Issue
78
June/16

Monthly
Market
Newsletter

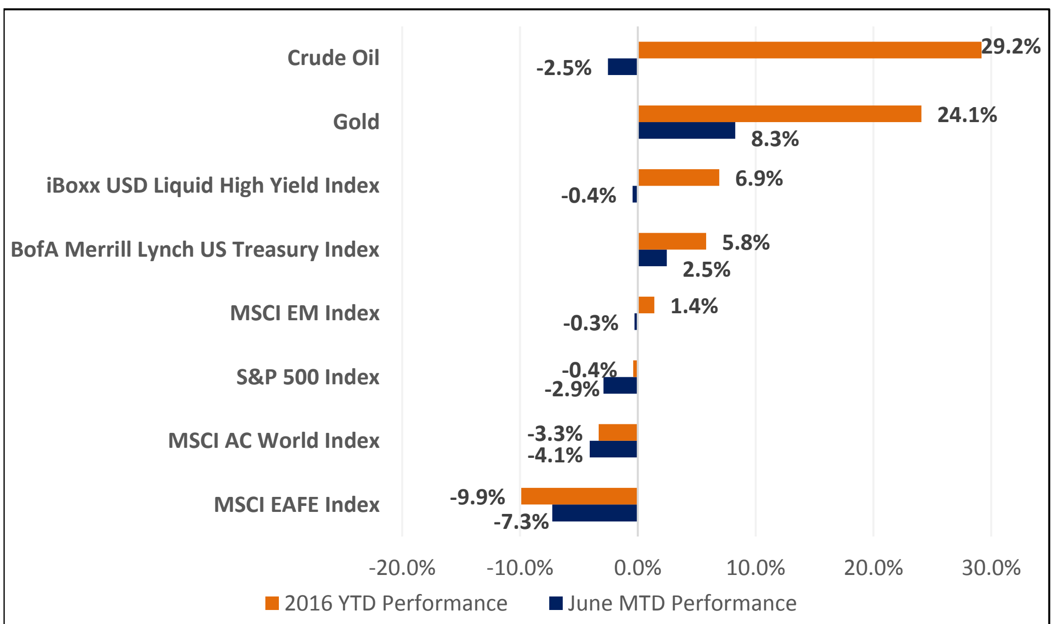
GLOVISTA INVESTMENTS

Glovista Global Perspectives

Risk Markets Sell Off Sharply on BREXIT: Likely Global Macro, Financial and Portfolio Implications; Glovista Sustains Defensive Portfolio Stance

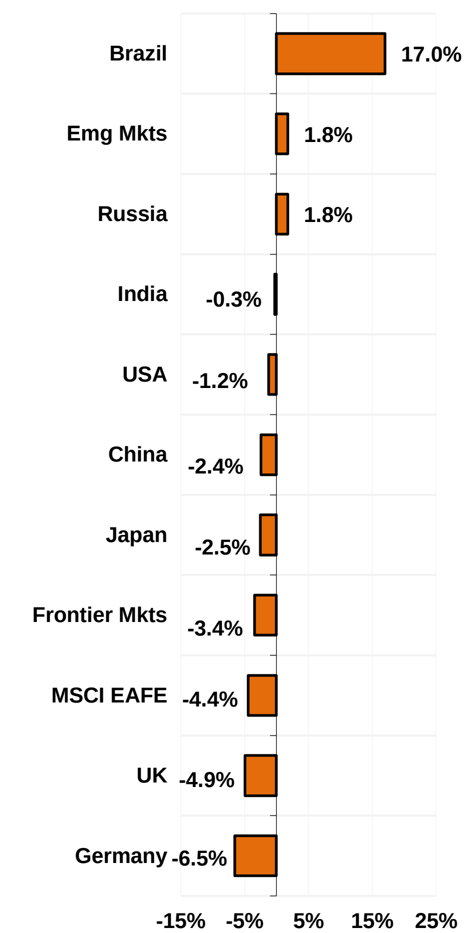
The month of June has brought about massive price declines across a large swath of risk assets globally, fueled by investor concerns over the macro, financial, policy and geopolitical implications stemming from the largely unexpected victory of BREXIT voters at the June 23rd referendum. Figure 1 captures the outsized negative return performance recorded by a number of risk indices globally both for the June month-to-date (MTD) and 2016 year-to-date (YTD) periods.

Figure 1. Risk Assets Sell Off Sharply in June, Fueled by Investor Concerns over Macro, Financial, Policy and Geopolitical Implications from BREXIT (As of June 28th, 2016)



Source: Bloomberg

Country-wise Monthly Performance in USD terms (June MTD 2016)



Source: MSCI & Bloomberg

S&P500 Monthly Sector Performance – June MTD 2016		
Sectors	% Change	FY1 PE Ratio
Energy	2.29%	97.3
Materials	-2.65%	17.6
Industrials	-1.19%	16.4
Cons Disc	-2.07%	17.8
Cons Stap	2.55%	21.8
Technology	-3.81%	16.7
Healthcare	-0.09%	15.9
Financials	-4.92%	13.9
Utilities	5.16%	18.6
Telecom	7.67%	14.8
S&P500	-1.25%	17.6

Source: S&P

In line with the multiple global macro considerations discussed at length in previous monthly newsletter columns, underpinning our longstanding 2016 YTD defensive portfolio stance at the global level, Glovista's managed GTAA portfolios met the BREXIT 'event' with low single digit equity exposure levels, high cash balances and overweight fixed income positions in US Dollar denominated securities.

