Issue
91
July/17

Monthly
Market
Newsletter

GLOVISTA INVESTMENTS

Glovista Global Perspectives

This Issue:

S&P Sector Performance P.2

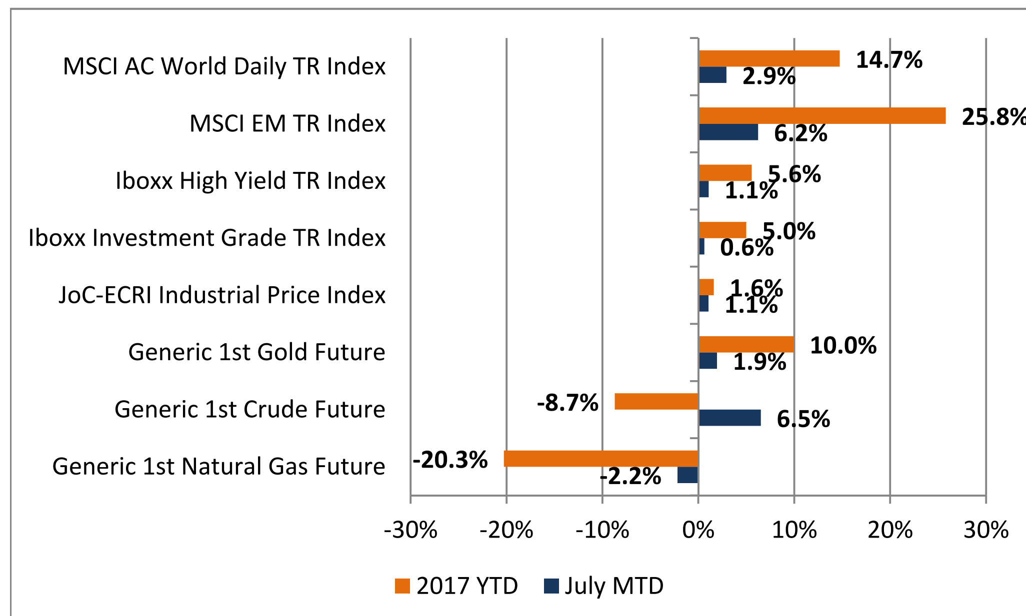
Ccy and Cmdty Performance P.4

Important Interest Rates P.4

FED and ECB Signal Continued Commitment to Liquidity Withdrawal as Inflation Remains Low and Stock Valuations High; Glovista Sustains Underweight Duration and Overweight Non-US Equities as well as Precious Metals Tilts

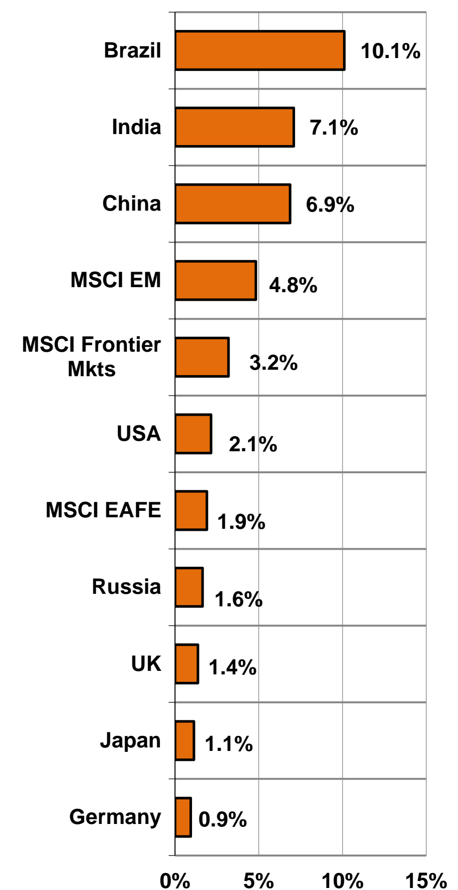
In July, risk markets have edged higher, as illustrated in Figure 1. The rise in risk asset prices reflect both (a) improved investor sentiment levels surrounding the global economy's second half given recent signs of an incipient stabilization of China's economic indicators following a long period of deceleration, and strengthened cyclical indicators out of the Eurozone region, and; (b) the unmitigated expansion of risk asset classes' – especially stocks and credit - valuation multiples along with the accompanying and self-reinforcing decline in realized and implied financial volatility that have obtained over the past several years.

