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Monthly
Market
Newsletter

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Glovista Global Perspectives

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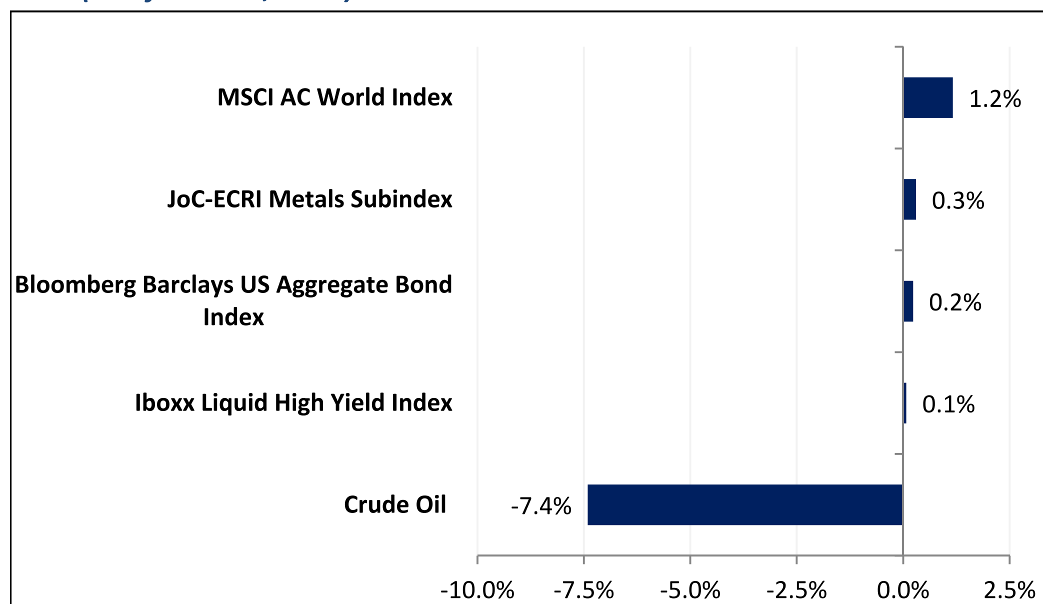
Glovista Sustains Defensive Portfolio Stance on Confirming Data Flow and Increased US Recession Risks Resulting from Ongoing FED Normalization Policy Stance

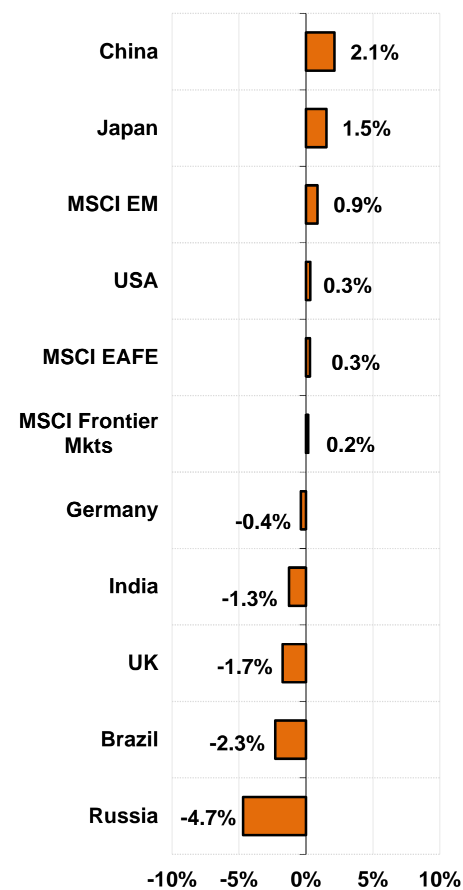
In June, risk market indices have remained within a narrow range or moved slightly higher (Figure 1) despite a continued soft economic calendar across the developed world, particularly in the USA (Figure 2). We credit risk indices' resilient June return performance, in the face of weakening economic fundamentals, to several factors supportive of equity valuation multiples, including the following, among others:

Figure 1. Risk Markets, Ex-Energy and Precious Metals, Rise Further in June MTD (As of June 29, 2017)



Source: Bloomberg

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



Source: MSCI & Bloomberg

**As of June 29th, 2017*

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S&P500 Monthly Sector Performance – June MTD 2017*

Sectors	% Change	FY1 PE Ratio
Energy	-0.63%	30.1
Materials	1.09%	18.9
Industrials	0.44%	18.7
Cons Disc	-1.89%	20.5
Cons Stap	-2.74%	21.5
Technology	-2.64%	19.4
Healthcare	4.60%	16.4
Financials	6.38%	13.9
Utilities	-2.79%	18.8
Telecom	-3.29%	13.2
Real Estate	1.44%	38.7
S&P500	0.33%	18.6

**As of June 29th, 2017*

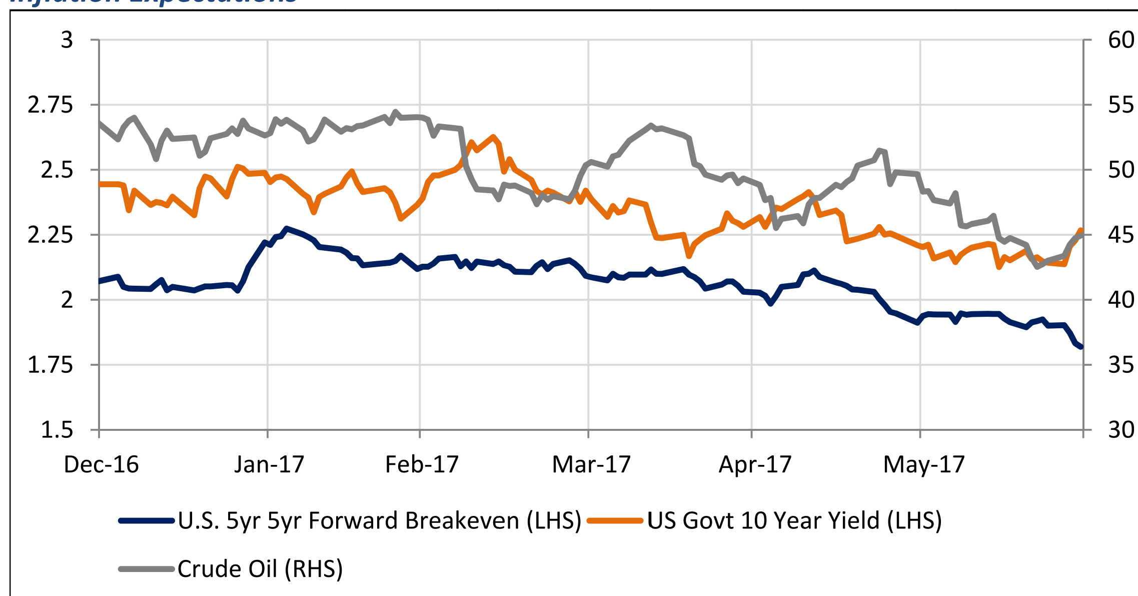
Source: S&P

Figure 2. US Economic Activity Indicators Underwhelm Further in June

Source: Bloomberg and Citigroup Global Markets

- A decline in long-term bond yields courtesy of a sharp decline in crude prices during the past several weeks (Figure 3). It is important to note that recent crude price declines have been driven by supply-side factors, including increased energy consumption efficiency and lower cost production technologies (shale), as opposed to weaker cyclical demand considerations. The distinction is important as a supply-side driven decline in crude prices amounts to a tax cut on the global consumer and producer – excluding the high savings oil producing countries. As such, at a global level, such crude price decline scenario would be viewed as growth enhancing as would the corresponding bond yield declines;

