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Glovista Global Perspectives

This Issue:

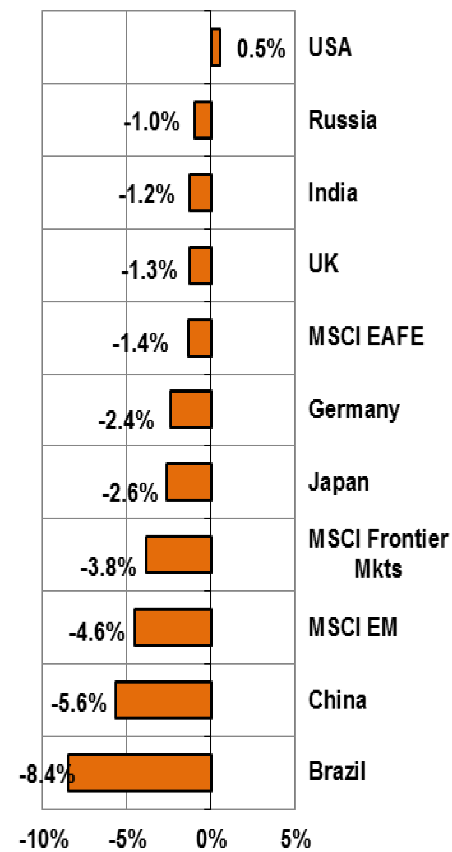
Trade War Concerns Fuel June Price Declines in Global Equities, Bonds and Commodities despite Strengthening Activity Calendar; Glovista Rebalances Equities Tilt in favor of US Value Sectors

In June, asset prices sold off across the equities, fixed income and commodity domains despite a strengthening economic activity calendar – Figure 1 and Figure 2. In our view, the broad asset price sell-off was fueled primarily by rekindled investor concerns over the possible escalation of trade war scenarios.

Specifically, the month of June has witnessed a material escalation in the narrative emanating from the US government surrounding trade relationships with China, Europe and NAFTA partners. For example, recent developments include the announcement of broader US trade restrictions (including tariffs on auto imports from the rest of the world), the deferral of NAFTA negotiations til after the US November mid-term elections, as well as the imposition of restrictions on foreign direct investment into the USA (especially out of China). In the process, China, Mexico, Canada and Europe have responded to the announcement of US trade and investment restrictions with proportionate trade restrictions of their own.

It is clear that the imposition of US trade and investment restrictions on the rest of the world is adverse to global economic growth while raising the potential for short-term cost-push inflation pressures. In that regard, the pool of professional economists on Wall Street estimates the impact of trade restrictions on global GDP – under a baseline case in which the US imposes an average 10 % tariff on all imports and all affected countries retaliate in a proportionate basis – to be in the order of 0.5 percent. A more significant adverse effect, approaching 1-1.5 percent, is possible, though not likely at this point, given the presence of knock-on effects stemming from the role of global supply chains and secondary effects tied to the resulting tightening of financial conditions that follow the imposition of trade restrictions.

Country-wise Monthly Performance in USD terms (June 2018)*



Source: MSCI & Bloomberg

**As of June 29th, 2018*

Sectors	% Change	FY1 PE Ratio
Energy	0.57%	19.4
Materials	0.12%	15.9
Industrials	-3.43%	16.7
Cons Disc	3.50%	21.3
Cons Stap	4.15%	17.9
Technology	-0.39%	18.7
Healthcare	1.51%	15.7
Financials	-2.02%	12.8
Utilities	2.46%	17.0
Telecom	2.24%	10.3
Real Estate	3.88%	39.6
S&P500	0.48%	17.1

