Issue
66
June/15

Monthly Newsletter for Global Investors

Glovista Global Perspectives

This issue :

S&P Sector Performance P.2

Ccy and Cmdty Performance P.3

Important Interest Rates P.4

Carlos Asilis, Ph.D.
Tel: (305) 333 0012
Carlos.asilis@glovista.net

Darshan Bhatt, CFA, CMT Tel: (212) 336 1542
Darshan.bhatt@glovista.net

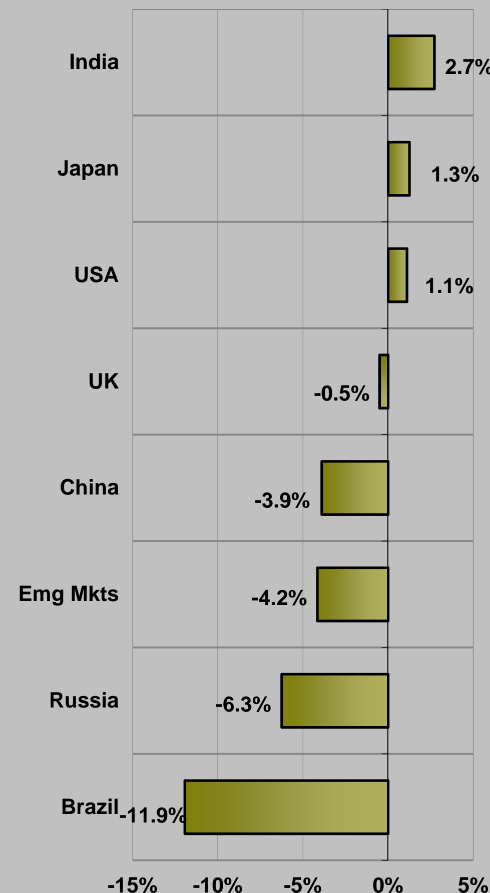
Alberto Pagan-Matos, CFA Tel: (212) 336 1540 ext 114
Alberto.Pagan@glovista.net

Risk Markets Decline on Extended Bond Market Volatility, Unresolved Greek Crisis and FED's Imminent First Rate Hike in 10 Years; Glovista Sustains Defensive Portfolio Stance

Over the past several weeks, risk markets globally have experienced material price declines (in the case of equities) and spread widening (in the case of credit), owing to several principal considerations, including:

- material deterioration of Greece crisis, entailing the potential for imminent imposition of capital controls and Greece's exit from EMU (Grexit scenario). Should they materialize, such dynamics may unleash fundamental credibility concerns surrounding the long term viability of EMU and the Euro currency;
- rising prospects of higher equity and credit market volatility resulting from the recent escalation of bond market volatility;
- increased likelihood of an impending Fed Funds rate hike in the coming months, the first by the US Federal Reserve in almost ten years;
- weak economic momentum in China and weakening economic momentum in the Eurozone.

As illustrated in Figure 1, since April 10th of this year, bellwether equity and credit spread indices globally have undergone some of the largest price declines of the ongoing multi-year bull phase that started in March 2009.