The remainder of this monthly column aims at:

- summarizing recent events impacting global markets and their outlook, including not only the recent BREXIT 'event' but also major economic releases and shifts in policy guidance on the part of major central bank institutions;
- assessing near-term and medium-term implications of BREXIT at the economic, financial, policy and geopolitical level;
- assessing investment portfolio implications, including global asset allocation implications, stemming from BREXIT and the ongoing pace of global economic and policy trends;
- summarizing the principal factor tilts defining Glovista's portfolios.

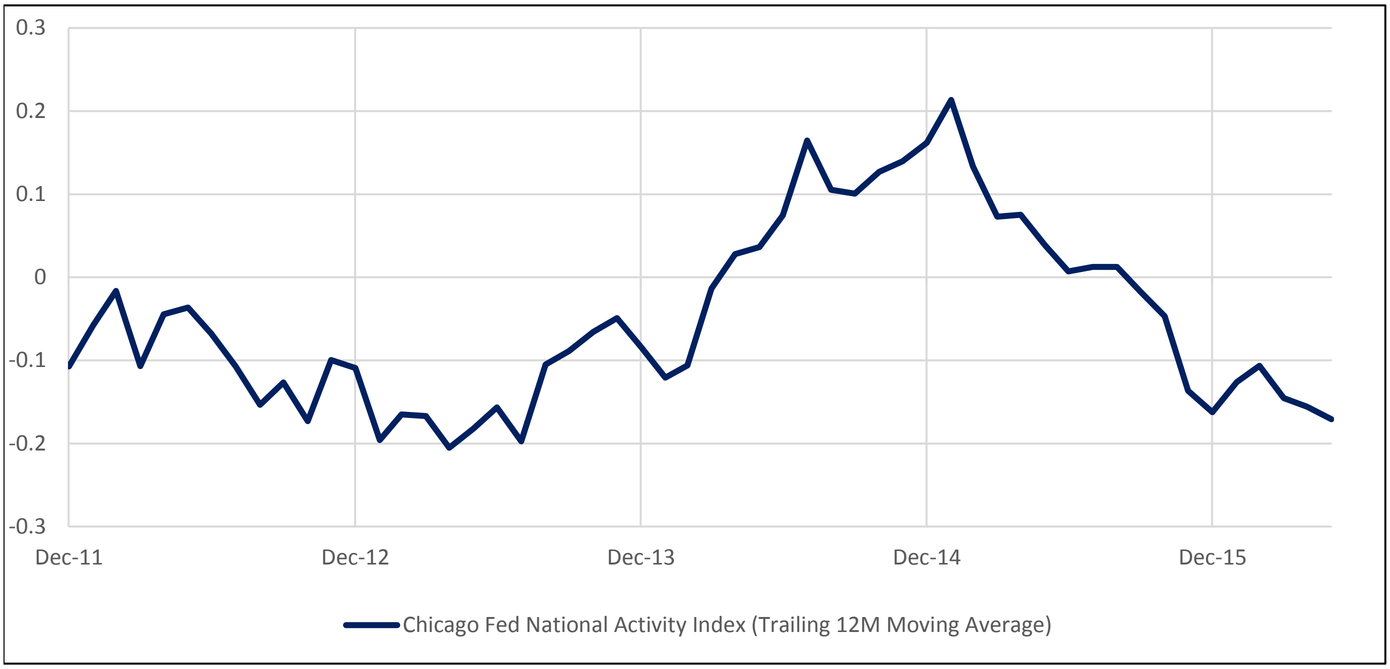
Decelerating Economic Momentum in the US and China along with Surprise BREXIT Vote Fuels Sharp Market Sell-Off

In the weeks prior to the jolt impacting global markets by the BREXIT referendum, the world's economic calendar showed signs of decelerating economic momentum out of the world's two largest national economies: the USA and China.

In the USA, recent economic releases have been significantly below consensus estimates. For example, Figure 2 illustrates the Chicago Fed's National Activity Index, an indicator that represents a broad summary statistic capturing all important US economic data releases on a monthly period. Likewise, Figure 3 captures the notable slowdown in US Gross Private Domestic Investment (Non-residential Equipment and Software) these past several months, an indication of decelerating investment expenditure momentum.