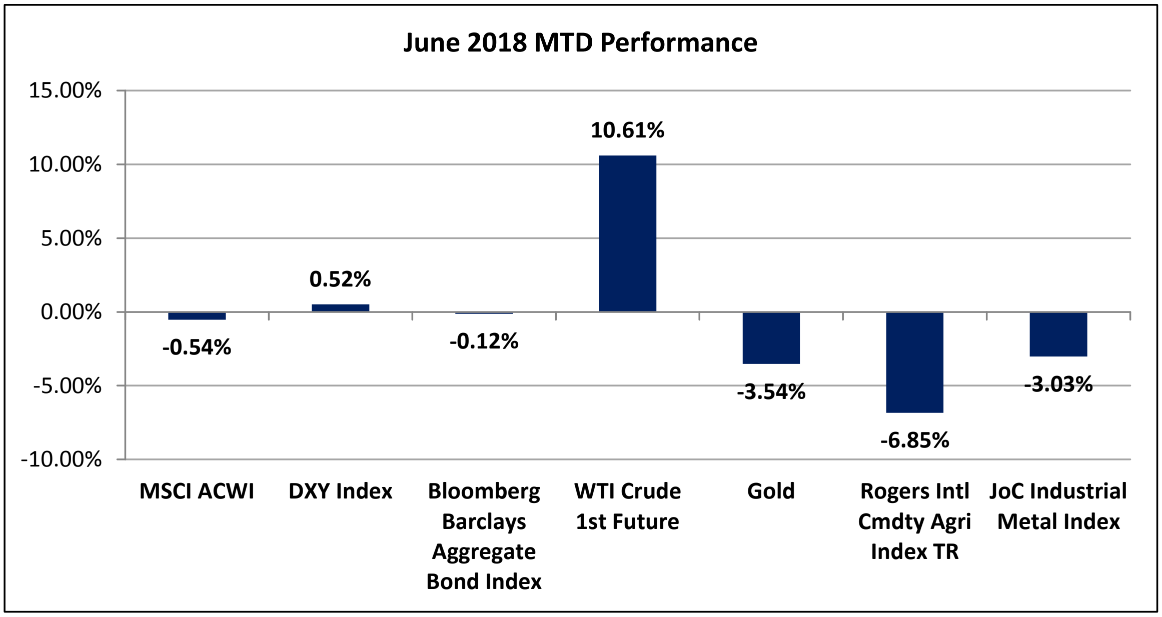
S&P500 Monthly Sector Performance – June MTD 2018*

**As of June 29th, 2018*

Source: Bloomberg

The Glovista investment team maintains a constructive outlook towards global equities, both on a standalone and also relative basis versus fixed income, despite the recent escalation of investor concerns surrounding global trade and investment flows. However, recent developments have led us to rebalance our equities portfolios away from growth sectors (greater vulnerability to trade restrictions) to value sector stocks, particularly in the US. Specifically, over the past several weeks we have trimmed our US technology sector exposures to the benefit of financial, energy sectors as well as selected consumer staples and healthcare sector industries.

Figure 1. June Asset Price Sell-Off across the Equities, Fixed Income and Commodity Domains

