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GLOVISTA INVESTMENTS

Glovista Global Perspectives

This Issue:

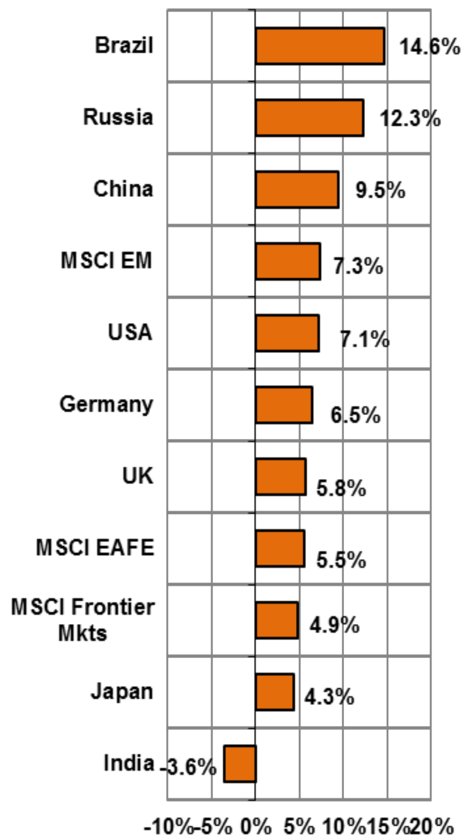
Risk Assets Rally on Risk Premium Compression, Courtesy of FED Policy Guidance U-Turn and Improved China-US Trade Negotiations; Glovista Reaffirms Quality, Stable Growth Value Tilts along with Weaker US$ Forecast

In January, risk asset prices have posted solid return performance across a number of asset groups, as illustrated in Figure 1. It is interesting to note that the January monthly recovery in risk asset prices has obtained despite an extension of the stream of weak economic activity indicators that accelerated early in the fourth quarter of 2018, as illustrated in Figure 2. As discussed in our December 2018 column, the massive sell-off in risk markets during the fourth quarter of last year resulted largely on the back of a weakening economic activity calendar and investor concerns over the rising potential of a US Federal Reserve policy mistake.

In our view, a quick look at the major non-data developments coloring the global economic landscape thus far in the month of January offers a convincing explanation for the sharp rally in asset prices. Specifically, the rally in risk asset prices has been fueled by a marked de-escalation of investor concerns (reflected in a compression in risk premium levels, illustrated in Figure 3) following two US centered policy developments on the monetary and trade fronts:

- On January 4th, US FED Chair Powell delivered a speech, before the annual meetings of the American Economics Association, signaling a marked turn in the magnitude of projected Fed Funds policy rate hikes for 2019 and 2020. That such material redirection of policy stance, from hawkish to dovish, took place a mere 6 weeks after a previous statement (accompanied the December FOMC meeting) unleashed important changes in the pricing of risk across asset markets globally, fueling a sharp decline in risk premium levels.

Country-wise Monthly Performance in USD terms (January 2019)*



Source: MSCI & Bloomberg

****As of January 30th, 2019***

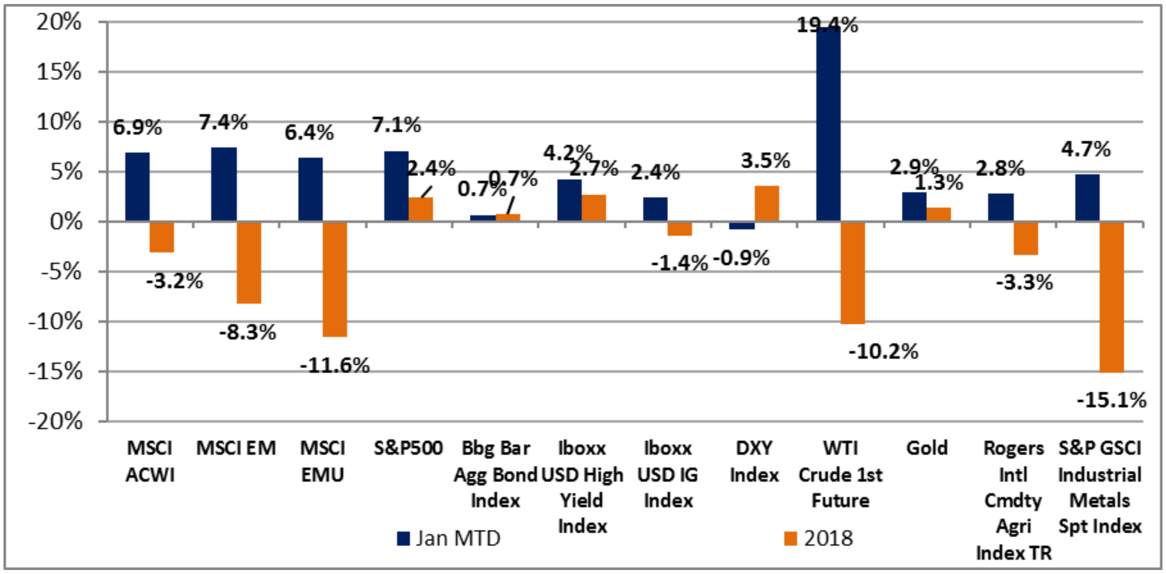
S&P500 Monthly Sector Performance – January MTD 2019*