Figure 1. Risk Asset Markets Edge Higher in July MTD Period



Source: Bloomberg

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



Source: MSCI & Bloomberg

**As of July 28th, 2017*

GLOVISTA INVESTMENTS

While the non-US economic outlook – particularly for the Emerging Markets and Eurozone regions – has improved over the past several months, rendering a constructive outlook at the economic level, we believe the market outlook is subject to non-trivial downside risks owing to the interplay of central bank policy, earnings momentum, investor ownership levels and valuations. We devote the remainder of this monthly column to a discussion of these considerations anchoring our medium-term investment thesis along with the various regional and asset class tilts we favor at this juncture of the cycle.

S&P500 Monthly Sector Performance – July MTD 2017*

Sectors	% Change	FY1 PE Ratio
Energy	2.58%	30.6
Materials	2.64%	19.1
Industrials	0.92%	18.7
Cons Disc	2.40%	20.2
Cons Stap	0.69%	20.9
Technology	4.71%	18.6
Healthcare	0.69%	17.2
Financials	0.92%	14.8
Utilities	1.87%	18.3
Telecom	4.98%	12.7
Real Estate	1.21%	40.1
S&P500	2.17%	18.6

**As of July 28th, 2017*

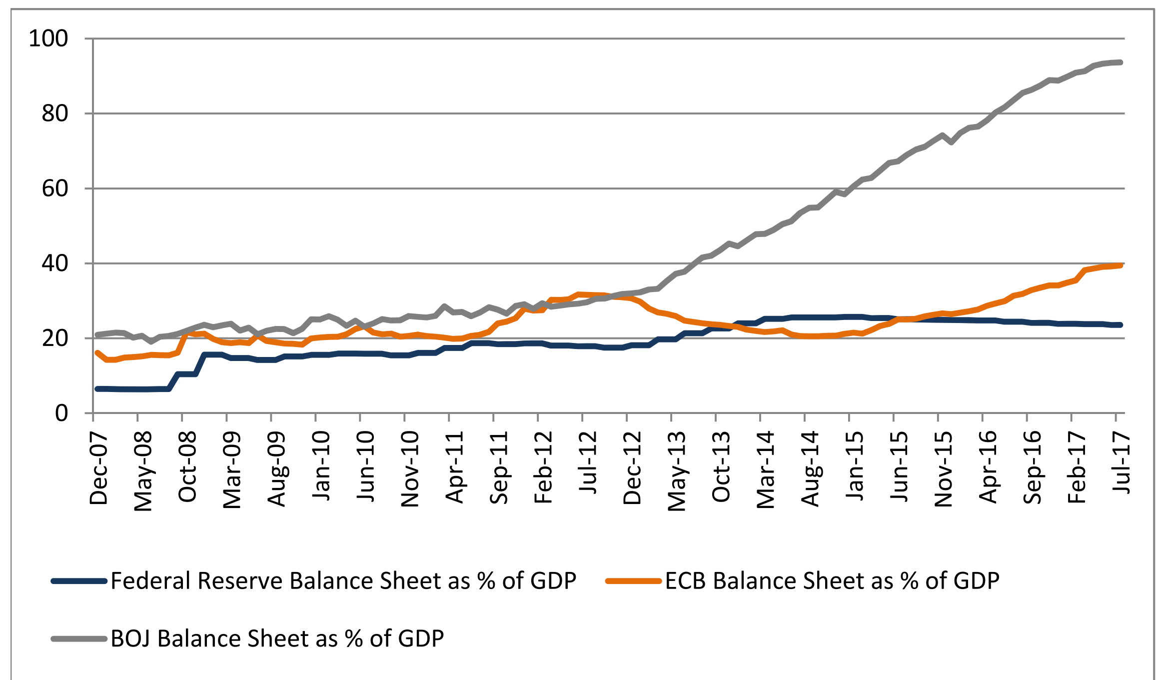
Source: S&P

US Stocks' Multi-year Long Performance Leadership Likely at Risk as Stretched Valuations Meet Central Bank Liquidity Withdrawal, Decelerating Earnings Momentum, Over-ownership Status and Stretched Long-term Earnings Growth Expectations