Source: MSCI & Bloomberg

GLOVISTA INVESTMENTS

GLOVISTA INVESTMENTS

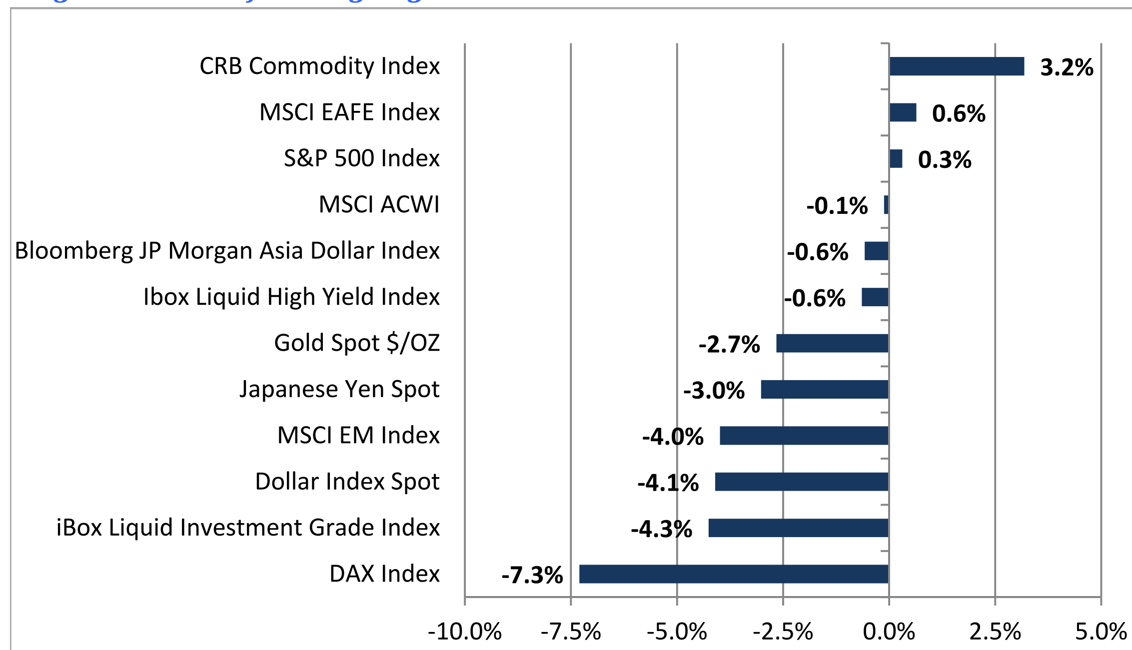
S&P500 Monthly Sector Performance – May 2015

Sectors	% Change	FY1 PE Ratio
Energy	-5.22%	29.2
Materials	0.25%	18.4
Industrials	0.05%	16.5
Cons Disc	1.19%	20.0
Cons Stap	0.73%	20.2
Technology	2.04%	17.2
Healthcare	4.33%	18.4
Financials	1.64%	14.4
Utilities	0.04%	16.6
Telecom	-1.86%	13.7
S&P500	1.05%	17.8

Source: S&P

For example, since April 10th of this year the German DAX equity index is off 7.3% percent.

Figure 1: From April 10th YTD High Levels, Bellwether Risk Market Indices Experience Largest Declines of the Ongoing Post-2009 Bull Phase



Source: Bloomberg

Recent Macro and Policy Calendar Raise Challenges for Anything But Modest Intermediate-term Upside to US Equity Prices

The latest round of economic releases and policy developments reinforce our longstanding concerns over the potential for US equity prices to record anything but modest intermediate-term positive returns. Specifically, two recent developments are worth highlighting: first quarter productivity data release with revisions to prior estimates and Federal Reserve policy developments.

Figure 2: Downward Revisions to 2015Q1 US Productivity Estimates Reinforce Concerns over Multi-year Slowdown
(Chart: 5 Year Moving Average of US Output Per Hour Nonfarm Business Sector QoQ, SA)

Source: Bureau of Labor Statistics and Glovista Calculations

GLOVISTA INVESTMENTS

	May'15	May Change
Gold	1190.55	0.5%
Silver	16.7493	3.7%
Oil	60.30	1.1%
EUR	1.0986	-2.1%
JPY	124.15	-4.0%
GBP	1.5291	-0.4%
CHF	0.9403	-0.8%
CAD	1.2454	-3.1%
AUD	0.7645	-3.3%
BRL	3.1787	-5.4%
MXN	15.378	-0.4%