Figure 3. Crude Records Sharp Price Declines in June, Fueling Accompanying Decline in Inflation Expectations



Source: Bloomberg

- Persistently high levels of US corporate executives' sentiment concerning the potential for a calendar year's second half economic acceleration (Figure 4). In the view of many analysts, the high levels of confidence among senior executives reflects both an expectation of passage later this year of a Trump-sponsored tax cut reform agenda;

Figure 4. US CEOs Remain Highly Confident of Economic Outlook One Year Out

Source: Bloomberg

- Signs of financial stabilization in China, the world's second largest economy and a key source of downside economic risk concerns for global investors, including a regained stability in the country's foreign exchange reserves levels, a barometer of country risk tracked by the analyst community (Figure 5).

Figure 5. China Foreign Exchange Reserves Stability Restored

Source: Bloomberg

	June 29th 2017	June MTD Change
Gold	1245.52	-1.8%
Silver	16.6225	-4.1%
Oil	44.93	-7.0%
EUR	1.1441	1.8%
JPY	112.18	1.3%
GBP	1.3007	0.9%
CHF	0.9559	-1.2%
CAD	1.3004	-3.7%
AUD	0.7683	3.4%
BRL	3.3029	2.4%
MXN	18.0432	-3.1%

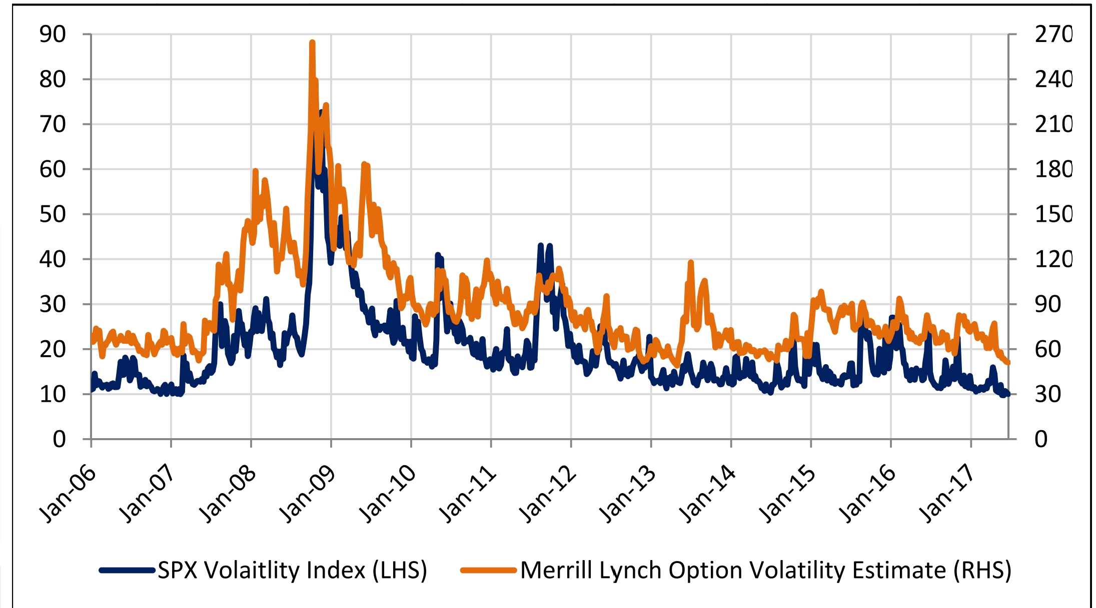
Source: Bloomberg

Rates	June 29th Level
1 Yr CD	0.68%
5 Yr CD	1.38%
30 Yr Jumbo Mortgage	4.29%
5/1 Jumbo Mortgage	3.43%
US Govt. 10 Year	2.2666%
10 Yr Swap Spread	-0.0275%

Source: Bloomberg

- Persistently low levels of financial volatility (Figure 6).

