 MTD Bounce in Risk Indices Likely Reflects Reflationary Effects Tied to Recent US Dollar Weakness*



Source: Bloomberg

- The string of robust readings across activity indicators for a number of the world's major regional economies thus far in January. Such indicators span not only activity and business sentiment indices but also consumer confidence and labor market indicators. Figure 4 illustrates the rebound posted by the economic surprise indicator for the world's major economies thus far in January.

Figure 4. Major Economies' Economic Surprise Activity Indicator Strengthens Further Early in 2017, Anchoring Bounce in Risk Market Indices



Source: Citigroup Global Markets

The above interpretation of the January rally in risk indices raises a number of questions, including the following:

- What factors underlie the 2017 MTD weakness in the US Dollar? Moreover, is such weakness likely to prove sustainable?

- What cross-asset market implications are likely to emanate from the increased potential for US Dollar weakness to color the world market outlook in the remainder of 2017, particularly versus Developed country peers?

We seek to address these questions immediately below, concluding with an outline of some of the potential portfolio rebalancing actions we may implement across Glovista's portfolios.

	Jan 27th 2017	Jan MTD Change
Gold	1191.3	3.4%
Silver	17.1425	7.7%
Oil	53.17	-1.0%
EUR	1.0699	1.7%
JPY	115.1	1.6%
GBP	1.2555	1.7%
CHF	0.9993	1.9%
CAD	1.3153	2.1%
AUD	0.7551	4.8%
BRL	3.1409	3.5%
MXN	20.8863	-0.8%

Source: Bloomberg

Rates	Jan 27th Level
1 Yr CD	0.59%
5 Yr CD	1.22%
30 Yr Jumbo Mortgage	4.44%
5/1 Jumbo Mortgage	3.70%
US Govt. 10 Year	2.4843%
10 Yr Swap Spread	-0.0875%

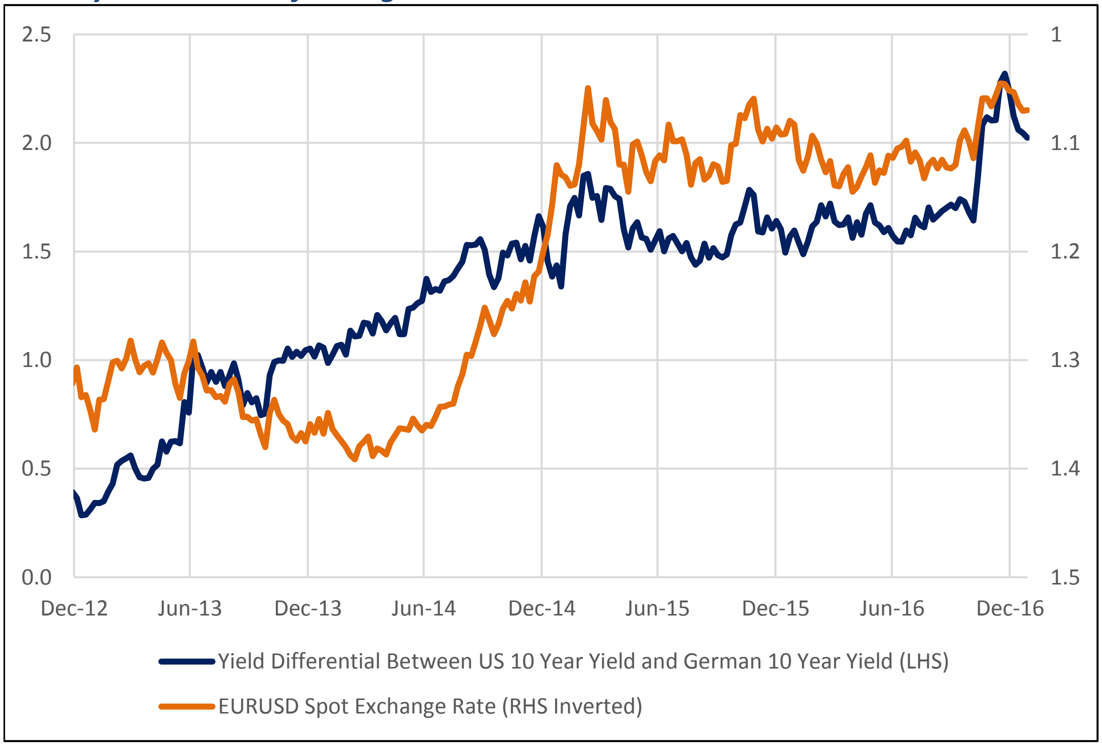
Source: Bloomberg

US$ Pulls Back on Shift in Europe-US Relative Economic Momentum, Signs of ECB Tapering Early in 2018 and Republicans' Guidance on Revenue Neutrality Requirement for Passage of Trump Fiscal Agenda; Recent US $ Weakness May Extend across Balance of 2017