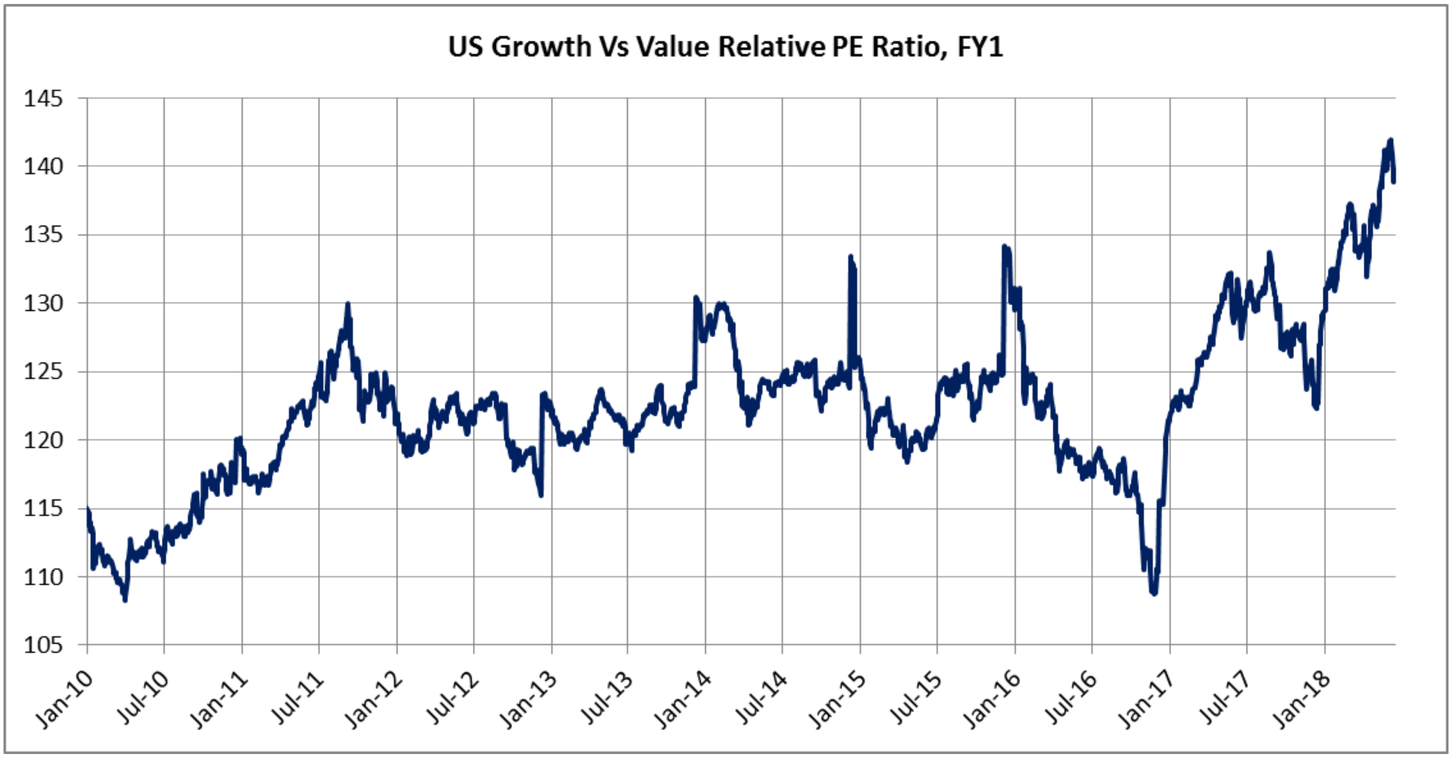


Source: MSCI, Bloomberg, WTI, Rogers International, JOC.com

Figure 2. World Economic Activity Calendar Surprises to the Upside in June, despite Broad Asset Price Sell-Off