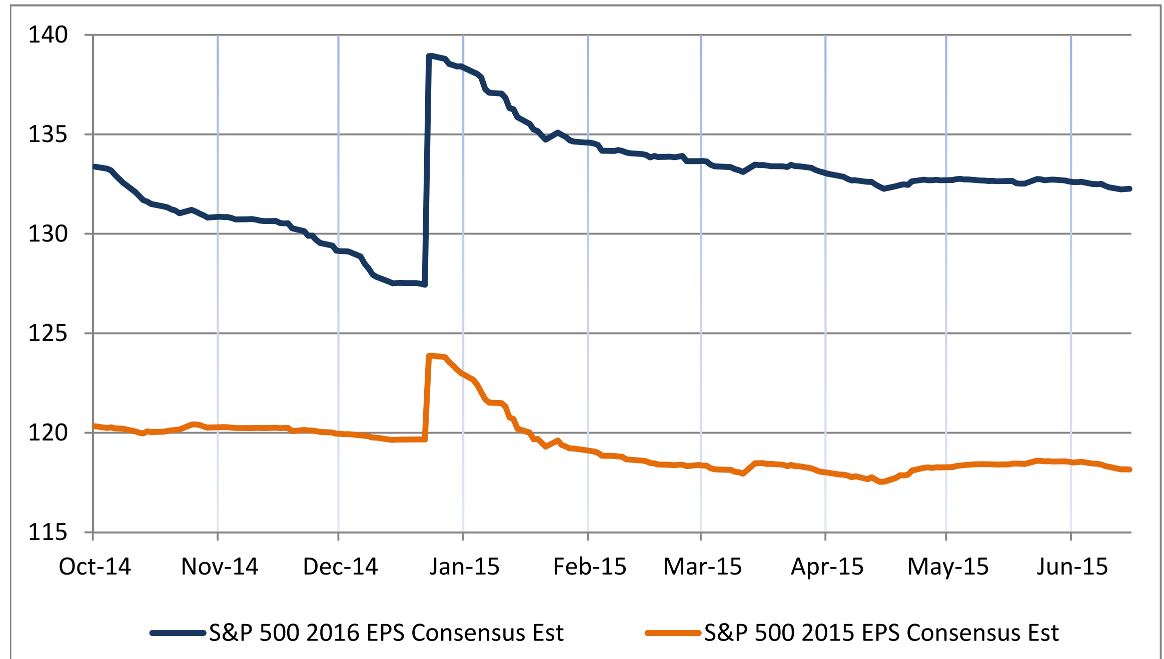
Source: Bloomberg

"…while the US Dollar strengthened considerably during the second half of 2014 and first quarter of 2015, the impact on US revenue per share growth has not YET been as sizable as it might be in the year-ahead; as the past year's earnings and revenue performance has been cushioned by the presence of FX hedging programs that are being rolled at much less advantageous (i.e. stronger US Dollar spot) levels. "

Since earlier this year we have expressed in this column our concerns over the then incipient combination of soft economic momentum alongside indications of weakening US productivity growth momentum, highlighted in exceedingly low rolling 5 year productivity growth (Figure 2).

Figure 2, embodies the most recent revision to first quarter productivity, released this past June 4th which represented a downward revision to -3.1% from an already weak -1.9% original release. Weak productivity growth translates into higher unit labor cost pressures. That such dynamics are at play---at a time in which US equity valuations hover at multi-year high levels and consensus earnings estimates are being shaved steadily for 2015 and 2016---is even more troubling for the US equity market outlook (Figure 3)

Figure 3: US Consensus Earnings Estimates Undergo Meaningful Downward Revisions for 2015 and 2016



Source:Bloomberg

Moreover, the US Dollar bull phase over the past twelve months raises a set of additional challenges to the US market outlook as prior market and macro cycles remind us that foreign exchange hedging programs of US corporates normally entail 4 to 6 quarter-ahead horizons. The latter consideration strongly suggests that, as we approach the year's second half and 2016, a non-trivial number of US large cap corporates are likely to face increasingly considerable challenges at the top and bottom line levels, than is likely reflected in US equity analysts' estimates. Figure 4 illustrates the year-on-year growth rate in the US Dollar index against the year-on-year growth in US revenue per share. It shows that while the US Dollar strengthened considerably during the second half of 2014 and first quarter of 2015, the impact on US revenue per share growth has not YET been as sizable as it might be in the year-ahead; as the past year's earnings and revenue performance has been cushioned by the presence of FX hedging programs that are being rolled at much less advantageous (i.e. stronger US Dollar spot) levels.