As this column has discussed at length over the past several years, the post-Great Financial Crisis (GFC) period encompassing the years that followed 2009 is one without precedent in modern financial history, particularly with regard to developed country governments' (especially the UK, USA, Eurozone and Japan) unprecedented use (or 'abuse' depending on one's philosophical inclination as regards fiat currencies' store-of-value attribute, one of money's three main attributes) of fiat money and central banks' ability to print unlimited amounts of it (Figure 2) for the dual purposes of:

- Surgically disrupting the depression-like economic and financial market dynamics that ensued the GFC' initial period around the fourth quarter of 2008, and;

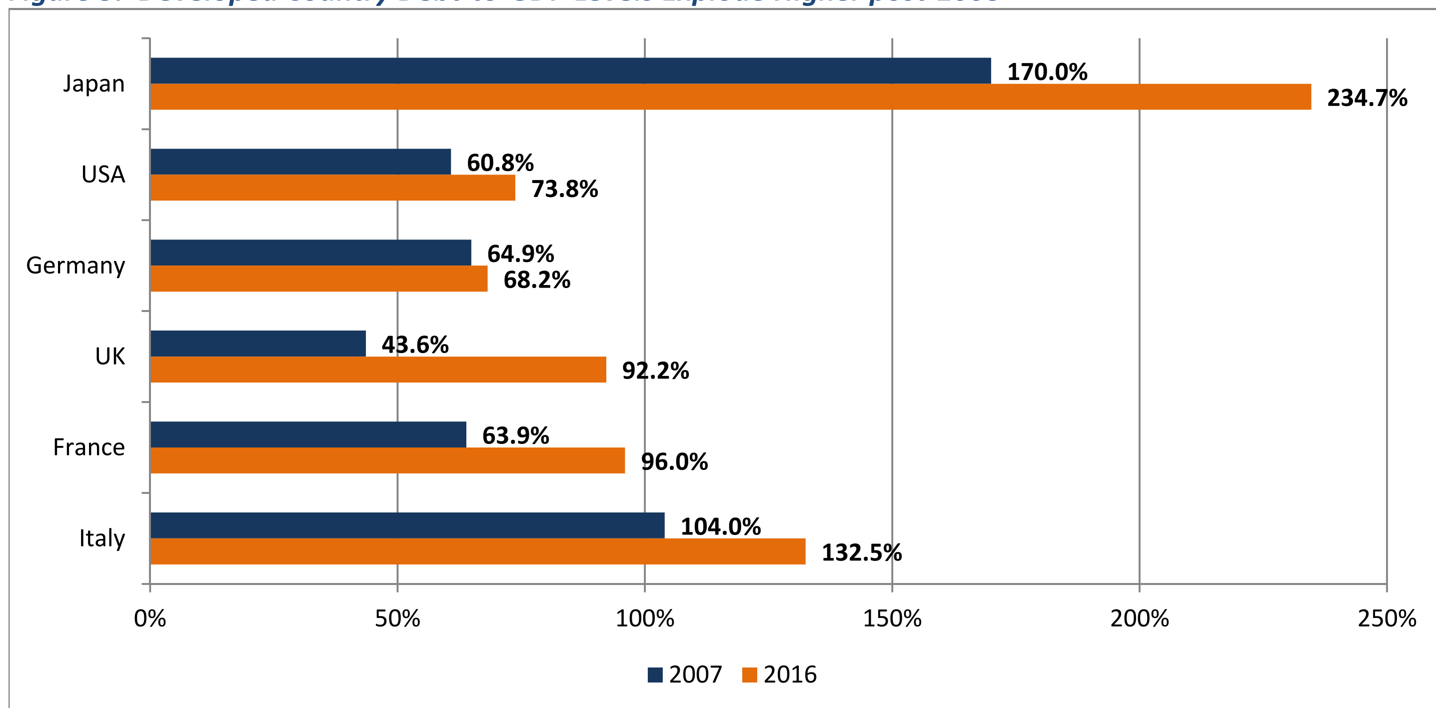
Figure 2. Developed Countries' Central Bank Balance Sheets Explode since 2008