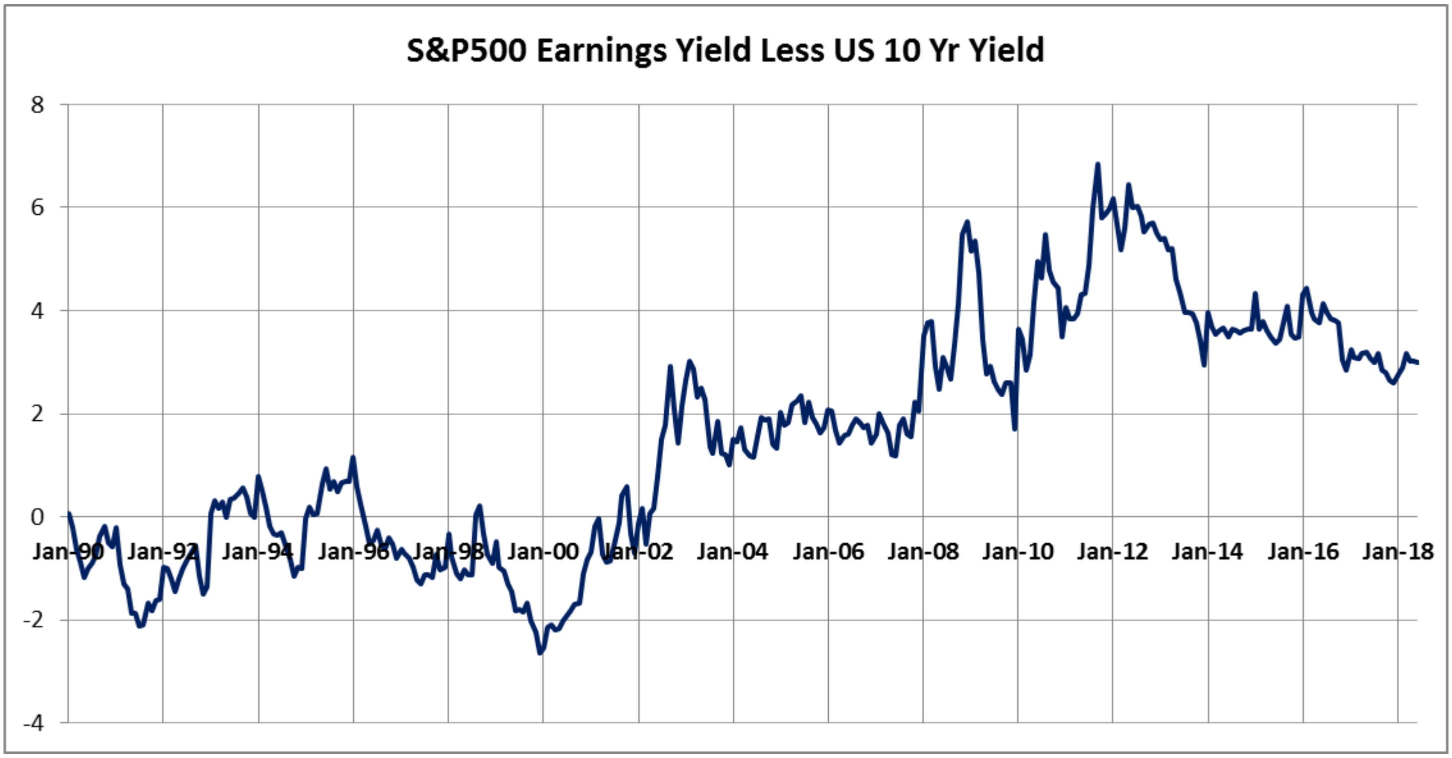
Source: Citigroup

Figure 3. Relative Valuations Point to Value Stocks' Increased Attractiveness versus Growth Peers



Source: Bloomberg

Figure 4. Equity Valuation Cheapness versus Fixed Income: U.S. Market



Source: Standard & Poor's

	June 29th 2018	June MTD Change
Gold	1253.16	-3.5%
Silver	16.115	-1.9%
Oil	74.15	10.6%
EUR	1.684	-0.1%
JPY	110.76	-1.8%
GBP	1.3207	-0.7%
CHF	0.9906	0.5%
CAD	1.3133	-1.4%
AUD	0.7405	-2.2%
BRL	3.7239	-4.1%
MXN	19.9078	0.0%

Source: Bloomberg

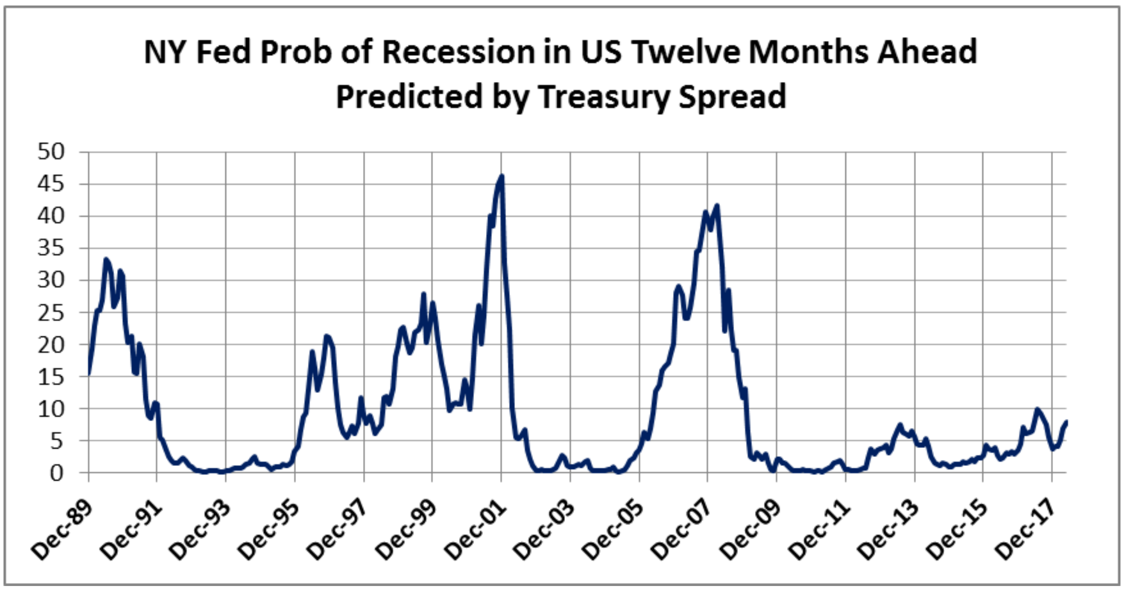
Rates	June 29th Level
1 Yr CD	1.15%
5 Yr CD	1.74%
30 Yr Jumbo Mortgage	4.61%
5/1 Jumbo Mortgage	4.28%
US Govt. 10 Year	2.8601%
10 Yr Swap Spread	7.38%