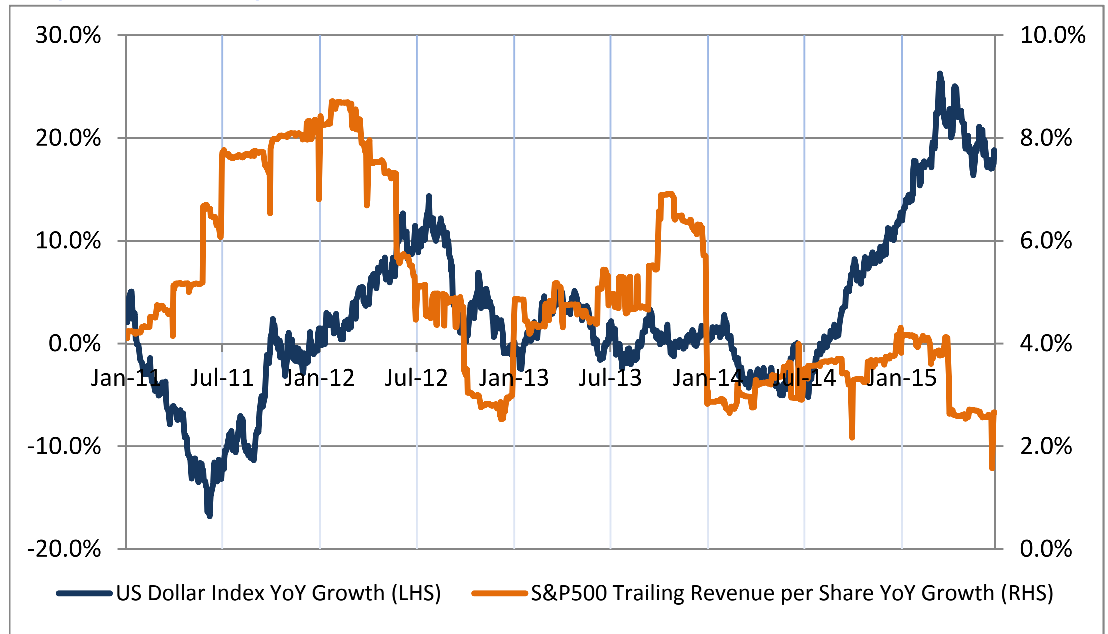
With regard to the international economic outlook, the recent economic calendar has been mixed. For example, the latest stream of business and consumer confidence indicators for the Eurozone points to a moderation in the pace of the economic expansion (Figure 5) while China's economic momentum continues to weaken, fueled by a significant deceleration in investment expenditure growth (Figure 6). In addition, weaker than expected economic releases out of other countries has resulted in recent unanticipated (by the consensus of economists) policy rate cuts, such as those out of New Zealand and Korea, among others.

GLOVISTA INVESTMENTS

Rates	May 29th Level
1 Yr CD	0.62%
5 Yr CD	1.44%
30 Yr Jumbo Mortgage	4.09%
5/1 Jumbo Mortgage	3.24%
US Govt. 10 Year	2.12%
10 Yr Swap Spread	0.09%