Sectors	% Change	FY1 PE Ratio
Energy	10.24%	17.0
Materials	7.13%	15.0
Industrials	10.85%	15.1
Cons Disc	9.04%	19.9
Cons Stap	3.12%	17.6
Technology	7.00%	17.2
Healthcare	3.49%	15.5
Financials	8.88%	11.5
Utilities	1.27%	17.3
Telecom	6.10%	15.8
Real Estate	9.68%	39.5
S&P500	6.95%	15.9

**As of January 30th, 2019*

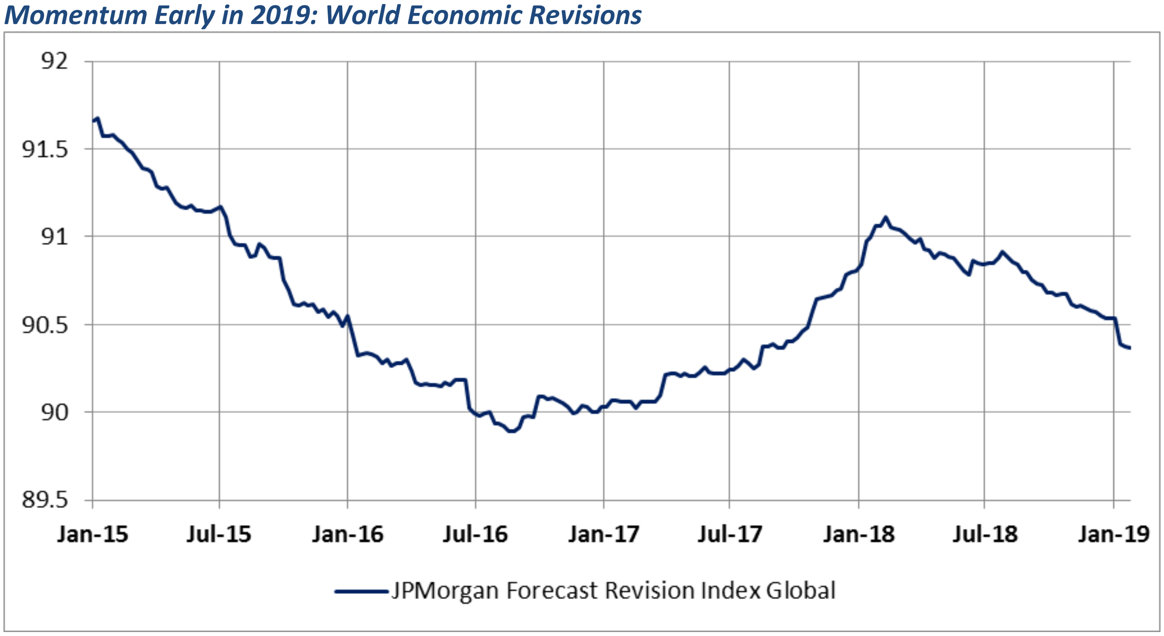
Source: Bloomberg

Figure 1. Risk Assets Post Strong January Rally on Declining Risk Premium Levels



Source: Bloomberg

Figure 2. January Bounce in Risk Asset Prices Obtains Despite Further Weakening of Economic Momentum Early in 2019: World Economic Revisions