Source: Bloomberg

Besides value stocks' smaller sensitivity to the escalation of trade war concerns, such portfolio rebalancing actions reflect improved earnings outlook for value stocks, particularly on the back of recently announced US bank stress test results and firmer energy price outlook, but also improved relative valuations for value stocks vis-à-vis their growth brethren (Figure 3).

At a macro level, our constructive outlook towards global equities – particularly versus fixed income – hinges on global equities' cheap valuations versus fixed income (Figure 4) as well as our continued baseline case of low probability of recession scenario for the US economy (Figure 5 and Figure 6). In our view, the recent pullback in asset prices, especially equities, discounts heavily adverse effects on the global economy stemming from the recent escalation of trade war narrative. Moreover, in our view, the breadth and depth of the ongoing global economic expansion is of a sufficiently large order of magnitude so as to compensate for the adverse growth effects stemming from the introduction of restrictions on global trade.

Figure 5. U.S. Recession Probability, 12 Months Out, Remains Exceedingly Low: Constructive Backdrop for Equities Outlook



Source: Federal Reserve Bank of New York

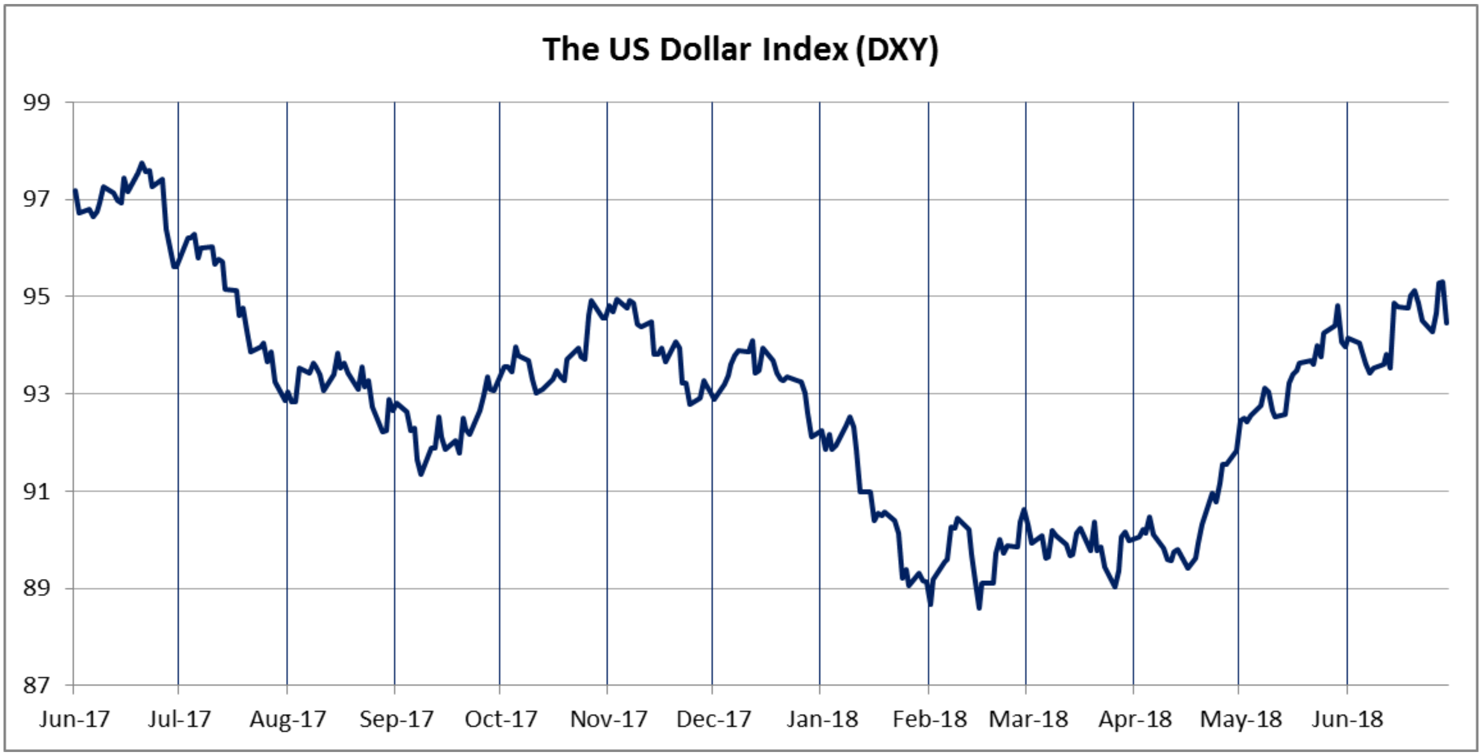
As for the recent rally in the US Dollar, illustrated in Figure 7, we view such development as the result of three intertwined dynamics, including: the work off of oversold US Dollar positioning on the part of speculators, stretched low core Eurozone government bond yield levels – courtesy of recent political noise out of Italy and Spain, and the Euro's high cyclical beta at a time in which trade war concerns escalated in investor eyes. As we look ahead, particularly over the next two quarters, we continue to harbor as baseline case a scenario of US Dollar weakness, including versus the Euro.