Figure 6. Bond and Equity Volatility Levels Remain Close to Historically Lows



Source: Merrill Lynch, Bloomberg

The above macro configuration - comprising supply-side driven declines in bond yields along with resilient growth expectations for the year's second half and continued low levels of financial market volatility – largely explain the resilience of risk market indices during a multi-week period in which the economic calendar has been nothing short of underwhelming.

Core Europe and Emerging Market Economies Continue to Harbor the Strongest Cyclical Growth Outlook along with Attractive Relative Valuations

As we review recent global macro developments, our standing macro and investment views remain largely unchanged from those embraced since the beginning of the year; specifically, we continue to favor core Eurozone and selected Emerging Market economies as the most attractive from a currency and equity market perspective. Specifically, the recent economic calendar has remained largely constructive for the core Eurozone economies (Figure 7) and a number of large Emerging Market economies (Figure 8).

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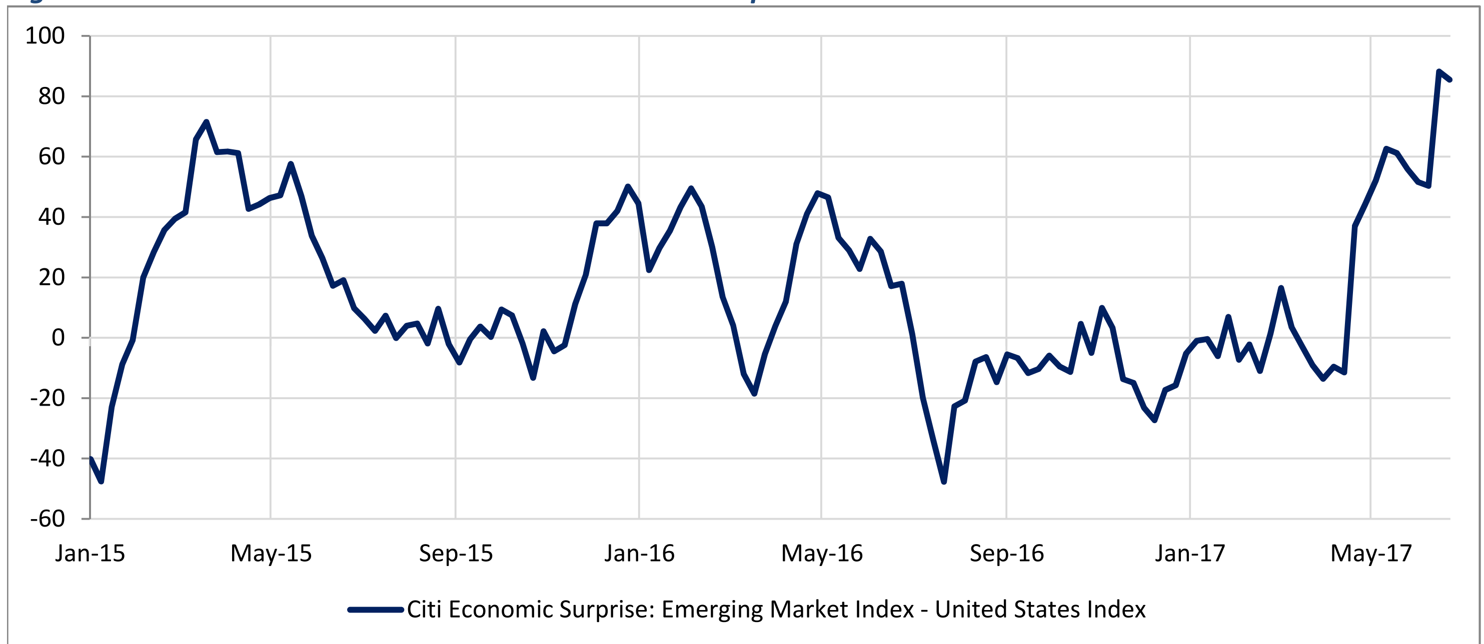
Figure 7. Eurozone Economic Growth Expectations on Sustained Rise