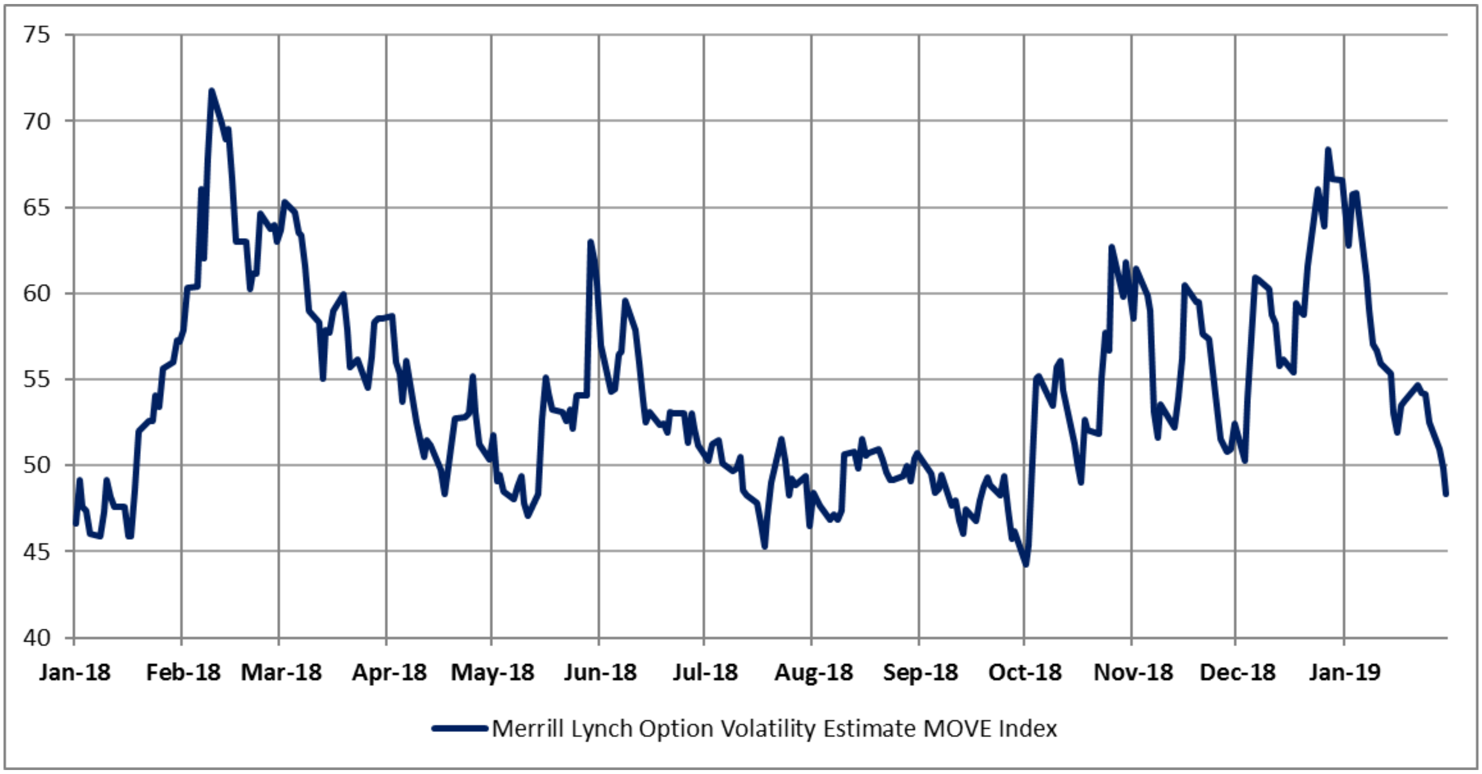
Source: JP Morgan

- Early in the month of January, the Trump administration cancelled a scheduled hike in trade tariffs with China originally expected to take effect in January, along with a decision to enter into serious negotiations with the Chinese over a 90 day period so as to reach a trade agreement between the two nations. That China-US trade frictions have lied at the epicenter of global investor concerns has become evident throughout a number of major global investor surveys. In that regard, such material shift in US trade policy negotiations with the Chinese amount to another round of risk premium compression besides that effected by the shift in monetary policy direction signaled by FED Chair Powell in January.

Figure 3. Risk Asset Market Bounce Accompanied by Decline In Risk Premium Levels: Decline of Equity VIX Implied Volatility Indicator

Source: Bloomberg

Figure 4. US Treasury Bond Market Volatility Declines Sharply in January, Fueled by US FED's Policy Guidance U-Turn in Dovish Direction