Source: Bloomberg

- prolonguing the anemic economic recovery that ensued the GFC period, on the presumption that fiscal conservatism plagued developed countries' capitals during a period in which Keynesian policy stimulus was much needed – a view embraced most notably by the ECB and the FED - at enormous cost to national government budgets (Figure 3).

Figure 3. Developed Country Debt-to-GDP Levels Explode Higher post-2008



Source: Bloomberg

While it is highly premature for the economics profession to venture a definitive judgment on the suitability of developed country central banks' response to the onset of the GFC via the employ of non-traditional policy measures, it has long been our stance that said policy response was justified with regards to the first purpose noted above but not with regard to the second. In a nutshell, the key rationale anchoring our view with regards to the use of non-traditional monetary policy at the turn of 2009 draws on the empirical constant across history suggesting the short-term inertia associated with the use of fiscal policy as a crisis-response measure. By logic of elimination, it follows that monetary policy was the 'only game in town' circa the fourth quarter of 2008 and 2009 given the speed and depth of the implosion in real activity indicators and financial system stress levels that prevailed at the time.

Insofar as the use of non-traditional monetary policy as a means to sustain or prolong the (lukewarm) expansion that followed the GFC period, our stance is one of disagreement with the course of policy employed by developed country central banks. This is because the use of non-traditional monetary policy effectively distorted the market's pricing mechanism, especially the value of money, and in doing so paved the way for a resource misallocation problem at a global level. The costs associated with said resource misallocation problem are measured not only in terms of the efficiency losses stemming from the availability of 'cheap money' but more importantly in the mortgaging of future generations' net worth in the form of the massive accumulation of government debt that has obtained during the past several years.

A third dimension of the non-traditional monetary policy stance that has characterized developed country economics since 2008 is the diminished effectiveness central bank policy may command in the future as central banks' outsized balance sheets have turned central banks as both 'judge and jury' when it comes to assessing the consequences of monetary policy on price and activity dynamics. There are multiple dynamics built into this aspect of monetary policy which we will address in future columns. For this monthly column's purposes, the key question facing investors lies in the assessment of the potential market consequences stemming from recent US FED and ECB communication to the markets concerning their intention to start - in short order - "relatively soon" in the FED's communiqué - with a phase of liquidity withdrawal in the form of balance sheet reduction (in the case of the FED; possibly with an announcement as early as the end of September) and tapering of balance sheet expansion (in the case of the ECB, with an announcement as early as this coming October to entail a reduction of monthly asset purchases from 60 billion Euros to 40 billion Euros to commence as early as 2018Q1).

	July 28th 2017	July MTD Change
Gold	1269.65	1.9%
Silver	16.759	0.8%
Oil	49.71	10.6%
EUR	1.1751	2.7%
JPY	110.68	1.3%
GBP	1.3136	1.0%
CHF	0.9687	1.3%
CAD	1.2433	4.4%
AUD	0.7987	4.0%
BRL	3.1316	5.2%
MXN	17.7769	1.5%