In our view, the measurable pullback recorded by the US Dollar versus a number of the world's major currencies thus far in January reflects a number of important economic, policy, technical and political developments. We outline said developments further below. In our discussion, we argue that a number of these dynamics carry the potential of sustaining themselves over the course of 2017. As a result, we conclude this section with an assessment that the US Dollar carries the potential to undergo further weakness versus a number of Developed currency peers over the rest of the year. As for Emerging Market currencies, we sustain our longstanding bullish view with a few exceptions including China's RMB, as discussed in our 2017 year-ahead outlook report, published in December 2016. Some of the recent developments accounting for the January MTD weakness in the US Dollar include the following:

- *Economic:* Thus far in January, Eurozone regional economic indicators – especially for the region's core economies, especially Germany – have outpaced those of the US. Against such backdrop, Eurozone government debt yields have rallied, resulting in a measurable narrowing of yield spreads versus US Treasury securities as implied real yield differentials respond to the relative strengthening in economic data for Europe (Figure 5).

Figure 5. Eurozone-US Government Debt Yield Differentials Narrow Considerably in January on the back of Strengthened Relative Economic Calendar



Source: Bloomberg and Glovista Calculation

- *Political:* Over the past several days, senior Republican leaders in Congress have gone on record calling for revenue neutrality to accompany the introduction of the fiscally expansive agenda posited by the Trump administration. Assuming such stance holds, the acceleration of US economic momentum over the next 24 months resulting from the implementation of fiscally expansive policies is likely to be markedly softer than expected. Consequently, the real GDP growth premium imbedded in the recent rise of US Treasury debt yields, anchoring the post-November US Dollar rally, is likely to lose force over the coming months.

- *Policy:* Throughout the month of January, multiple senior FED leaders, including Chair Janet Yellen, have gone on record expressing the FED's readiness to raise policy interest rates more aggressively under an expansionary fiscal policy scenario. Put differently, FED policy is less likely to accommodate the Trump administration's expansionary fiscal policy agenda. Moreover, the European Central Bank (ECB) recently announced an earlier than previously expected date by when its standing quantitative easing (QE) program will begin to undergo tapering – first quarter 2018 – while over the past several months the Bank of Japan has begun to implement a turn away from QE to a yield targeting approach. At the margin, these recent policy shifts on the part of the ECB and the BOJ amount to a tightening of liquidity conditions for Euro and Yen, potentially anchoring a sustained rebound in the Euro and Yen versus the Greenback.

- *Technical:* CFTC data together with survey data tallied by large investment banks, showing overbought USD positions, highlight important risks facing the prospects for a sustained further near-term strengthening of the US Dollar and rise of US Treasury debt yields.

Of the above mentioned factors, we believe the political and policy developments carry the potential of sustaining themselves over the balance of the year, thereby laying the ground work for a period of sustained US Dollar weakness versus Developed currency peers.

Should a period of sustained US Dollar weakness crystallize over the coming months, we believe the cross-asset market implications will prove to be material. Specifically, commodity markets are likely to rally further, non-US equities are likely to strongly outperform US equity peers over the balance of the year, led by Emerging Market equities. As for fixed income markets, various scenarios are possible depending upon the profile of the Trump fiscal agenda to be put forth over the coming months together with the ensuing FED policy response.

Glovista Further Raises Non-US Equities Exposure, Maintaining Overweight Credit Market Exposure

Against recent developments, discussed above, we have sustained our portfolio tilts across asset classes approximately unchanged these past several weeks. We have raised our equities exposure modestly, with a focus on non-US equities, including EAFE and Emerging Markets. Within the equities sleeve of the portfolio, we have also purchased a basket of commodities-linked equities, including in the agriculture sector.

Our decision to raise non-US equities exposure is made not only on the increased potential for US Dollar weakness versus Developed country peers but also EAFE and EM equities' more attractive relative valuations versus US peers. At the asset class level, our decision to raise equities exposure modestly is made on the back of the impetus provided by (a) strengthened activity momentum globally together with (b) improved flows backdrop facing global equities given reflationary trends stemming from a weaker US Dollar and strengthened wage momentum out of the US and Europe, a result of labor market tightness in those two major economic blocs.