Source: Bloomberg

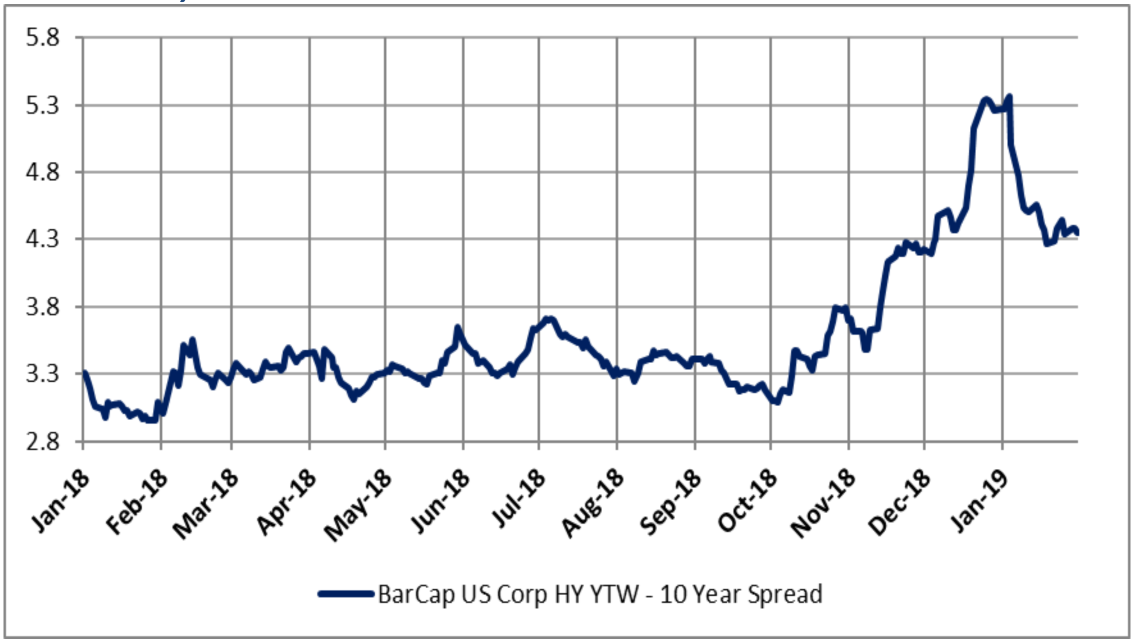
	January 30th 2019	January MTD Change
Gold	1319.97	2.9%
Silver	16.0655	3.7%
Oil	54.23	19.4%
EUR	1.148	0.1%
JPY	109.04	-0.6%
GBP	1.3116	2.8%
CHF	0.9942	1.2%
CAD	1.3149	-3.6%
AUD	0.7248	2.8%
BRL	3.6804	-5.2%
MXN	19.1337	-2.6%

Source: Bloomberg

Rates	January 30th Level
1 Yr CD	1.49%
5 Yr CD	2.04%
30 Yr Jumbo Mortgage	4.42%
5/1 Jumbo Mortgage	3. 91%
US Govt. 10 Year	2.6775%
10 Yr Swap Spread	3%

Source: Bloomberg

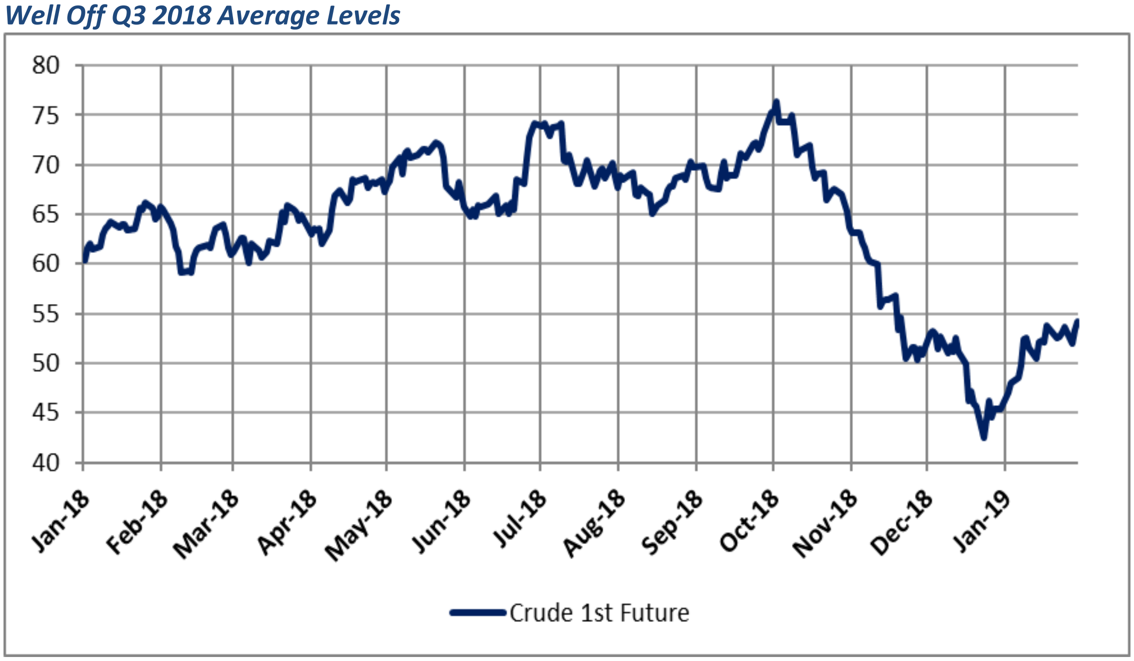
Figure 5. In January, US High Yield Bond Spreads Retrace Early December 2018 Levels – still Far Above Early October Levels