Source:Bloomberg

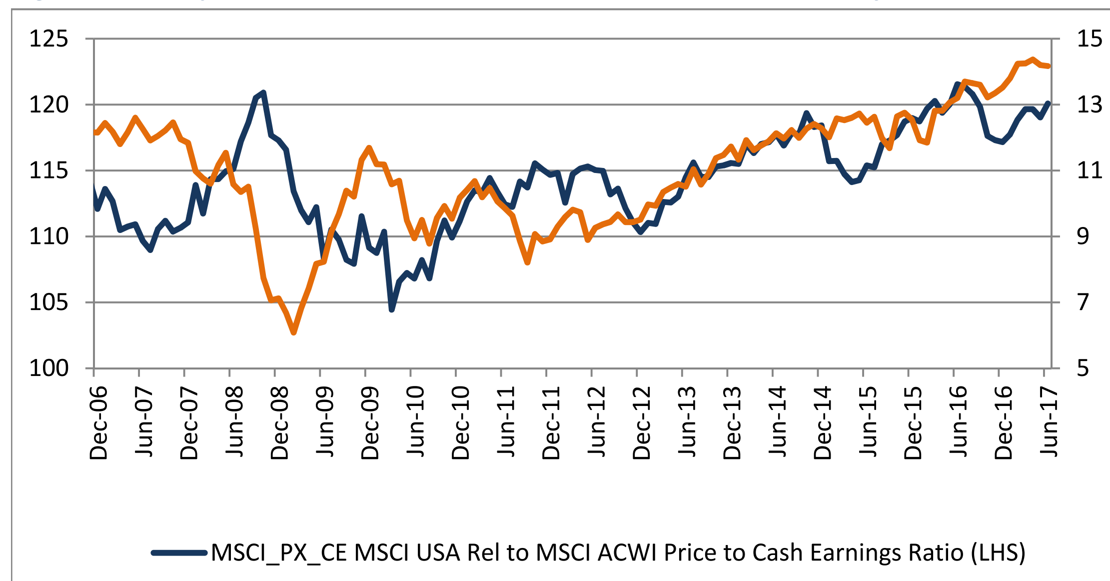
Rates	July 28th Level
1 Yr CD	0.75%
5 Yr CD	1.44%
30 Yr Jumbo Mortgage	4.11%
5/1 Jumbo Mortgage	3.38%
US Govt. 10 Year	2.29%
10 Yr Swap Spread	-0.0438%

Source:Bloomberg

In our view, the recent signaling by the US FED and the ECB with regard to their commitment to initiate a withdrawal of liquidity later this year is of first-order importance to the global market outlook. This is especially the case for US equities, a key segment of global equities, accounting for around 54 percent of world market capitalization weighting within the MSCI all Country World Index. Specifically, our concern on the potential adverse effect on US equities from the upcoming liquidity withdrawal is based on the interplay of waning earnings momentum, extended valuations and investor positioning:

- US equities' extended valuations, on a historical basis as well as relative to non-US peers (Figure 4). Besides the illustrative content of US equities' stretched valuations as shown in Figure 4, one can also point to the so-called "Buffet yardstick" that captures US market capitalization expressed as a percentage of GDP – currently hovering at historically high levels. In addition, the so-called Shiller P/E multiple – measured on the basis of rolling multi-year earnings averages – highlights US equities' valuations sitting at levels comparable only to those prevailing in 2000, ahead of the onset of an important bear market cycle.

Figure 4. US Equities' Valuations at Stretched Levels versus History and Peers



Source: MSCI and Glovista Calculations

- US corporate earnings are likely to be cyclically extended, rendering current cyclically-adjusted valuations even more stretched than reported levels. This is because of the widespread leveraging of US corporate balance sheets during the past several years, courtesy of the loose credit market conditions associated by the QE regime in place since 2009.

Stretched investor positioning towards US equities. The latest investor positioning surveys tallied by major Wall Street banks highlights exceedingly low cash levels and well above average equities exposure levels on the part of US retail investors. In addition, the long period of low volatility has paved the way for generalized selling of volatility on the part of long only investors (via the switch into so-called passive strategies, especially ETFs – as passive investing is nothing more than momentum buying via the purchase of increasingly larger exposures to stocks whose capitalization weightings grow larger) as well as total return players (such as private equity, relative value, volatility arbitrage, high frequency strategies,

among many others). As a result, if and when a sizable (in excess of 10 percent) equity market pullback unfolds, the potential for further market weakness is larger.