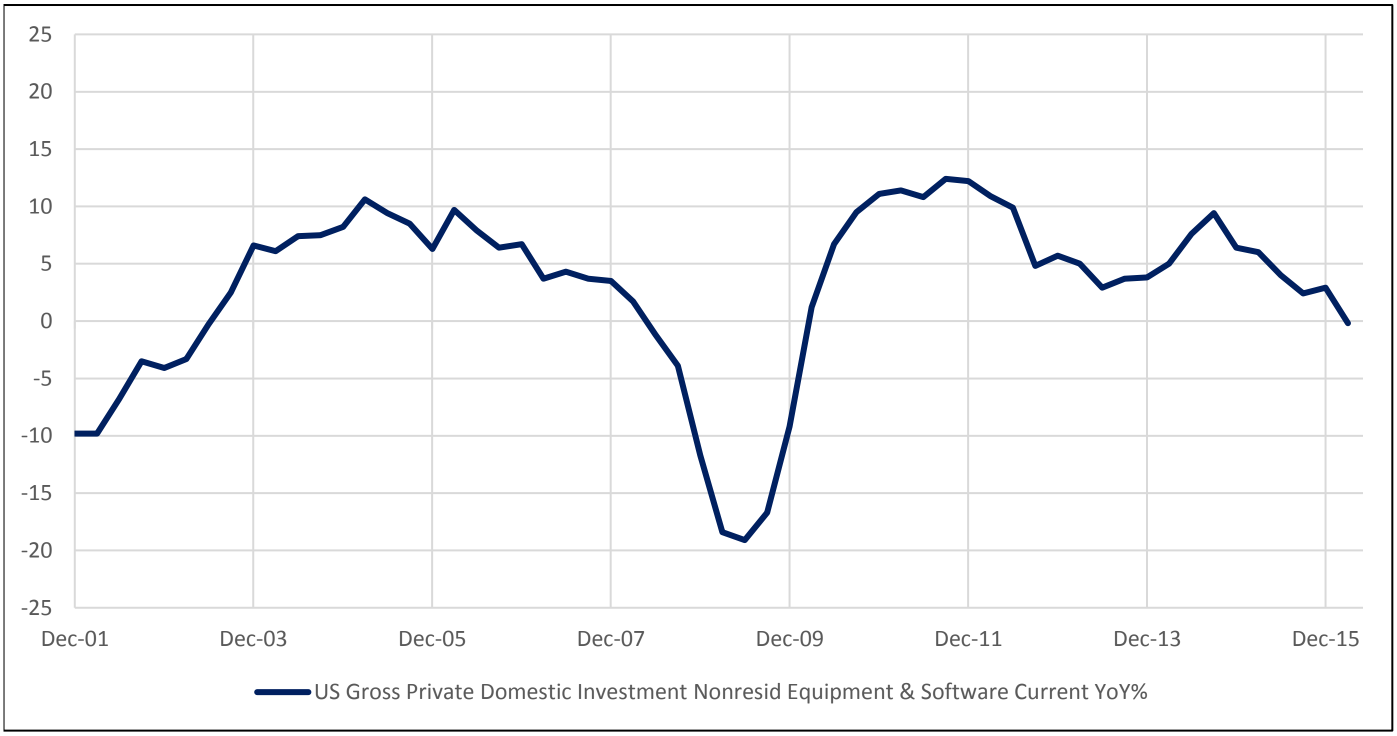
Signs of decelerating economic momentum in the USA are evident not only at the composite (Figure 2) and investment sector (Figure 3) levels but also at the level of the all important US labor market, as illustrated in Figure 4. Weakening US labor market conditions is of concern given US private consumption's large GDP share. Softening US labor market conditions at a juncture when investment expenditure growth (leading factor for employment conditions) is waning and energy prices bouncing strongly (close to 80 percent higher from low levels reached earlier in the year) is of significance to the economic outlook. The US labor market condition index is a comprehensive indicator of US employment conditions in that it encapsulates 19 labor market indicators, with private sector payrolls and the unemployment rate being the most important. The indicator also includes the labor force participation rate, hiring, dismissals and wage data. A reading below 0 indicates deteriorating activity momentum.

Figure 2. US Chicago Fed National Activity Index Signals Marked Deceleration of Economic Momentum in Recent Months



Source: Federal Reserve Bank of Chicago

Figure 3. Slowdown in US Gross Private Domestic Investment (Non-residential Equipment and Software) these past Several Months: Indication of Decelerating Investment Expenditure Momentum



Source: Bureau of Economic Analysis

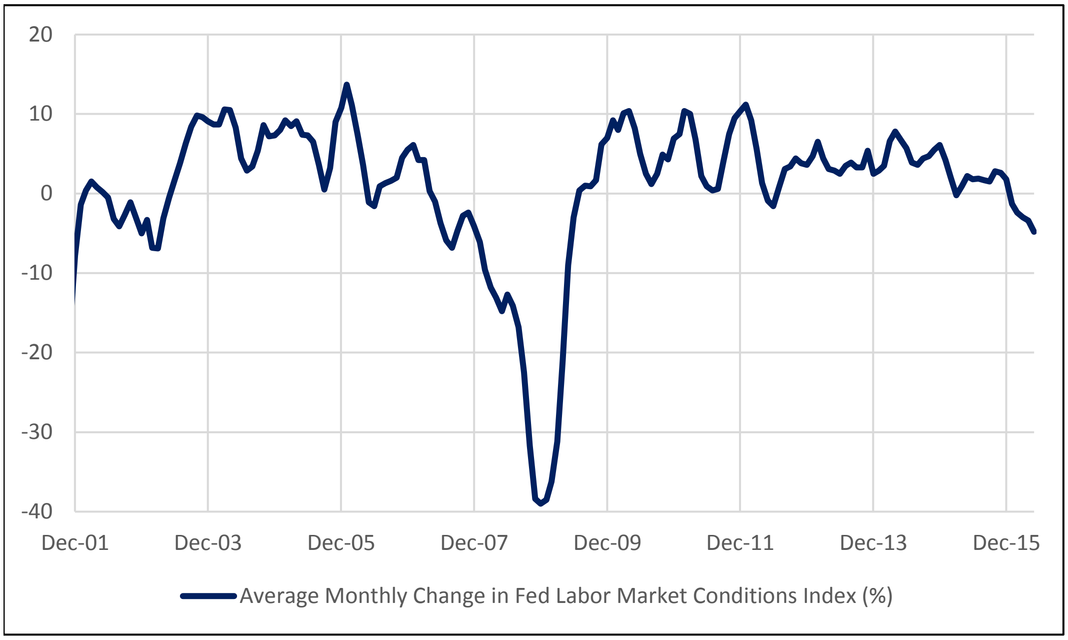
	June 29th 2016	June MTD Change
Gold	1319.02	8.5%
Silver	18.2965	14.4%
Oil	49.88	1.6%
EUR	1.1125	-0.1%
JPY	102.83	7.1%
GBP	1.3429	-7.3%
CHF	0.9797	1.4%
CAD	1.2935	1.2%
AUD	0.7451	3.0%
BRL	3.2206	10.8%
MXN	18.4839	-0.1%