Source: Bloomberg

Outside the equities market, risk premium levels have also come down in other segments of the risk asset space though not by the same order of magnitude, with the notable exception of developed government bond market volatility (Figure 4). For example, US high yield bond spreads over US Treasury have declined to early December levels, as illustrated in Figure 5. Similarly, crude prices – as a barometer of world economic growth momentum – have regained early December 2018 levels (Figure 6).

Figure 6. Early January 2019 Bounce in Crude Prices Regains Early December 2018 Levels, Well Off Q3 2018 Average Levels



Source: Bloomberg

Downside Risks to 2019 World Economic Outlook Abate Early in 2019 given Stabilization of Leading Economic Indicators, Announcement of Policy Stimulus in China and the U.S., and Reflationary Effects of Weakening US Dollar

Outside the U.S., recent economic releases paint a picture of stabilization in economic growth momentum, as evidenced in the German ZEW expectations of economic growth indicator (Figure 7) and China's non-manufacturing PMI new orders indicator (Figure 8).

Figure 7. German Economic Growth Expectations Stabilize Following Q4 2018 Declines

Source: ZEW GmbH

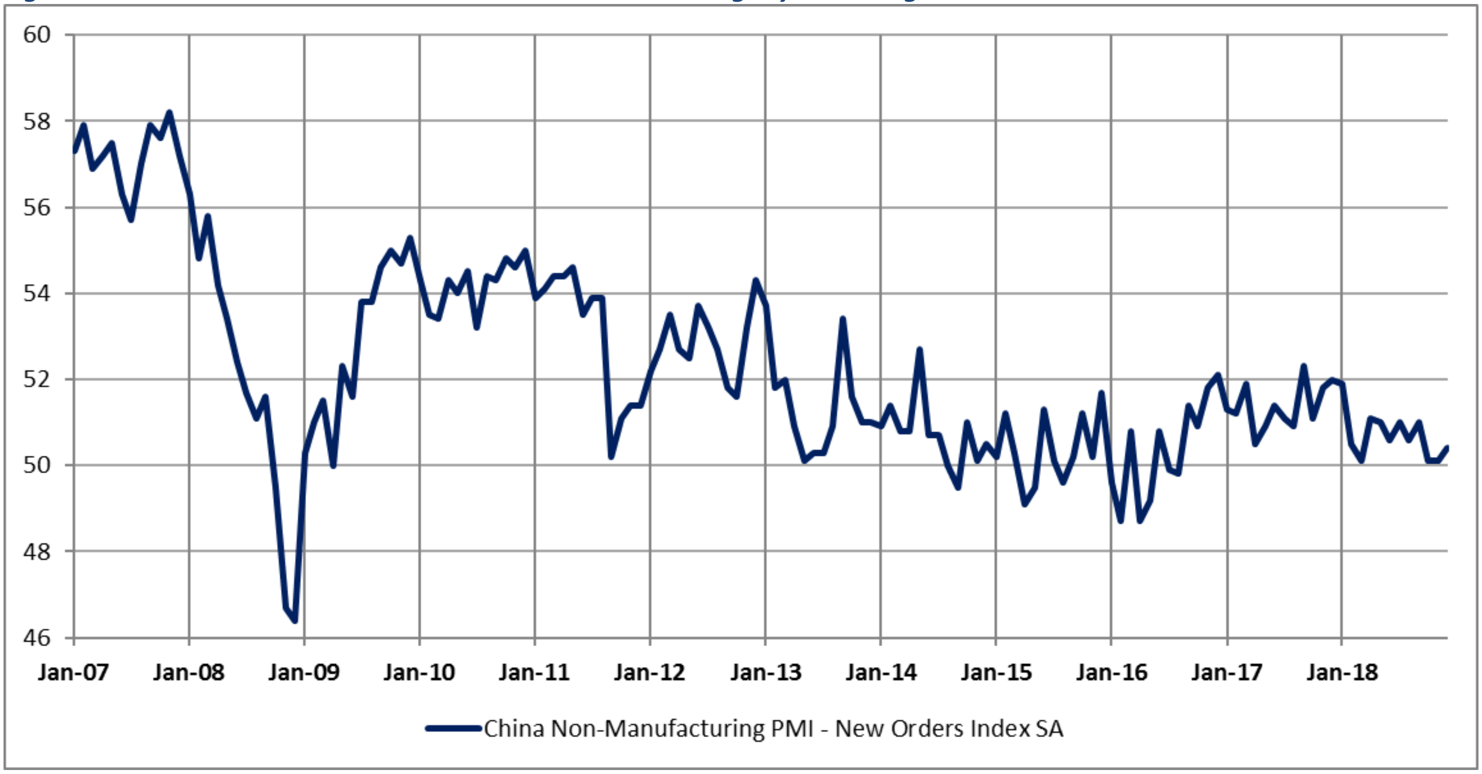
Insofar as the Chinese economic outlook is concerned, it is important to acknowledge upside risks to the outlook. Specifically, early in January the Chinese government announced a series of additional fiscal and monetary policy stimulus measures, including tax cuts and reserve requirement ratio cuts. Those measures are counter-cyclical in nature, thereby lending support to global investors' economic growth expectations for the balance of the year. Moreover, that the Chinese government is resorting to fiscal and monetary stimulus measures at a juncture in which the country is seeking an improvement in trade ties with the US should be taken by the market as an indication of continued stability in the outlook for the Chinese Renminbi. In the process, the Chinese currency along with other Asian currencies have strengthened markedly thus far in January (Figure 9).