Against such backdrop, we believe market history strongly suggests the desirability to tweak investment portfolio tilts in favor of value factors, away from growth. We believe this holds true not only within the confines of equity factor tilts but also across asset classes, including currencies. Within the currency space, we sustain our thesis calling for the US Dollar to decline further versus most of developed country currencies (the Japanese Yen and Swiss Franc are likely to prove an exception). We maintain our bearish US Dollar view versus EM currencies, going back to the beginning of last year. Within the commodities space, we maintain a bullish stance towards precious metals and increasingly favor soft commodities. Within global equities, we favor Eurozone and selected Emerging Market equities owing to attractive relative valuations versus US peers, much more attractive top-line and bottom-line cyclical backdrop facing the corporate sector in those regions and global investors' underinvested status towards those regional indices.

Glovista Favors Continued Underweight US Dollar, Overweight Non-US Equities, Underweight Bond Duration, Overweight Precious Metals Tilts

Against the changing macro and policy backdrop discussed above, the Glovista investment team continues to favor exposure to non-US equities (especially Eurozone and Emerging Markets), short-duration corporate debt, and precious metals (especially via mining stocks).

First, our overweight exposure to non-US equities reflects not only our bearish US Dollar view (in place since January this year for the case of developed country currencies and since the beginning of last year with regard to EM currencies) but also US equities' expensive valuations relative to non-US peers along with the US corporate profit cycle's extended nature versus non-US peers.

Second, with regard to our managed portfolios' bond duration levels, earlier this year we chose to reduce portfolio duration given our assessment long-term Eurozone government bond yields looked poised to rise sharply following the fading of the Euro currency existentialist threats that persisted over the past five years. Specifically, we believe the results of this year's elections in Europe (especially France) have rendered of little use the Euro dissolution scenario insurance-like feature imbedded in owning core Eurozone government debt paper. As a result of such drastic reduction in Euro currency risk premium along with the cyclical economic upturn permeating the core of Europe at this time, we believe there remains considerably upside risk to long-term Eurozone region bond yields. Under such view, our bearish US Dollar view is validated as is also our decision to have trimmed bond duration across major developed markets.

Third, our preference for precious metals – especially miners – derives both from our bearish US Dollar view as well as our expectation risk premium (and financial market volatility) levels look poised to rise over the year's second half. In addition, leading precious metals mining companies have shown considerable improvement in cost efficiencies these past two quarters, affording strong impetus for valuation multiple expansion to unfold over the coming quarters.