Source: Bloomberg

Figure 8. EM Economic Momentum Continues to Far Outpace the US in 2017



Source: Bloomberg, Citigroup Global Markets and Glovista Calculation

Such macro state of affairs reaffirms our standing bearish US Dollar stance (going to the beginning of last year in the case of EM currencies and going back to the beginning of this year in the case of Developed Market currencies). Moreover, Emerging Market economies' and Eurozone regional economic growth momentum and diminished political risks (following recent election results in France) underpin the potential for further return outperformance versus US equity peers in the coming months, particularly given US equities' stretched valuations versus international peers (Figure 9).

Figure 9. US P/CE Equity Valuations Hover at High Levels versus International Peers on a Historical Basis

Source: Bloomberg, MSCI and Glovista Calculation

From a cross-asset class perspective, we have recently trimmed our overweight allocation to fixed income, raising equity exposure to income oriented sectors as well as non-US markets (strategic rebalancing). We have also implemented a number of tactical rebalancing actions, including the purchase of income generating energy sector securities following the sharp crude price declines recorded these past several weeks. These rebalancing actions reflect our views concerning the limited upside potential in bond yields over the medium term (absent a spread widening in a recession scenario over the coming months --- not our baseline case), owing to term premium considerations as well as speculator investor positioning.

Glovista Sustains Defensive Portfolio Stance owing to Downside Risks Facing the US Economic Outlook as well as the FED's ongoing Rate Normalization Stance

As we look ahead over the coming months, we expect to maintain a defensive portfolio stance owing to the limited visibility surrounding the US economic outlook along with US asset prices' stretched valuations and the US Federal Reserve's commitment to sustain its Fed Funds rate normalization stance.

The latest string of US economic indicators – ranging from declining core CPI inflation, weak CAPEX orders, decelerating employment growth, weakening auto sales growth, rising high yield debt spreads – all point to the potential for protracted economic deceleration. While financial markets – as reflected in the continued low levels of implied market volatility - remain sanguine over such downside economic scenarios, history reminds us the fast speed with which asset prices, including volatility, adjust following a succession of economic and policy developments that jolt the consensus view.