Of course, our investment team will continue to monitor developments on the trade front so as to update our assessment on the global economic and inflation outlook. From an overall portfolio perspective, we remain underweight global fixed income, overweight floating rate fixed income instruments, and overweight emerging markets and US equities (on tactical and risk management considerations, tied to the lingering risks of escalation in trade restrictions). Within US equities, we have rebalanced overall exposure in favor of value stocks. As for the inflation outlook, we continue to harbor the thesis that underlying inflation trends remain well behaved, as evidenced by the de facto flat-lining of year-on-year ex-shelter core CPI inflation in the US and Europe.

Figure 6. U.S. New Orders Data Firms in May following Recent Soft Patch Period

Source: Institute for Supply Management

Figure 7. US Dollar Extends Counter-trend Rally in June



Source: Bloomberg

Glovista Emerging Markets Perspectives

EM Equities Sell Off as US Protectionism Escalates and China Growth Softens on the Back of Deleveraging Measures; Glovista Raises EMEA Regional Exposure

In June, emerging market equities sold off in sympathy with the sell-off recorded during the period by global risk markets across the equities, commodities and fixed income domains, as discussed in the adjoining *Glovista Global Perspectives* column. During the month of June, emerging market equities extended their recent period of return underperformance versus developed peers, fueled by:

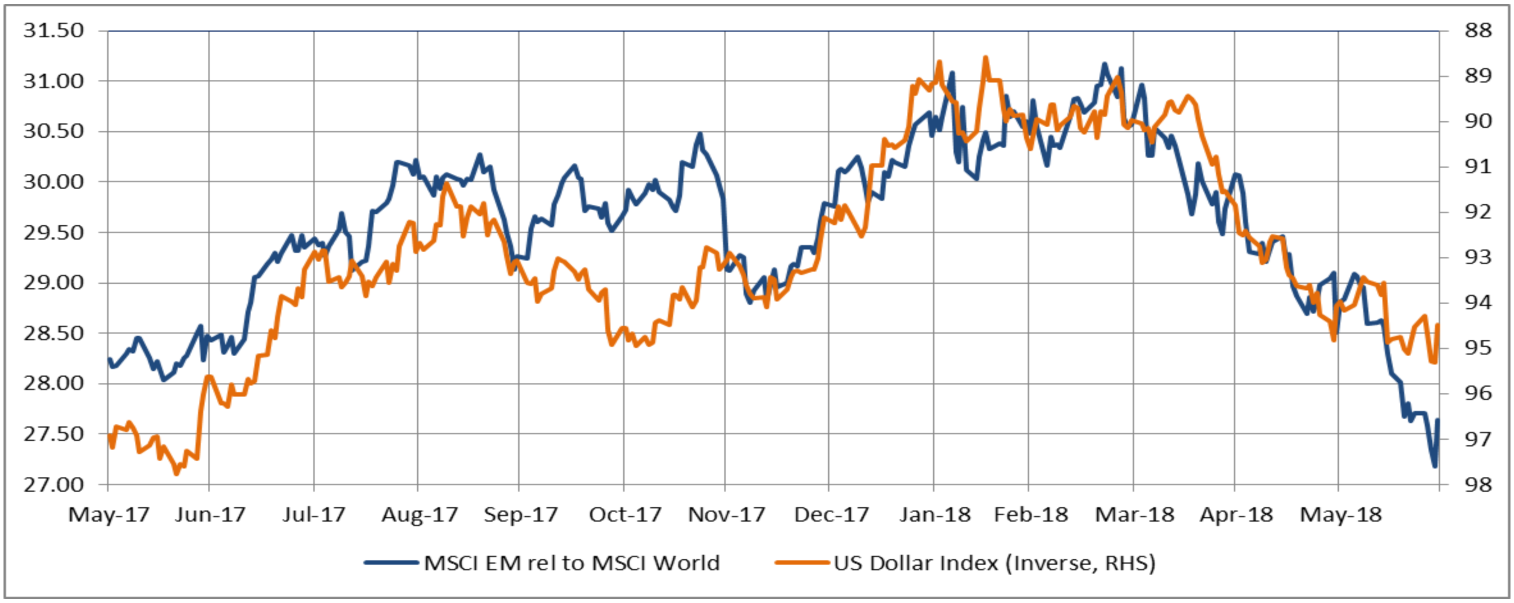
- EM equities' outsized sensitivity to shifts in GDP growth expectations (tied to the June 15 announcements by the Trump administration, concerning trade restrictions on China and the rest of the world), and;

- The weakening of EM currencies versus developed peers that unfolded during the period, led by the Chinese central bank sponsored weakening of the Renminbi, discussed further below (Figure 8).

On June 15, the Trump administration approved a final list of $50 billion worth of Chinese imports that would be subject to 25 percent tariff, with rolling effective dates starting July 6th. Later in the month of June, the Trump administration has announced additional tariff measures on other countries around the world, beyond the steel and aluminum sectors announced earlier this year, extending to the auto sector. As a result, a number of countries around the world have riposted with the introduction of tariff and investment restrictions of their own.

Against the backdrop of US led protectionism and given signs of deceleration in China's pace of economic growth (our longstanding baseline case) on the back of the ongoing deleveraging of the economy, a policy aim of the Chinese government, in June China's central bank sponsored a sizable weakening of the currency via a set of targeted reserve requirement ratio cuts. Moreover, local China economists increasingly expect the loosening of fiscal policy over the coming months so that both monetary and fiscal policy measures are used in offsetting the U.S.-led tightening of global financial and trade conditions as well as the growth decelerating effects of China's deleveraging process. Figure 9 illustrates the Chinese Renminbi US Dollar rate of exchange having recorded in June one of its largest monthly depreciation phases since the one-off devaluation of August 2015.

Figure 8. June EM Equities Underperformance versus Developed Peers Fueled by EM Currency Weakness and Trade War Concerns



Source: MSCI and Glovista Calculations

Figure 9. Chinese Renminbi Records in June One of its Largest Monthly Declines versus the US Dollar