Source: Bloomberg

Rates	June 29th Level
1 Yr CD	0.55%
5 Yr CD	1.23%
30 Yr Jumbo Mortgage	4.29%
5/1 Jumbo Mortgage	3.26%
US Govt. 10 Year	1.5155%
10 Yr Swap Spread	-0.1150%

Source: Bloomberg

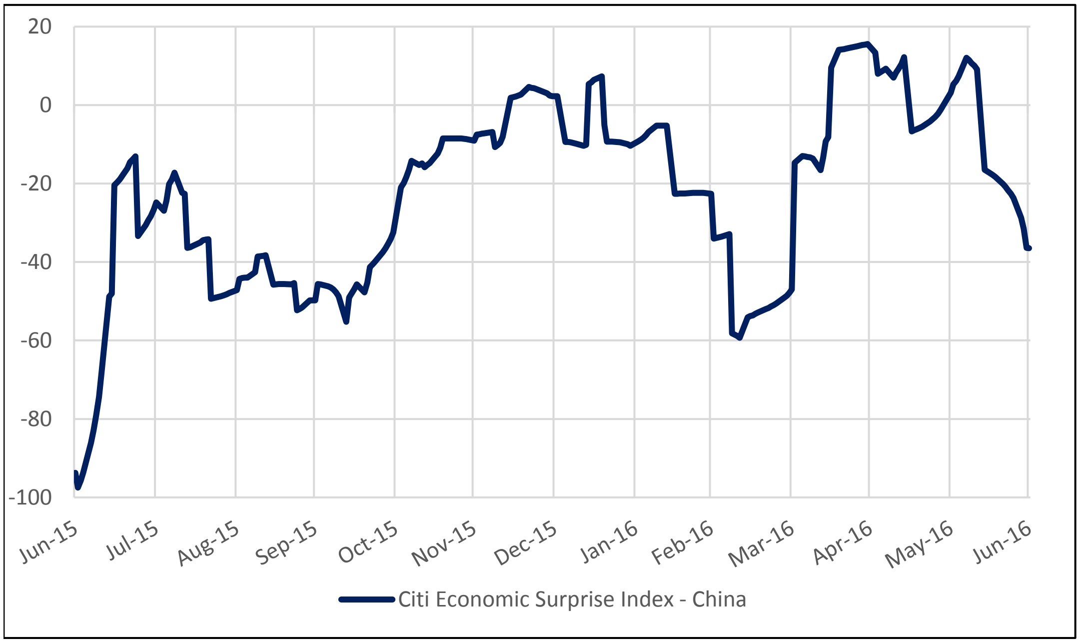
Figure 4. US Labor Market Conditions Soften Markedly in 2016



Source: Federal Reserve

In China, recent economic indicators show an impending deceleration in momentum (including housing sector activity) as the government has stated publicly its intent to arrest the pace of fiscal and credit measures implemented over the past six months, including the material reduction of interest rates facing a number of industrial sector borrowers. The government's renewed focus in putting forth supply side reforms, if followed through, will result in a loss of economic momentum later this year. Figure 5 illustrates an incipient slowdown in economic momentum, as captured via the weakening in China's economic surprise activity index.

Figure 5. China's Economic Activity Surprise Index Softens Ahead of Implementation of New Round of Supply Side Reforms



Source: Citigroup Global Markets

On June 23rd, the United Kingdom held a national referendum on its membership status in the European Union (EU). The referendum resulted in a majority vote in favor of exiting the EU. The result shocked markets and political analysts as the consensus view, indicated by a majority of polls tallied in the days prior to the vote, showed a majority in support of the UK remaining within the EU (BREMAIN vote).

The Lisbon Treaty's Article 50 dictates the process for member countries exiting the EU. Once a member country invokes Article 50, the exit process initiated is required to end within a 2 year period. As a result of the BREXIT vote, the UK PM, Mr. Cameron, has announced his resignation as he had campaigned aggressively for the BREMAIN vote. Mr. Cameron is expected to remain as a 'caretaker' PM until his replacement is elected by the Conservative Party at or before the Tory conference in early October this year. The successor PM to Mr. Cameron is expected to initiate the exit process from the EU along with the responsibility of designing the UK's position vis-à-vis its new relationship status with the EU. Consequently, the UK will remain in the EU until at least the Fall of 2018. In all likelihood, the UK will take on an affiliated EU membership status similar to that enjoyed by some Nordic countries and Switzerland, though the precise definition of the new status is virtually impossible to determine at this point.

Given the above description of recent events surrounding BREXIT as well as some of the protocols likely to unfold in the coming months, several fundamental questions stand out as relevant to the investment, economic, political and geopolitical outlooks. We will focus on the investment outlook while briefly touching upon the others as they have an impact through various important channels, including risk premium, price and output dynamics.