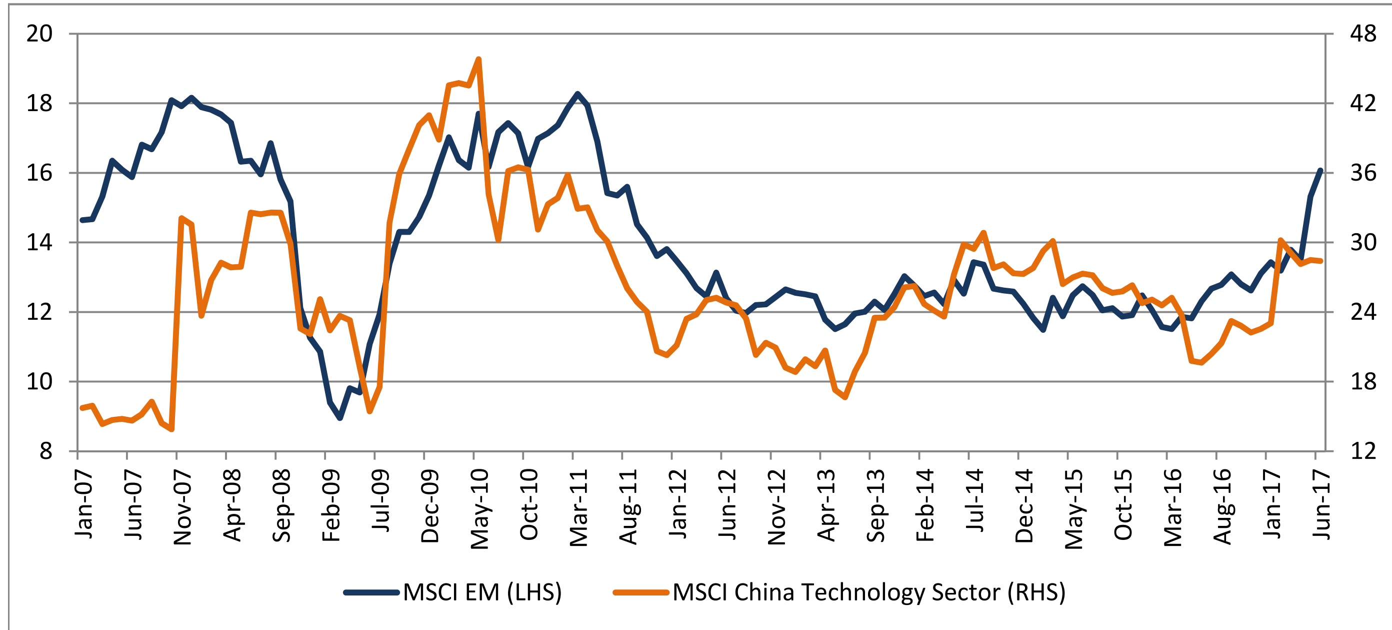
Emerging Markets Perspectives

China Secular IT Service Sector and Continued USD Decline Fuel Further EM Outperformance versus DM Peers; Glovista Sustains EM Growth Style Overweight Tilt along with Bullish Value Country Picks, such as Chile and India

In July, Emerging Market equities have further extended their post-2016Q1 return outperformance of Developed Market peers (Figure 5). The most recent leg of return outperformance for Emerging Market equities has been anchored on two

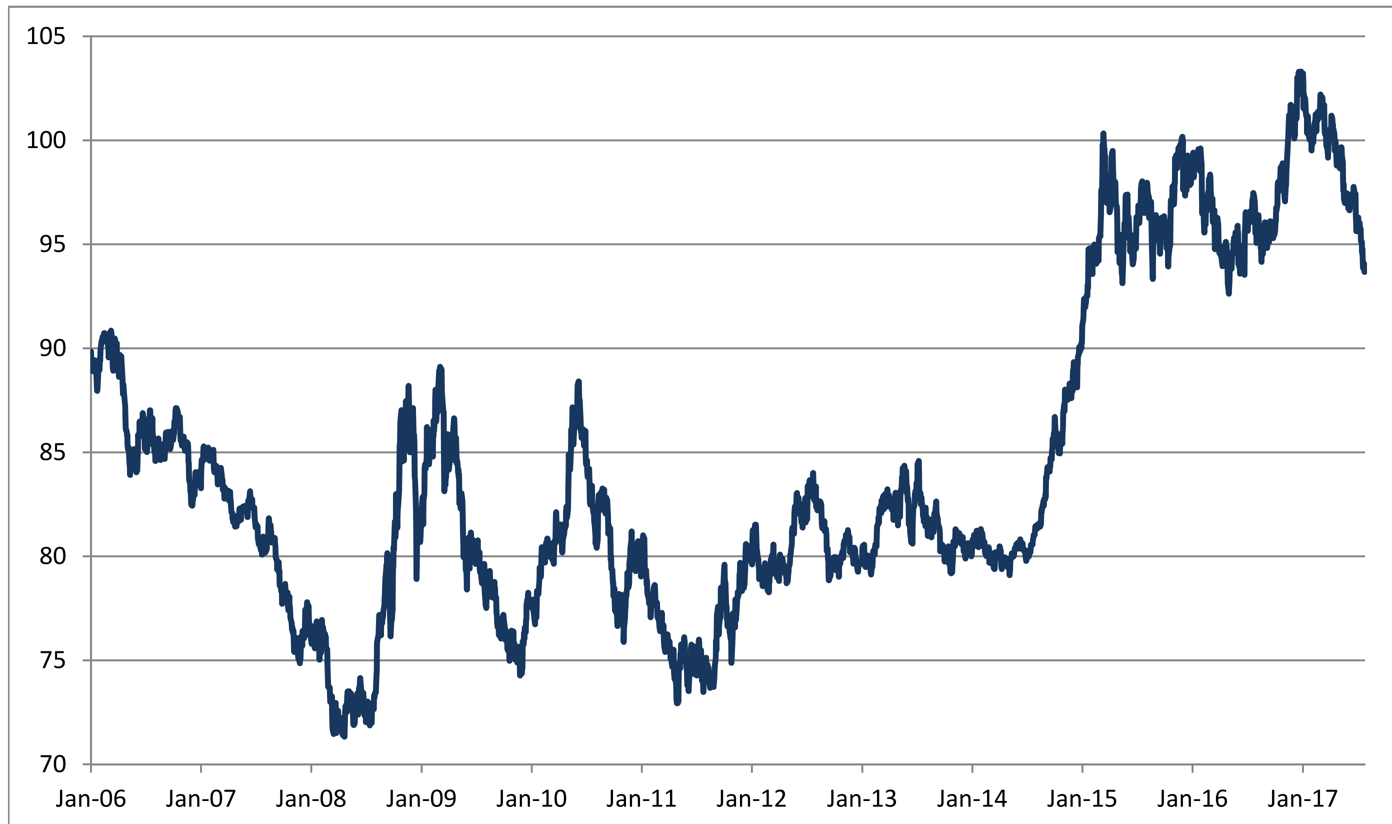
key pillars: the further validation of the secular nature associated with China's IT service sector's growth dynamics, and the supportive price revaluation effects accruing a large number of EM country indices from the recent acceleration in the US Dollar index's decline (Figure 6).