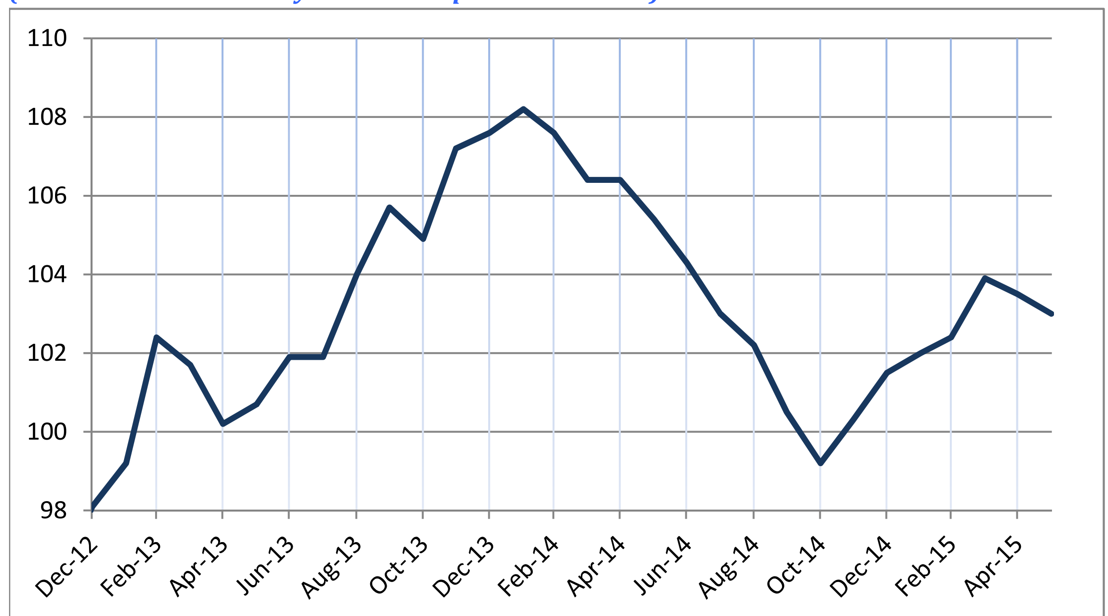
Source:Bloomberg

Figure 4: US RPS YOY Growth Likely to be Adversely Impacted by Roll of FX Hedging Programs at Stronger US Dollar Spot Levels



Source: Bloomberg&Glovista Calculations

Figure 5: Eurozone Business Confidence Levels Soften from Cyclical High Levels (Chart: IFO Pan Germany Business Expectations Index)



Source: IFO Institute

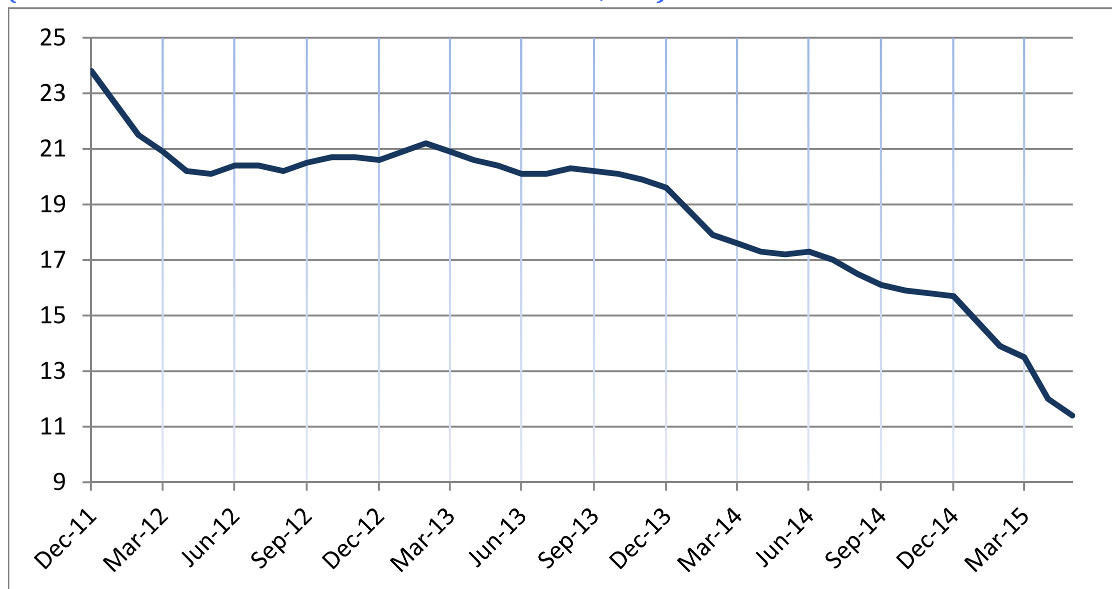
In the policy domain, the past several days and weeks have witnessed several developments that carry important economic and market implications:

- US FOMC meeting held on June 17, at which the Federal Reserve released a set of revisions to its policy rate (Fed Funds "dots") targets alongside new estimates for its reference inflation barometer, the core PCE, and real GDP growth. As illustrated in Figure 7, revisions to policy rates, GDP growth estimates and core PCE are best characterized as dovish.

- European Court of Justice's (ECJ) June 16 ruling whereby the European Central Bank's OMT program is rendered legitimate. Such development, both on account of its timing (*vis-à-vis* the

Figure 6: Deceleration of China's Economic Momentum Continues, Fueled by Weakening Fixed Investment Expenditure Growth

(Chart: China Fixed Assets Investment Cumulative, YoY)



Source: National Bureau of Statistics of China

increasing likelihood of a Grexit scenario) and the powerful monetary and liquidity tool it affords the ECB in forestalling speculative attacks on the Euro money and capital markets. The ruling represents an unambiguous material development at the macro and market levels. In fact, we credit this recent development for the surprising resilience shown by Euro markets – including the periphery of Europe – throughout this most recent chapter in the Greece crisis (Figure 8).