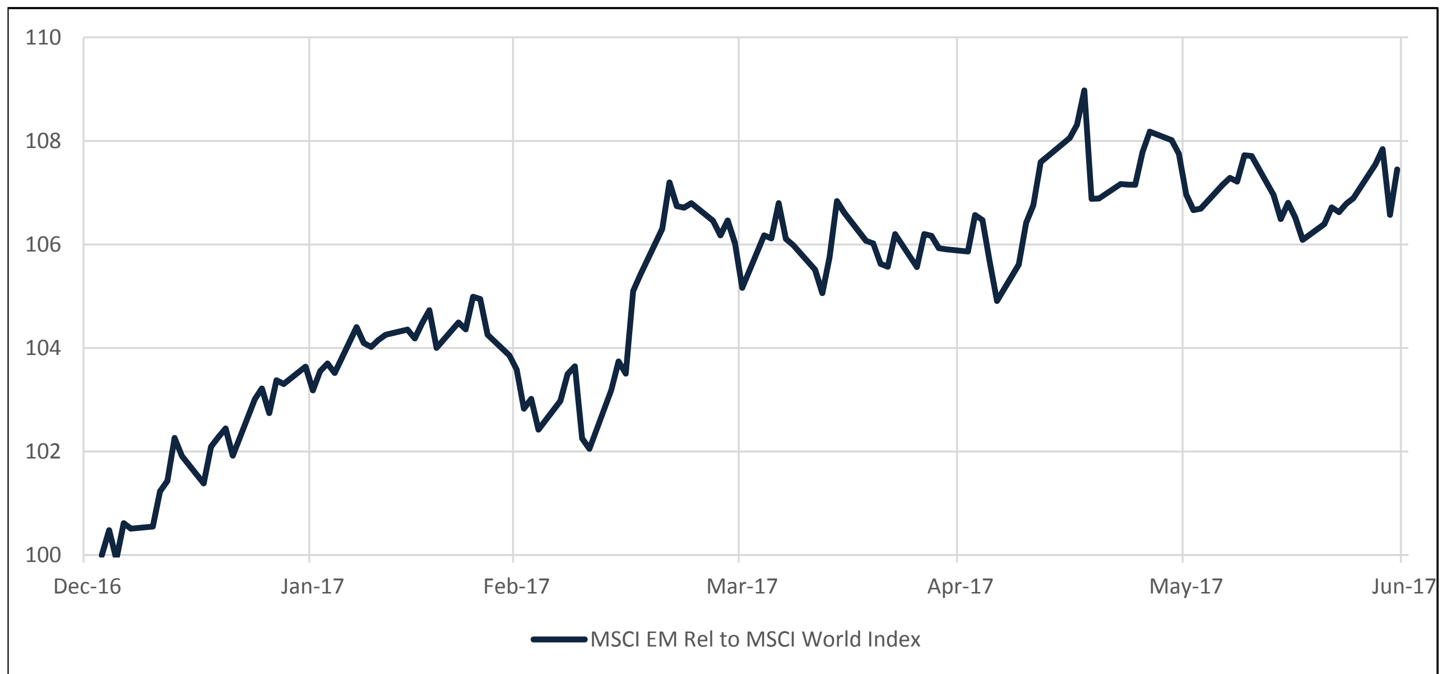
From a cross-asset class perspective, we continue to favor non-US equities, income generating equities, precious metals and high quality corporate debt (in fixed income), having recently cut back significantly our bond portfolios' duration exposure following the sharp rally at the longer end of the government bond curves.

Emerging Markets Perspectives

EM Equities Hold Strong YTD Outperformance of DM Peers Despite Sharp Commodity Price Sell-off and Challenged DM Cyclical Backdrop; Glovista Trims Growth Tilt in favor of Value-oriented Markets in EMEA and LatAm

In June, Emerging Market equities – as represented by the MSCI EM benchmark index – have managed to post a slight return outperformance versus DM (Developed Market) peers, further extending the strong YTD (year-to-date) return outperformance for the asset class (Figure 10). In our view, most observers in the investor community would find such strong return performance for the asset class during the month of June to be most impressive given the sharp commodity price declines and pullback in DM economic growth momentum during the period (Figure 11). We draw such observation on the basis that investors historically have associated Emerging Market equities' performance dynamics to be closely aligned with the performance of commodity prices and the global business cycle.

Figure 10. EM Equities Relative Performance versus DM Peers in June: Extension of Strong YTD Outperformance despite Challenged Backdrop