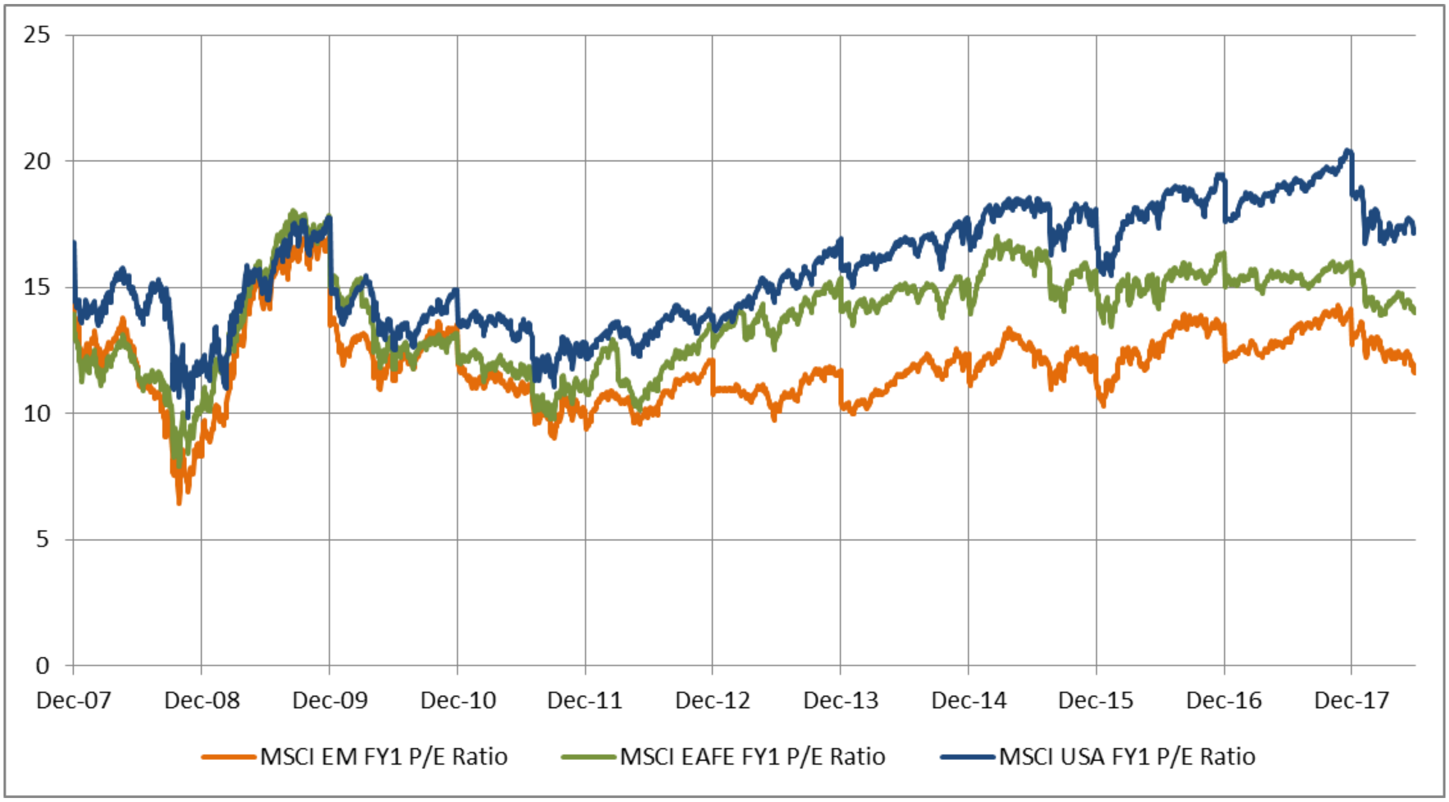
Top: USD vs. Offshore Chinese Renminbi
Bottom: Monthly return performance for USD vs. Offshore Chinese Renminbi

Source: Bloomberg

As we look ahead, we expect EM equities to resume the period of return outperformance versus developed peers that began in early 2016. We hold such expectation on the back of several considerations, including:

- Recent world economic releases support the thesis of reacceleration of economic momentum in the US, the Eurozone, Japan and a number of emerging market economies;
- Our expectation of a resumption of US Dollar weakness as we approach the second half of the year, when the ECB is likely to announce a more hawkish revision to its 2019 monetary policy program while the economic calendar is likely to show improving relative economic growth momentum between the Eurozone and the USA;
- Institutional investors remain underinvested towards the emerging markets asset class;
- EM equity valuations hover at close to multigenerational cheap levels versus developed peers (Figure 10).

Figure 10. EM Equity Valuations Hover at Close to Multi-year Low Levels versus Developed Peers: P/CE Multiple (Relative)



Source: MSCI and Glovista Calculations

The Glovista investment team has implemented a number of portfolio rebalancing actions these past several weeks, on the back of the recent escalation of trade war concerns. Specifically, we have trimmed our Emerging Asia regional exposure to the benefit of our EMEA regional portfolio exposures, with a particular emphasis on Russia and Poland owing to improving earnings momentum, attractive valuations, and solid macro balance sheet fundamentals and below average sensitivity to the escalation of trade war concerns.

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