- Chinese policymakers' intensified stimulus program as the People's Bank of China (PBOC) implements a 25 basis points cut in its reference policy rate and 100 basis points cut in reserve requirement ratio for the banking system, on May10th and April 19th, respectively. In addition, at the fiscal level, the Chinese government continues to up the ante both via a set of specific policy measures (e.g. scrapping of more than decade long restriction of loan-to-deposit ratio for banks) and qualitative policy stances at the international level, such as the strong sponsorship of the newly founded Asian Infrastructure Investment Bank.

Figure 7: FOMC Downwardly Revises Policy Rate/PCE/GDP Estimates Closer to Private Sector Consensus Levels while Ratifying Imminent Policy Rate Hike

(Note: The green cells highlight dovish revisions and red cells highlight hawkish revisions)

Variable	2015 Outlook		2016 Outlook		2017 Outlook	
	June Est	March Est	June Est	March Est	June Est	March Est
GDP Growth	1.8%-2.0%	2.3%-2.7%	2.4%-2.7%	2.3%-2.7%	2.1%-2.5%	2.0%-2.4%
Core PCE Inflation	1.3%-1.4%	1.3%-1.4%	1.6%-1.9%	1.7%-1.9%	1.9%-2.0%	1.9%-2.0%
Fed Funds Rate	0.625%	0.625%	1.625%	1.875%	2.875%	3.125%

Source: Federal Reserve

The above mentioned constellation of policy initiatives out of the USA, Europe and China carries differential effects at the economic and market levels. Glovista's investment team believes the US FOMC's latest round of interest rate and economic estimates, while moving the Fed's view more towards the market's (as reflected in the forwards market), ratify a high volatility environment (including, but not limited to fixed income markets) for longer. As a result, these developments are potentially

GLOVISTA INVESTMENTS

"… Glovista's investment team has determined to sustain our standing defensive portfolio tilts across asset classes and within asset classes. Specifically, our GTAA portfolios reflect underweight allocations to equities and commodities, and overweight allocations to cash and fixed income."

Figure 8: Eurozone Periphery Markets' Resilience to Grexit Scenario Concerns Likely a Beneficiary of the ECJ's June 16 Ratification of OMT Program's Legitimacy

Source: Bloomberg

deleterious for risk markets, including equities and credit. Insofar as the ECJ's latest action, and the implications on ECB policy and the Euro currency outlook, we believe these developments are bullish Eurozone equities, a regional market we continue to favor at the global level. Finally, Chinese policymakers' latest round of policy stimulus measures all but confirm the Chinese leadership's unswerving commitment to smoothing the Chinese economy's multi-year transformation away from goods-sector-led to service-sector-led growth. In that regard, those dynamics are supportive of global risk markets, particularly sectors highly complementary to China's targeted growth model. In practice, such dynamics are especially favorable to global healthcare, information technology and selected financials sectors, with many US firms exerting a dominant role in those sectors at a global level.

Glovista Sustains Defensive Portfolio Stance on Multiple Grounds: Valuation, Soft Economic Momentum, Increased Bond Market Volatility, Investor Complacency, Soft US Productivity Trends

Against the global macro and policy backdrop delineated above, Glovista's investment team has determined to sustain our standing defensive portfolio tilts across asset classes and within asset classes. Specifically, our GTAA portfolios reflect underweight allocations to equities and commodities, and overweight allocations to cash and fixed income.

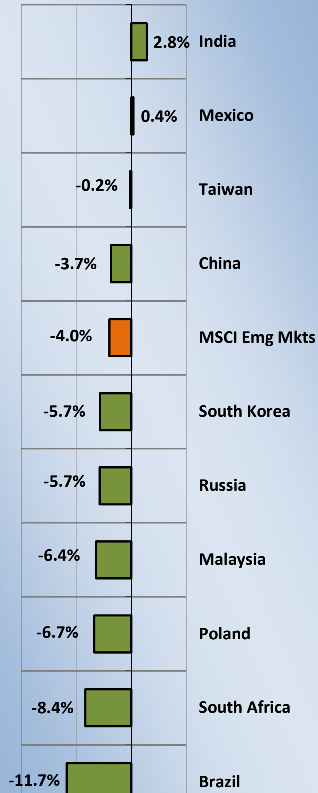
Within fixed income, we favor exposure to short-duration US high yield and high grade allocations in recognition of US long duration securities' outsized sensitivity to yield gyrations stemming from the European government bond market, a dynamic we have discussed over the past several months and that is unprecedented in the post-War period.