BREXIT June 23rd Vote Result: Assessing Some Key Economic, Financial, Policy and Geopolitical Implications

As shown by the outsized market moves following the June 23rd referendum, BREXIT is without doubt a highly consequential development at the economic and financial levels, not to mention at the policy and geopolitical domains. Specifically, we list immediately below some of the major likely implications stemming from BREXIT:

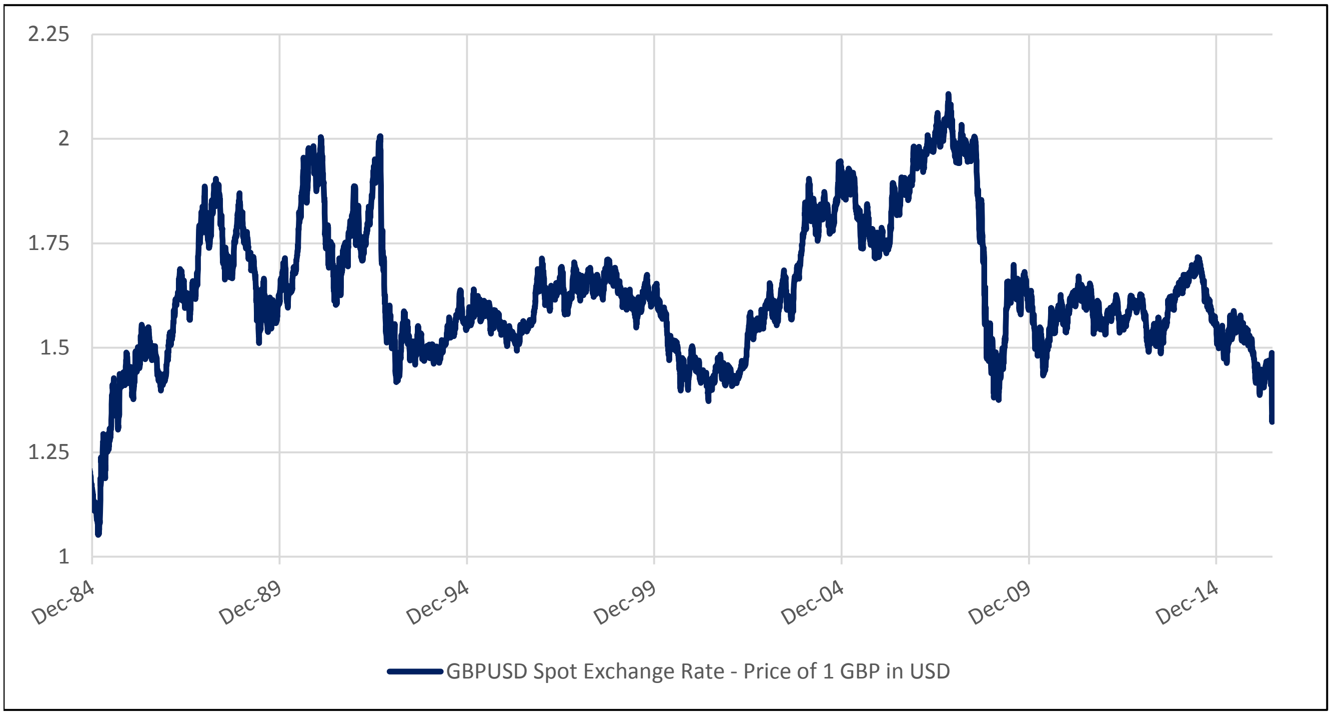
- ***Vastly increased risks of economic recession in the UK by the second half of this year.*** The UK economy is highly imbalanced from a savings-investments flow perspective as it runs close to 7 percent of GDP in Current Account Deficit. It is no surprise that shortly after the results of the BREXIT referendum became known, the Pound Sterling crashed (Figure 6) to the lowest levels since 1985. The UK economy, heavily dependent on private consumption, is likely to be adversely impacted by this currency adjustment in the coming months, by at least 1 percent GDP growth detraction at an annualized basis by the third quarter of this year.

- ***Non-trivial, though moderate, GDP growth deceleration on the Eurozone*** (60-90 basis points) and US (30 basis points) economies over the next twelve months.

- ***Tightening of financial conditions globally*** as European banking institutions – by far the most important globally in fueling international trade – face a materially more adverse outlook, directly via lower economic momentum in the UK and the Eurozone but also flatter government yield curves. It is quite telling that the European banking sector equity index has fallen to the lowest levels since the 2011-12 Euro area crisis (Figure 7).