Figure 5. China IT Sector's Secular Growth Affirmed by Latest Company Releases



Source: Bloomberg

Figure 6. US Dollar Index Decline Accelerates Further in July 2017



Source: Bloomberg

Glovista's longstanding premises anchoring our bullish prospective absolute as well as relative (versus Developed peers) return performance outlook for Emerging Market equities remain unchanged: attractive valuations; superior cyclical top-line and earnings growth performance growth dynamics versus DM peers, and; EM equities' continued under-owned status on the part of retail as well as institutional investors (including the USA and Europe, with the exception of the UK).

Looking ahead, we continue to harbor an overweight regional tilt towards Emerging Asia (including China and India) owing to those country indices' secular growth propositions, including the rotation of growth away from the goods to the service sector (in the case of China, where the manufacturing sector's GDP weighting continues to decline, currently at slightly less than 40 percent) and the continental, closed-economy nature of India's corporate earnings outlook, particularly following the recent progress made in the cleansing of the state-owned banking system's non-performing loan problem.

As we look ahead, we maintain a bullish outlook towards the asset class. We continue to overweight "New China" sectors, particularly the IT service sector as growth is secular in nature and sector companies' balance sheets are clean. Likewise, we favor continued overweight allocations to a number of value oriented country indices, including Chile and India owing to an improved policy and national economy outlook that includes the potential for further currency revaluation versus the EM peer group. We maintain an approximately neutral or moderately underweight allocation to a set of countries for which the global sector outlook is supportive (especially the continued potential for further commodity price strength) but where national political dynamics are likely to remain challenging. Two important EM country indices that meet such criteria include Brazil and South Africa. In the case of Brazil, the potential for pension and social security reform ahead of the 2018 presidential elections remains low while South Africa's ANC Party holds important leadership elections this upcoming month of December, with considerable uncertainties associated with the outcome. Likewise, with the exception of Naspers, the South African corporate sector manifests some of the steepest earnings downgrade dynamics across the EM universe.

Our outlook is not bereft of risks. Specifically, some of the major risk factors conditioning the outlook on emerging market equities include:

- the potential for a policy mistake on the part of developed countries' central banks (e.g. overtightening);
- a generalized technology sector sell-off that could result in downward valuation multiple pressures across world regions';
- policy mistake on the part of China's central bank as it targets a continued rotation of economic growth away from the goods into the service sectors (over-tightening). Such policy mistakes could impact China's large shadow banking system with not only national but also global implications.

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 beforeentering 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 constituteinvestment advice and should not be reproduced, transmitted or published by the recipient. Thisdocument 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 consequentialincluding 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