Such latter mentioned expectations dynamic is reflationary for the global economy to the extent to which the prospects for a material depreciation in the Chinese currency becomes less likely over the coming quarters. An outlook of stabilization to strengthening in Asian currency valuations versus the US Dollar would reinforce our expectation for a weakening in the US Dollar cycle globally in 2019. We believe recent economic releases along with US monetary policy shifts in guidance serve to reinforce our baseline case scenario for the US Dollar in 2019. In particular, we consider the following developments:

- The early January shift in rate policy guidance by the US FED serves to mitigate the yield spread advantage enjoyed by the US Dollar versus developed peers these past several years, particularly as the European Central Bank looks poised to extend the reduction in balance sheet size these coming quarters;
- The deceleration in US economic growth leadership versus international peers, especially Emerging Market economies, anchor further the prospects for a weaker US Dollar on an intermediate term basis;
- Investors remain overweight the US Dollar, as indicated – among other metrics – by the level of speculators' exposure as a percentage of open interest in futures markets;

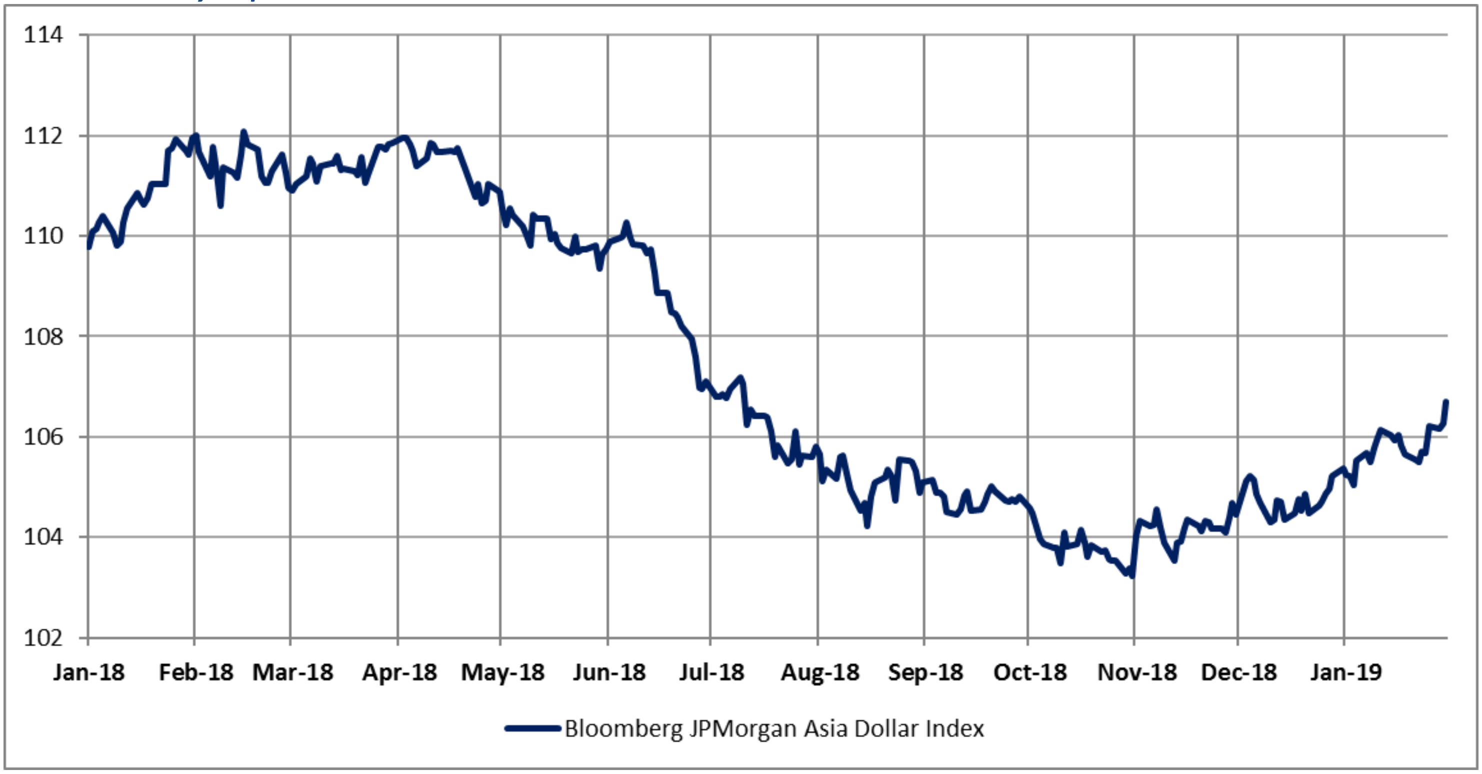
- An abatement in geopolitical risk is bearish the US Dollar. In that vein, the improved tone of discussions between the US and China as well as the removal of a no-deal Brexit scenario in the UK – as approved by Parliament on January 29 – are bearish the US Dollar on an intermediate-term basis.

Figure 8. Chinese Service Sector New Orders Data Bounce Slightly Following Q4 2018 Declines



Source: China Federation of Logistics and Purchasing

Figure 9. Asian Currencies Strengthen Markedly versus the US$ in January, Fueled by Lowered Expectations of Large Chinese Currency Depreciation in 2019



Source: Bloomberg

Glovista Sustains Portfolio Strategy Stance, with Emphasis on Underweight Duration and Overweight Quality, Sustainable Growth, Value Tilts in Global Equities