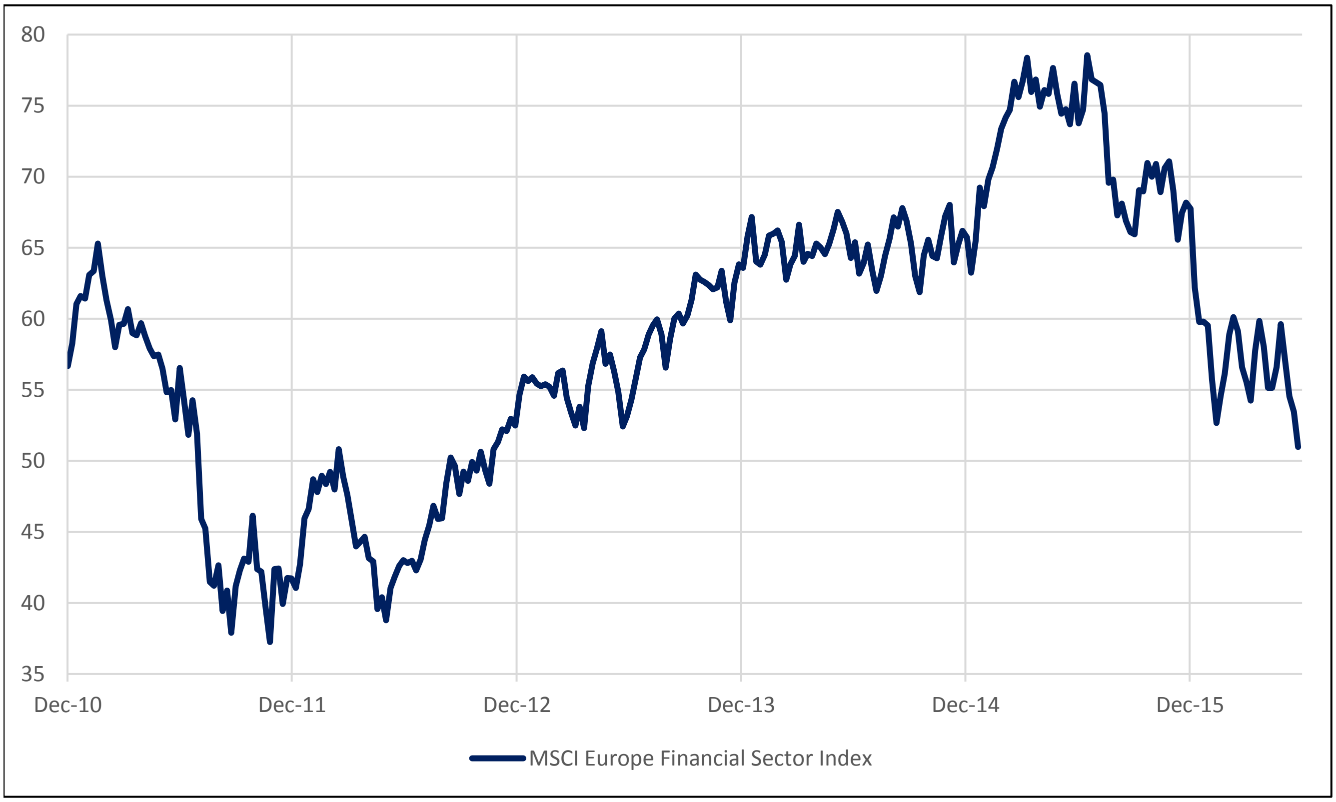
- ***Vastly diminished probability of additional interest rate hikes by the US FED, outside the potential of a single hike in December.*** As illustrated in Figure 8, in the hours following the release of the BREXIT referendum results, US money, Eurodollar and Fed Fund futures markets repriced drastically the number of likely interest rate hikes to be introduced by the US FED over the balance of the year.

Figure 6. British Pound Crashes to Lowest Levels versus US Dollar in 30 Years



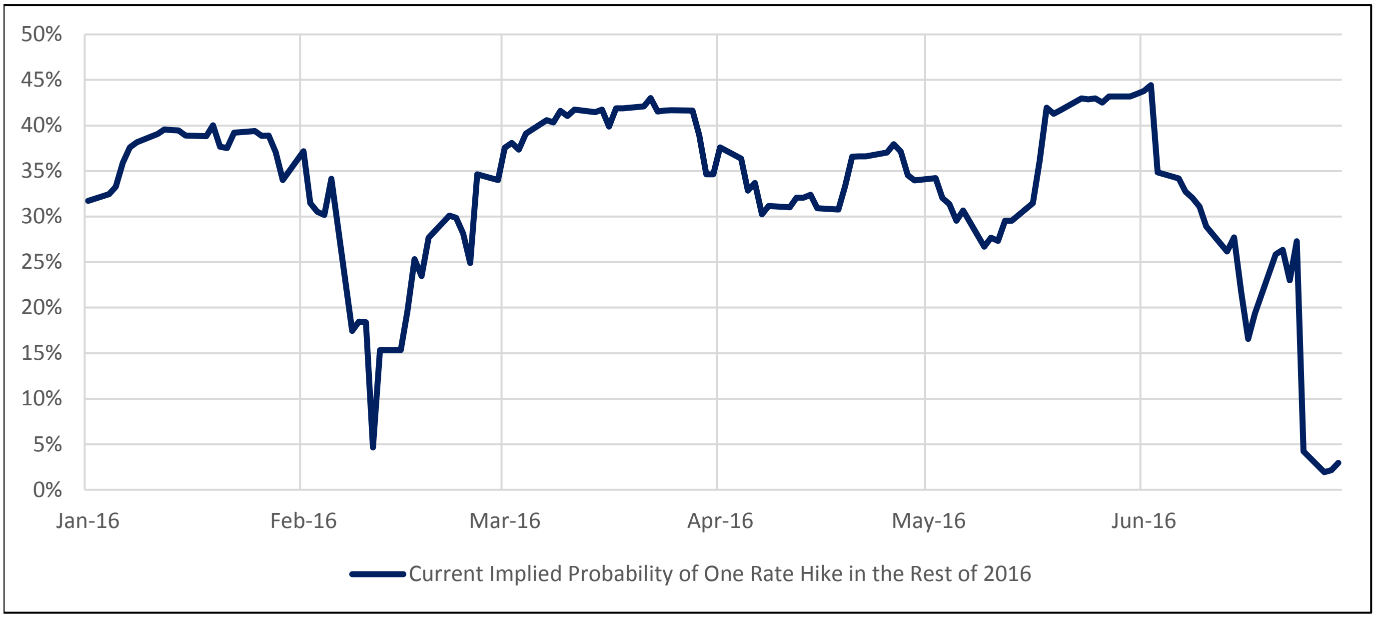
Source: Bloomberg

Figure 7. Collapse in European Bank Stock Prices Discounts Marked Tightening of Financial Conditions resulting from BREXIT



Source: MSCI

Figure 8. US Fed Funds Futures Adjust Downwardly the Number of Interest Rate Hikes by the FED in the Rest of 2016



Source: Bloomberg

- ***Enhanced risks of EU dissolution scenarios***, with the accompanying risk facing the permanence of the Euro common currency experience, as a number of countries may give serious consideration to exiting the EU. Said list of countries includes Austria, Hungary, Netherlands, Italy, among others.