Within global equities, we continue to favor non-US equities on valuation grounds, including selected Emerging Asia, Japanese and core Eurozone equities. Within US equities, while our process leads us to maintain a generally cautious stance, we favor exposure to US large caps on relative valuation grounds as well as the natural hedge tool afforded to US large caps by a strengthening US Dollar through the cheapening of labor costs of foreign based operations.

EM Cross-Country Cyclical and Policy Dispersion Intensifies Further; Glovista Raises Asia Overweight at EMEA's Expense

GLOVISTA INVESTMENTS

EM Country wise Performance (Gross) May 2015



Source: MSCI

"The recent pullback in risk markets stems from a cocktail of factors including valuations, increased uncertainty surrounding US Fed policy, normalizing term premium levels in the Eurozone interest rate curve, shifting relative earnings and revenue leadership across country groups and lagged effects of US Dollar strength that began in July 2014."

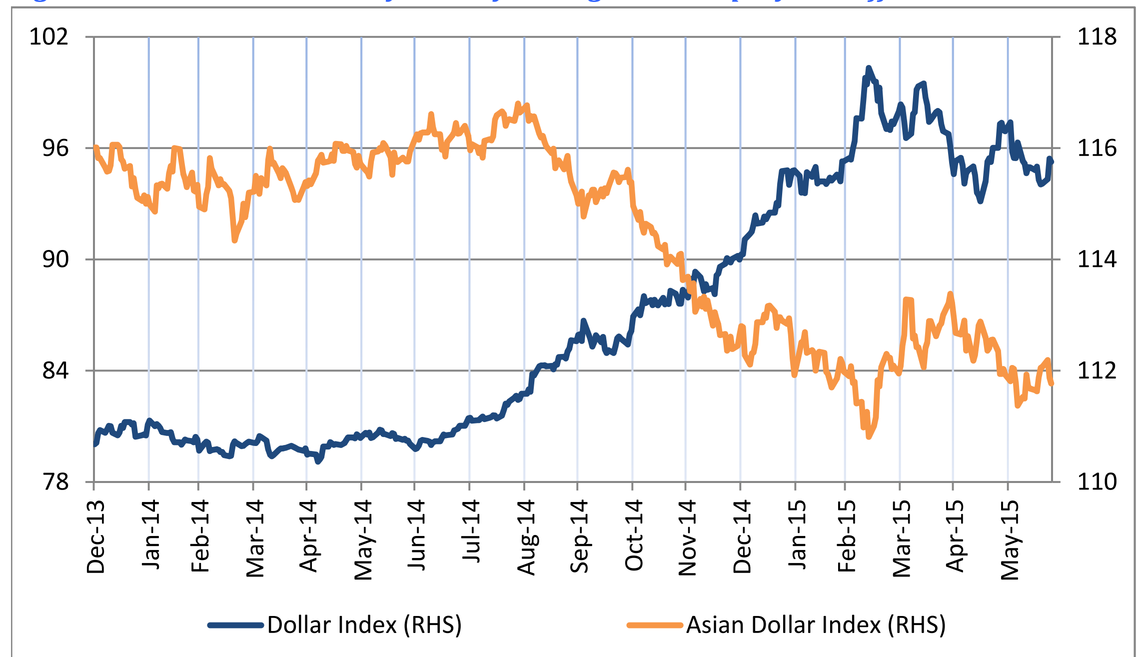
Over the past several weeks, risk markets have sold off at a global level fueled by several macro and policy developments, outlined above. The recent pullback in risk markets stems from a cocktail of factors including valuations, increased uncertainty surrounding US Fed policy, normalizing term premium levels in the Eurozone interest rate curve, shifting relative earnings and revenue leadership across country groups and lagged effects of US Dollar strength that began in July 2014.

During this recent period of softness across an important subset of global equity indices, Emerging Market (EM) equities have been more resilient versus their EAFE peers, in contrast to prior episodes of global equity market softness during which EM equities typically display some of the higher downside betas among global equity peers.