Of course, the investment outlook, including the near-term, is not bereft of risks. Some of the principal risk factors include the following:

- Current elevated bullish equity investor sentiment in the USA, including corporate insiders' net sell traded volumes.

- Geopolitical risks, including the fast-approaching Dutch elections and the potential for snap elections in Italy – the recent widening of debt spreads between the European periphery's sovereign benchmarks and Germany's attests to such risk factor. Likewise, the newly inaugurated Trump administration's anti-globalization rhetoric carries the potential for setting off trade wars with important trading partners in Asia and the Western Hemisphere.

- Hawkish FED rhetoric to intensify, thereby triggering a reset higher in the number of projected policy interest rate increases for the balance of 2017 from the current 50 bps, should the Trump administration's fiscal policy rhetoric intensify accordingly. In such scenario, equity valuation multiples could well compress, especially given the recent guidance given by senior Republican leaders surrounding the revenue-neutrality requirement to be attached to the Trump legislative agenda on the fiscal side later this year.

Emerging Markets Perspectives

EM Equities Rally Sharply versus Developed Peers Early in 2017, Fueled by Pullback in US $ Index; EM Commodity-linked Country Indices Extend Multi-month long Lead

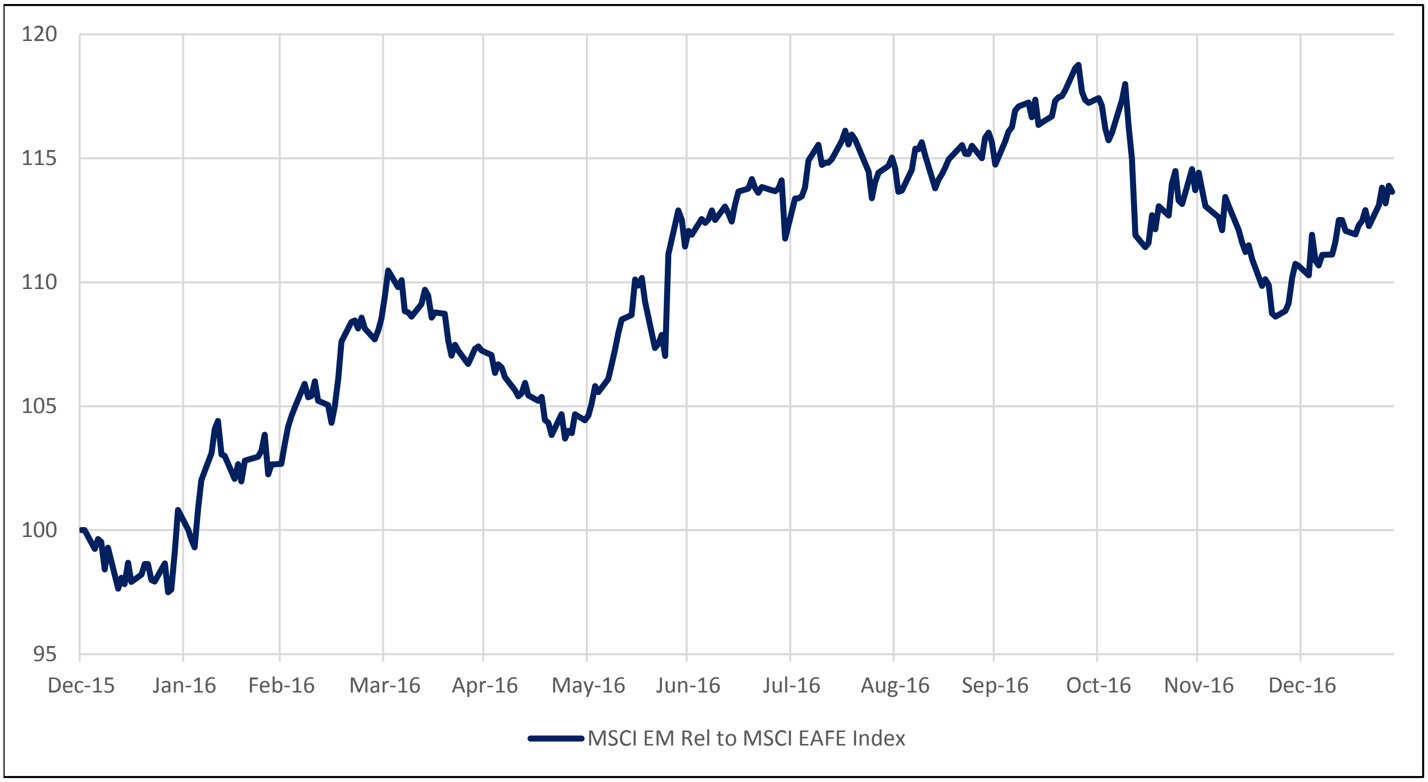
Through January 27th, Emerging Market equities have recorded a strong return outperformance of Developed Market peers. Specifically, thus far in January the MSCI EM index has outperformed the MSCI EAFE index by 279 basis points, thereby extending said cumulative return outperformance post-January 1, 2016 to an impressive 1328 basis points (Figure 6). We attribute EM equities' strong return outperformance of Developed peers thus far in 2017 to a number of macro factors, including the following:

- Strengthening economic calendar out of most of the world's regions, extending not only to the corporate but also consumer sectors, across both the developed and developing world. We discuss some of these dynamics in the sections above;

- Weakening of the US Dollar not only against a large number of EM but also Developed country currencies given a number of political, policy, economic and technical developments unfolding thus far in 2017.

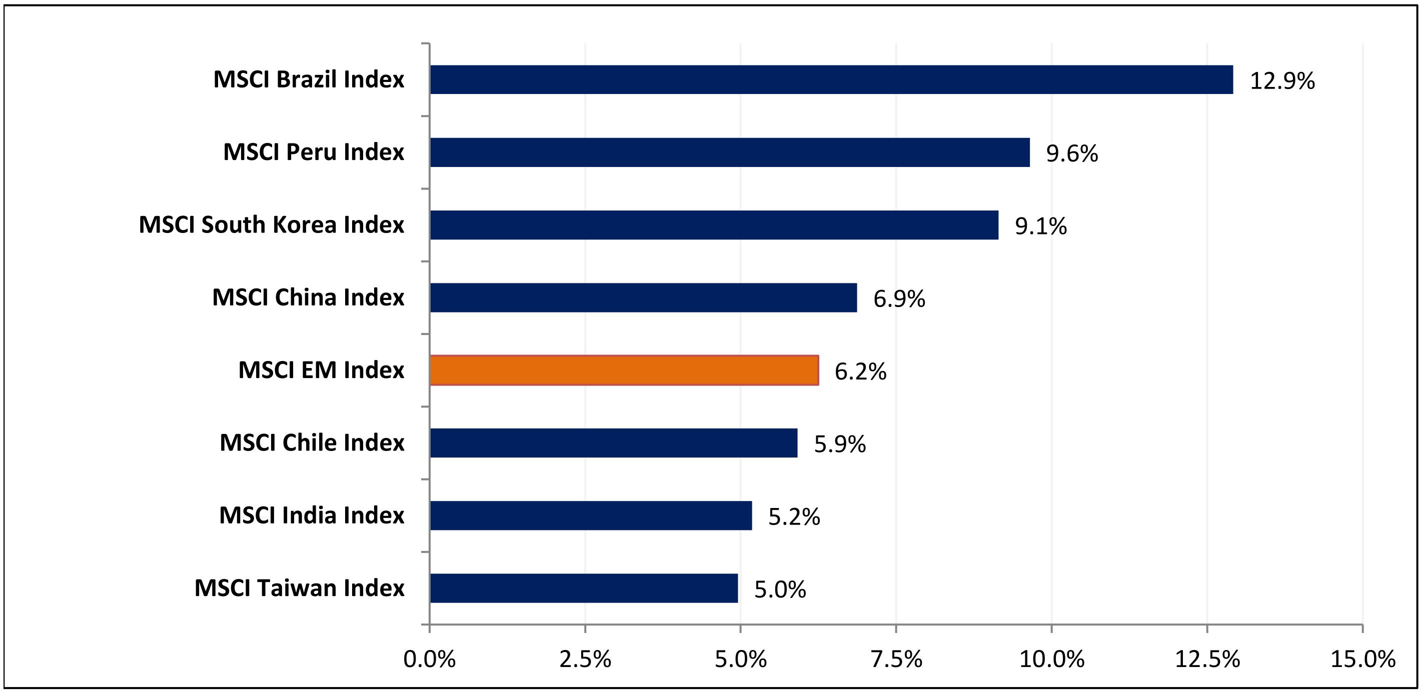
Given the recent pullback in the US Dollar index and the correspondingly supportive impact on commodity prices, it should come as no surprise that most of this year's top performing EM currencies versus the US Dollar includes commodity-linked currencies such as the Chilean Peso, the South African Rand, the Brazilian Real, the Peruvian Sol and the Colombian Peso. In turn, it should come as no surprise that those country indices have performed strongly versus the EM benchmark thus far in January (Figure 7).