- ***Materially enhanced risks of secession from the UK*** by Northern Ireland and Scotland. In the hours following the results of the BREXIT referendum, key leaders from N Ireland and Scotland have called for the scheduling of secessionist referenda from the UK.

- ***Redesign of global geopolitical map*** as an (ex-UK) EU represents a markedly less assertive bloc in the global sphere. Moreover, given the EU's close historical political alignment with US interests in world affairs (e.g. Middle East, Russia, China), the BREXIT 'event' represents an unambiguous adverse development to US geopolitical interests. As corollary, it follows that the world is likely to turn multi-polar at an even faster pace than expected before. In many respects, the US government's proactive stance these past few years in engaging India, Southeast Asian countries and others in the Asia Pacific region could not have been more prescient as a means to counterbalance the ramifications likely to ensue from an (ex-UK) EU world.

BREXIT June 23rd Vote Result and Softening Economic Momentum: Assessing Some Key Investment and Global Portfolio Strategy Implications; Glovista Sustains Defensive Portfolio Stance

The Glovista investment team believes that the recent marked softening of economic momentum for the world's two largest national economies (USA and China) and the widespread effects from BREXIT carries a number of first-order investment and global portfolio strategy implications across asset markets, including the following:

Fixed income: Developed country government yield curves are likely to remain flat for longer given BREXIT as major central banks are guaranteed to maintain extraordinarily loose liquidity conditions. These dynamics carry adverse implications for financial sector stocks and financial sector credit instruments. Within fixed income markets, the post-BREXIT world reinforces the Glovista investment team's preference for intermediate-duration US high grade corporate debt instruments and, increasingly, cross-over US high yield instruments as a world economic recession of significance remains a low probability event. Finally, at the global level, recent developments are bullish high grade Emerging Market sovereign debt and selective corporate debt owing to the enhanced value (carry) allure inherent to EM fixed income instruments. Insofar as our baseline case of no meaningful global recession in the near future, we note signs from governments in Europe, Asia and the USA indicating a loosening of fiscal policy as a means to instill stronger momentum to the world economy.

Currencies: We believe BREXIT supports our ongoing thesis calling for a topping out of the US Dollar cycle versus most Emerging Market currencies (except the Chinese Renminbi) as well as a number of Developed country commodity currencies. These commodity based Developed economies will begin to post increasingly stronger current account balance positions and improved profits cycle dynamics following several years of economic softness or contraction. Within the Developed world, we remain bullish the US Dollar, with few exceptions.

Equities: From a strategic asset allocation perspective, there is little doubt that equities trump fixed income on account of value (yield) and given our baseline case of NO significant world recession over the investment horizon. However, the dispersion of value, top line momentum, ownership status and margin dynamics vary meaningfully across regional indices so that we remain bullish Emerging Market equities and defensive Developed country sectors (telecom, utilities and energy). Our constructive stance toward energy sector stocks derives from the stocks' highly attractive valuations and dividend yields in a world where upwards of 11.5 trillion US Dollar of government debt paper carries negative yields. In addition, a more constructive supply /demand backdrop facing the oil market globally renders additional support to the constructive outlook to energy stocks. Notwithstanding our bullish relative outlook towards equities, we maintain a tactical defensive stance towards the asset class owing to headline event risks surrounding (a) the upcoming October referendum in Italy on the passage of important constitutional reforms, as well as (b) the upcoming US November general elections, and (c) the US equity market's over-owned status, particularly given the ongoing deceleration of corporate stock buybacks. Corporates have been a crucial net buyer of US equities since 2010 (to the tune of $2 trillion!).

Energy commodities: Bullish given the industry's improved supply/demand fundamentals as well as given our US Dollar view calling for a top in the US Dollar versus EM currencies earlier this year. The latter consideration plays an important role in our view given the growing contribution of Emerging Market countries' energy consumption as a percentage of the world's.