During this recent period of outsized volatility, we credit EM equities' greater resilience in their relative return performance versus DM equity peers to multiple factors, including:

- US Dollar's inability to rally further versus both Developed and Emerging Market currencies these past several weeks (Figure 9);
- improving cyclical and policy backdrop facing large capitalization EM economies;
- EM equities' compelling relative valuations versus EAFE peers (Figure 10).
- improving domestic liquidity conditions across a number of large capitalization EM economies, particularly those in Asia as regional economies remain largely net commodity importers, a condition that combined their strong balance of payments positions, allows central banks in those countries to embark or remain on a path of declining policy rates (Figure 11).

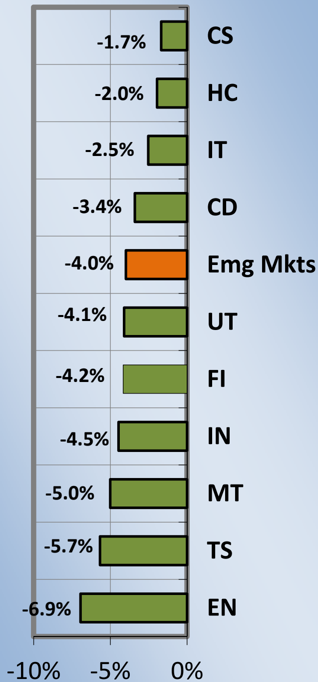
Figure 9: US Dollar's Inability to Rally during Recent Equity Sell-off



Source: Bloomberg

GLOVISTA INVESTMENTS

EM Sector Wise Performance (Gross) - May 2015



Source: MSCI

"...we maintain an overweight India country exposure owing to our secular bullish outlook, attractive valuations, the country's beneficiary status from declining commodity prices and cleaner investor positioning."

Figure 10: EM Equities' Relative P/CE Valuations Hover Well Below Multi-year Average Levels

Source: MSCI, Bloomberg ad Glovista Calculations

Figure 11: EM Asia Central Banks Increasingly Disposed towards Additional Policy Rate Cuts

Country	Last Policy Action	Last Policy Action Date	Previous Policy Action	Previous Policy Action Date
Emerging Asia				
India	-0.25%	2nd June	Hold	7th April
China	-0.25%	10th May	-0.25%	28th Feb
South Korea	-0.25%	10th June	Hold	14th May
Thailand	Hold	10th June	-0.25%	29th April
EMEA & Latam				
Russia	-1.0%	15th June	-1.5%	30th April
Brazil	+0.5%	3rd June	+0.5%	29th April

Source: National Central Banks & Bloomberg

The contrast between EM Asia countries and other EM countries could not be starker when it comes to interest rate cycles as a number of large Latin America (e.g. Brazil) and EMEA (e.g. Russia and South Africa) economies are confronting a toxic cocktail of weakening currencies, high inflation and anemic economic growth (e.g. the entry into recession of Brazil and Russia).

Against the backdrop summarized above, the Glovista investment team continues to favor our standing multi-year long EM Asia regional overweight allocation. Recent macro and policy developments have led us to reaffirm such regional portfolio tilt by raising further our Taiwan country overweight allocation via the cut of exposure to the EMEA regional markets, specifically South Africa. Within Asia, we maintain an approximately neutral country allocation towards China. Elsewhere in Asia, we maintain an overweight India country exposure owing to our secular bullish outlook, attractive valuations, the country's beneficiary status from declining commodity prices and cleaner investor positioning. We continue to avoid exposure to ASEAN markets owing to relative valuation considerations, with the exception of Indonesia, a market that harbors large cap individual names favored by our sector analysts. Within EMEA, we continue to hold approximately market neutral exposure to Turkey and Russia owing to relative valuations, having cut our South Arica exposure to underweight from approximately neutral these past few weeks. In Latin America, we continue to hold underweight country allocations across the board, with the notable exception of Chile, a market we continue to favor overweight exposure given attractive relative valuations and improving cyclical backdrop, partly as a result of the implementation of an increasingly activist policy stance.

GLOVISTA INVESTMENTS

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 before entering 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, however, 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 constitute investment advice and should not be reproduced, transmitted or published by the recipient. This document 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 consequential including 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