Source: MSCI, Bloomberg and Glovista Calculations

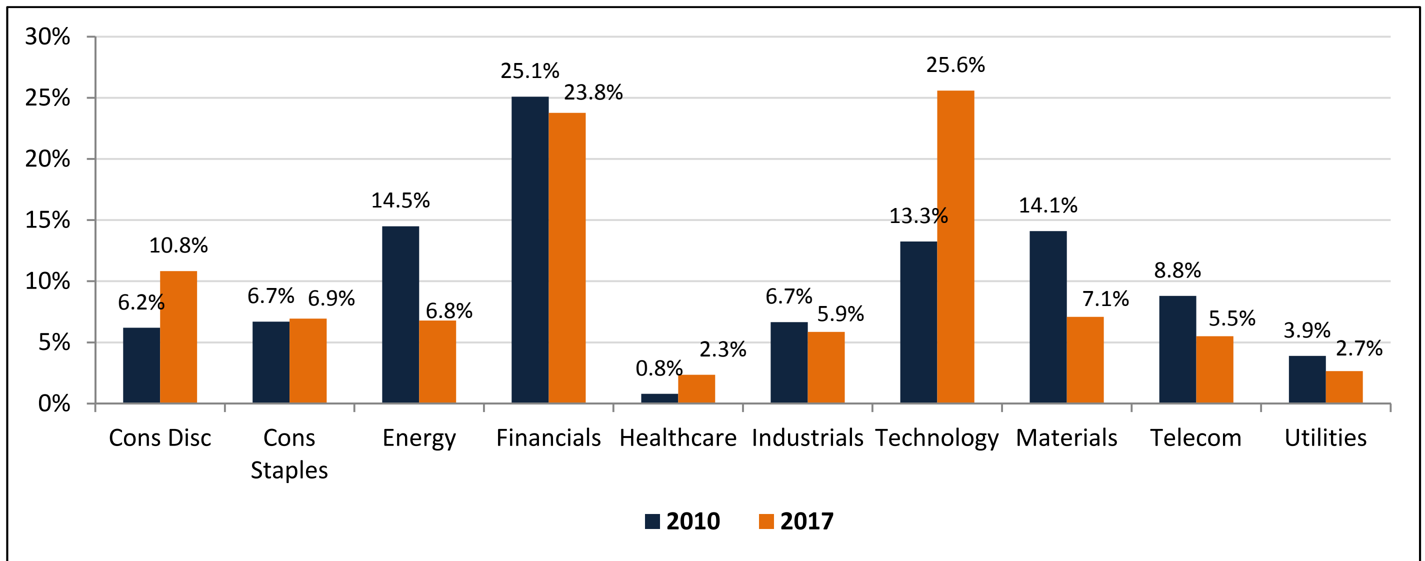
Figure 11. Commodity Prices Post Sharp Declines in June, Fueled by Crude Price Sell-off

Source: Bloomberg

In our view, the resilience shown by Emerging Market asset prices during the month of June vis-a-vis (a) the pullback recorded by commodity prices and (b) the significant softness evidenced by cyclical indicators out of Developed Market economies these past several months, discussed in the accompanying *Global Perspectives* segment, reflects a number of considerations, including:

- The vast changes experienced in the sector weightings comprising the Emerging Market equity benchmark these past several years, including the sharp decline of commodity and energy sector index weightings and the rise in the information technology sector weighting (Figure 12).

Figure 12. Sector Weighting Changes for EM Benchmark: 2010 versus 2017



Source: MSCI

- Confirmation by recent macro data flow of an improved cyclical backdrop facing EM economies, boosted by stronger domestic demand conditions both on a stand-alone basis as well as relative to Developed country peers (Figure 8);

- Improved EM economic fundamentals supportive of an upswing in domestic demand conditions as (a) inflation rates remain low, (b) balance of payments positions continue to strengthen, (c) policy interest rates are being cut across most EM countries and (d) profit cycles stand on an acceleration phase boosted not only by high profit margins but also solid top-line growth;

- Attractive relative valuations versus DM peers (Figure 13).

Figure 13. EM Valuations Remain Considerably Cheaper than DM Peers: P/CE Relative Multiples

Source: Bloomberg, MSCI and Glovista Calculation

The above considerations highlight an environment in which EM valuations versus DM peers are cheaper than historical averages at a cyclical backdrop that is arguably more favorable for EM equities owing to the secular nature of underlying growth in those countries. Moreover, EM equities remain significantly under-owned as an asset class while the relative cyclical momentum favors EM economies vis-à-vis DM peers. Given those considerations, we believe that EM equities look poised to strengthen their YTD outperformance versus DM peers in the coming months and quarters. In that light, we believe that the recent embrace by the US FED and the ECB to proceed with their corresponding rate normalization cycles will instill a more cyclical tilt to global markets. In that vein, EM assets' performance will be boosted higher, in our view.

Within the EM space, we continue to favor a barbell approach whereby we hold overweight allocations to secular growth sectors – such as those in the China ecommerce and IT industries – along with recently increased exposure to attractively valued markets in Latin America and Asia.

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