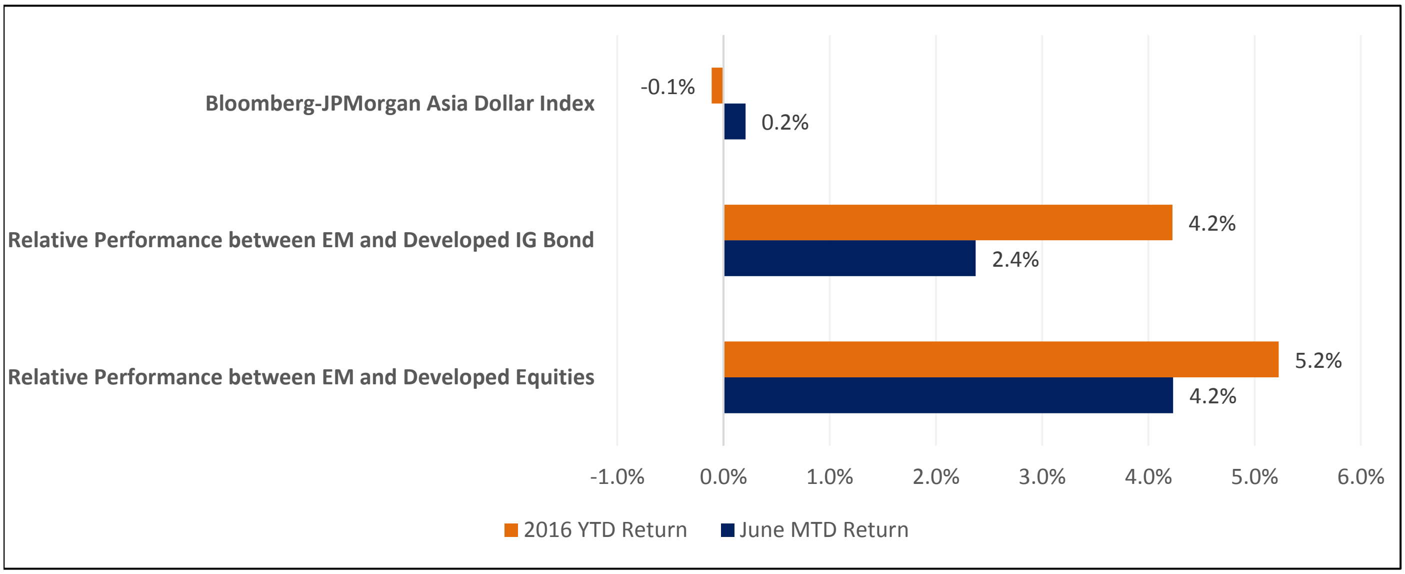
Precious metals: Bullish outlook given our currency markets' and policy interest rate views. Moreover, from a portfolio risk management perspective, ownership of gold is also attractive given the commodity group's safe haven status in environments under which financial sector pressures remain elevated, as is the case in Europe at present.

Glovista Emerging Market Perspectives

BREXIT to Fuel Further EM Outperformance of EAFE; Glovista Raises Exposure to Continental Economies of China, India and Brazil at Expense of North Asia (Korea, Taiwan)

Against most industry analysts' expectations and broad market consensus, Emerging Market asset prices have proven exceedingly resilient to BREXIT. For example, Figure 9 illustrates Emerging Market currency, debt yields and equity price dynamics for June MTD and 2016 YTD periods. Figure 9 not only shows EM asset prices' significant outperformance versus their Developed Market peers during the month of June that includes the BREXIT date of June 23rd but also shows EM asset markets' relative bottom versus Developed country peers far earlier in the year, around the early part of February.

Figure 9. Emerging Market Asset Prices Prove Resilient to BREXIT



Source: Bloomberg

Our global macro evaluation of both the short- and long-term implications of BREXIT leads us to the inescapable conclusion that Emerging Markets comprises one of the asset classes most likely to benefit from BREXIT in terms of prospective relative return performance versus global benchmarks as well as absolute returns for an important subset of EM markets. We arrive at such conclusion on the basis of multiple considerations, including the following:

- EM economies' strengthened relative economic growth momentum versus advanced economies, especially Europe and the USA as they are likely to bear the direct effects from BREXIT thru trade and service flows amongst them. Such dynamic carries over positively to EM corporate earnings' prospective relative growth momentum versus Developed peers.

- EM economies' beneficiary status from a 'lower for longer' interest rate environment in the USA, Europe and Japan as those countries' central banks are likely to intensify and also extend the duration of existing quantitative easing programs.

- EM currencies' improved secular investment allure before global asset allocators as a growing number of developed country government debt yields have fallen into the negative domain (in excess of 11.5 trillion US Dollars!), a state of affairs unlikely to reverse itself anytime soon as the ECB and the BOJ are likely to further intensify their quantitative easing programs while the US FED is likely NOT to raise policy rates till 2017.

- EM consumers' beneficiary status from the more aggressive interest rate easing programs sponsored by their own central banks as inflation momentum decelerates further at the global level amidst an environment in which EM currency stability for most countries extends further in 2016.

While BREXIT and the recent upturn in economic performance leadership by a growing number of EM national economies (such as India and China) versus Developed country peers (including the USA) represent unambiguous positive catalysts for the EM asset class, the Glovista investment team believes country-level dynamics will remain of paramount importance in generating alpha within long-only programs. Specifically, our investment team expects the country factor to remain of the essence owing to several considerations, including the following:

- Vast differences across EM countries in terms of economic sensitivities to global macro and financial factors likely to be impacted by BREXIT. Specifically, continental economies such as China, India and Brazil are likely to experience a far smaller share of the adverse effects (trade and service flows sensitivities to Europe and the UK) from BREXIT while participating disproportionately more in its beneficial effects (low interest rates, capped US Dollar strength versus EM currencies).

- Desynchronized state of monetary and fiscal policies across EM countries. For example, a number of EM economies in North Asia have either initiated or announced the imminent implementation of expansive fiscal policy programs (e.g. China and Korea) while others remain constrained from pursuing such policies.

Owing to these considerations, over the past week we have rebalanced our EM managed equity portfolios by raising exposure to continental economies within EM, especially China, India and Brazil, at the expense of downgrades to Taiwan and Korea, export-oriented economies far more exposed to Developed country business cycle dynamics.

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, 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