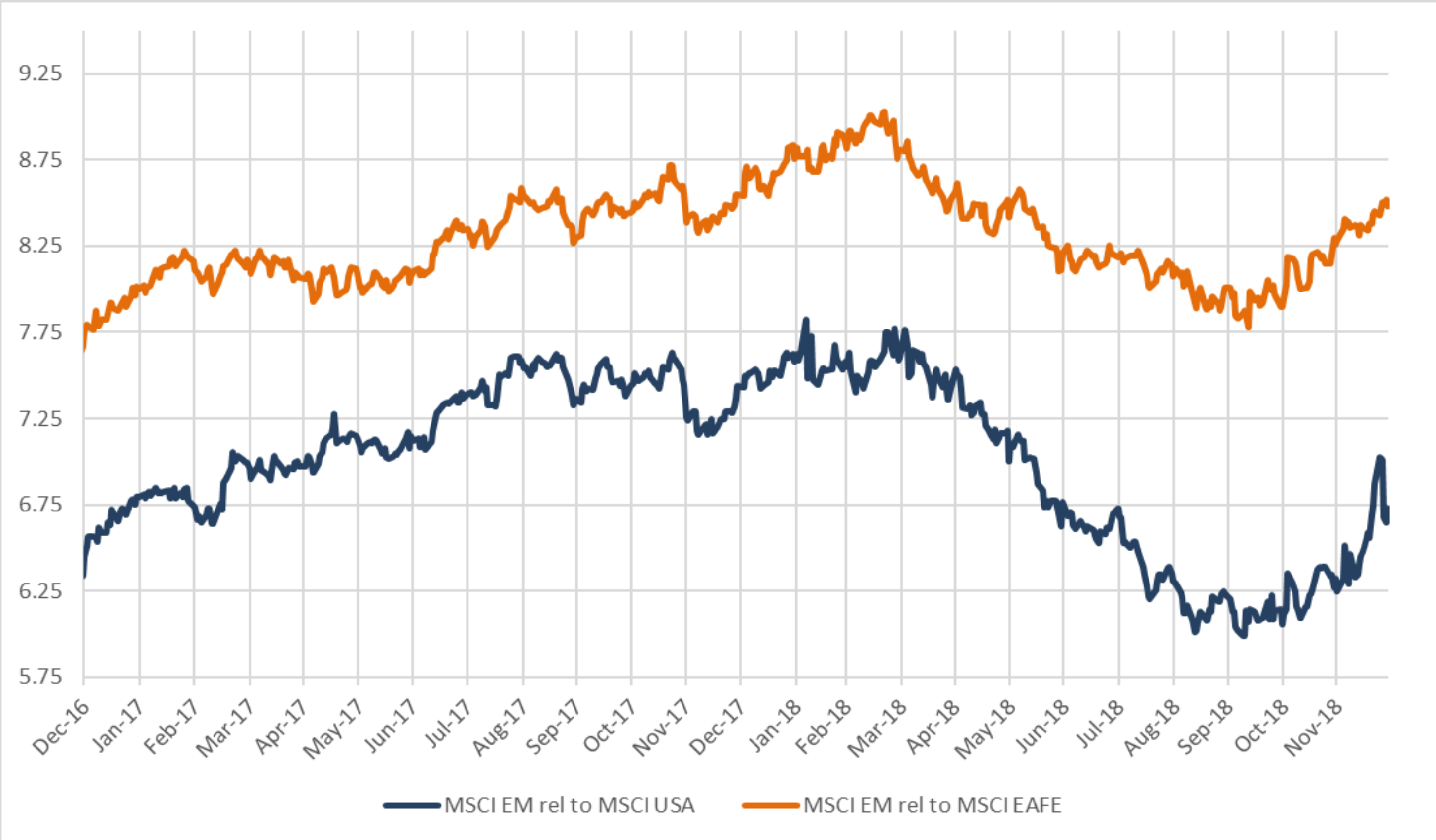
Against the global macro and financial backdrop discussed above, the Glovista investment team maintains an underweight duration exposure in fixed income as we do not expect an economic recession to ensue in 2019 but more likely an earnings growth recession in the US market. Moreover, fixed income term premium levels in the US government bond curve remain exceedingly unfriendly to taking on duration risk. Within global equities, we continue to favor international equities, including Emerging Markets on valuation, position and relative earnings growth and profit margin considerations. Within international equities, we favor value and sustainable growth oriented sectors.

Glovista Emerging Markets Perspectives

EM Equities Extend Post-October 2018 Outperformance versus Developed Peers, Fueled by Decline in US$ and Risk Premium along with Improving Economic Momentum; Glovista Sustains Value Sector Overweight Tilts

In January, Emerging Market equities have extended the strong relative return outperformance versus Developed peers that began at the early October high levels in US equity indices (Figure 10). The recent period of outperformance has been fueled by a steady decline in the US Dollar index, especially versus Emerging Market peers as well as a marked decline in risk premium levels, both of which are discussed above.

Figure 10. EM Equities Extend Post-October 2018 Rally versus EAFE and US Peers



Source: Bloomberg, MSCI and Glovista Calculations

The Glovista investment team continues to favor overweight allocations to value sector-oriented Emerging Market regions, especially Latin America and Eastern Europe, maintaining underweight allocations to North Asia markets. Such tilts reflect our macro investment thesis entailing a continuation of the weakening US Dollar trend versus Emerging Market currencies that has been in place since October 2018. Such dynamics are especially constructive for the Latin America and Eastern European region owing to the reflationary effects from a weaker US Dollar. Moreover, the North Asian equity markets' large IT sector weighting limit, in our view, the upside potential afforded by those market indices in the rest of the year given cyclical headwinds facing the sector at a global level.

There are a number of markets we favor on a longer-term basis, including India, where we have dialed down exposure to these past several weeks owing to fast approaching general elections. Similarly, in the case of Brazil, we have lowered our overweight allocation these past several weeks as the new President Bolsonaro will soon have to confront Congress in his quest to pass a number of controversial economic reform legislative measures. Finally, over the past several weeks we have trimmed considerably our underweight allocation to Chinese equities, taking profits in our longstanding underweight allocations, given that market's increasingly compelling valuations.

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