Figure 6. Through January 27, 2017, EM Equities Extend Sharp Relative Outperformance of EAFE Peers that Commenced in January 2016



Source: MSCI, Bloomberg and Glovista Calculation

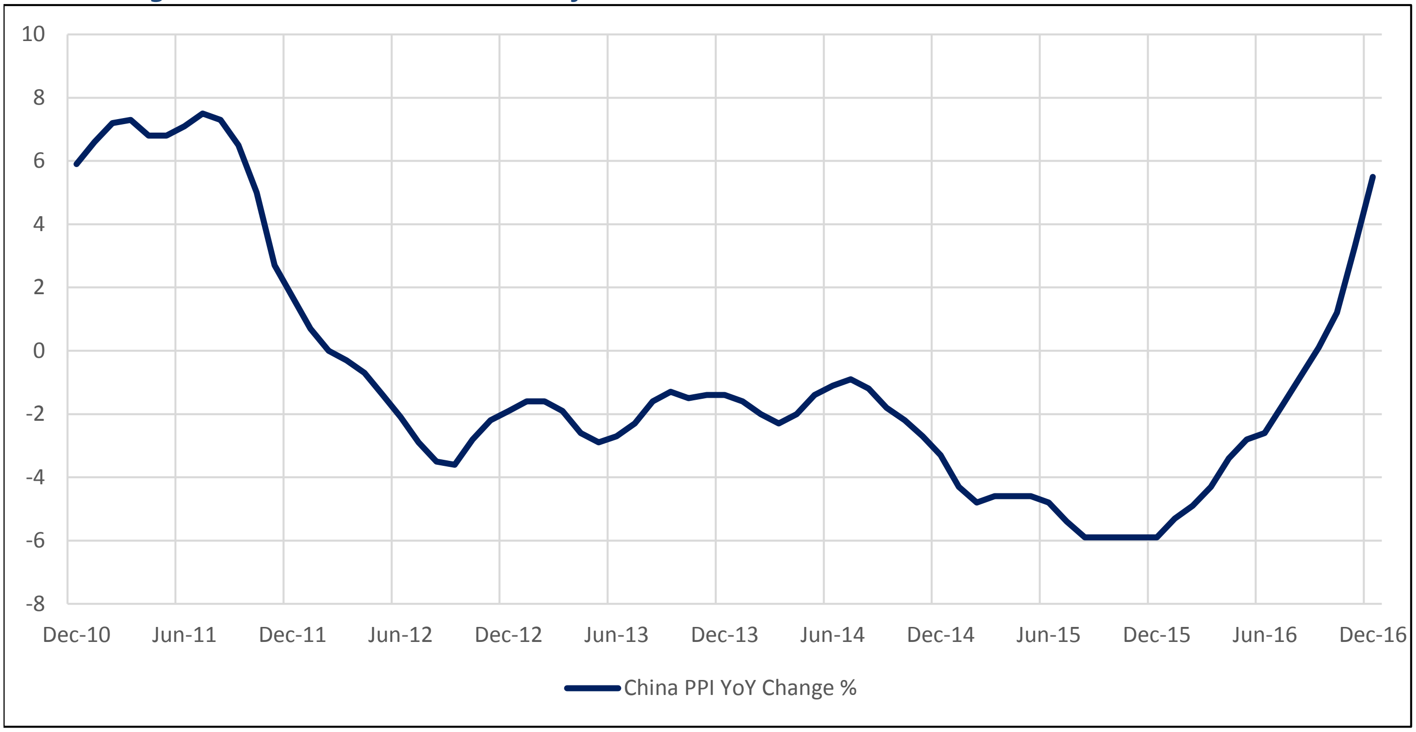
Figure 7. Commodity-linked EM Country Indices Lead 2017 YTD EM Performance Ranking (As of January 27th, 2017)



Source: MSCI and Bloomberg

The US Dollar factor along with global investors' pursuit of exposure to high real interest rate markets within EM countries undergoing sustained disinflationary trends are likely to prove determinant in identifying the set of top performing EM countries in 2017. We remain encouraged by EM equities' under-owned status, attractive relative valuations and sustained improvement in cyclical momentum versus Developed peers. We continue to favor overweight exposure to value-oriented country indices within EM. Though we see China as a source of downside risk facing the EM asset class in 2017, we are encouraged by the upturn recorded in PPI inflation these past several months, a good indication of a basing in corporate profit margin compression in the industrial sector (Figure 8).

Figure 8. China's Core Intermediate PPI Inflation Pick-Up Viewed as an Abatement of Investor Concern Surrounding Chinese Industrial Sector's Profit Outlook



Source: National Bureau of Statistics of China

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