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Newsletter

GLOVISTA
INVESTMENTS

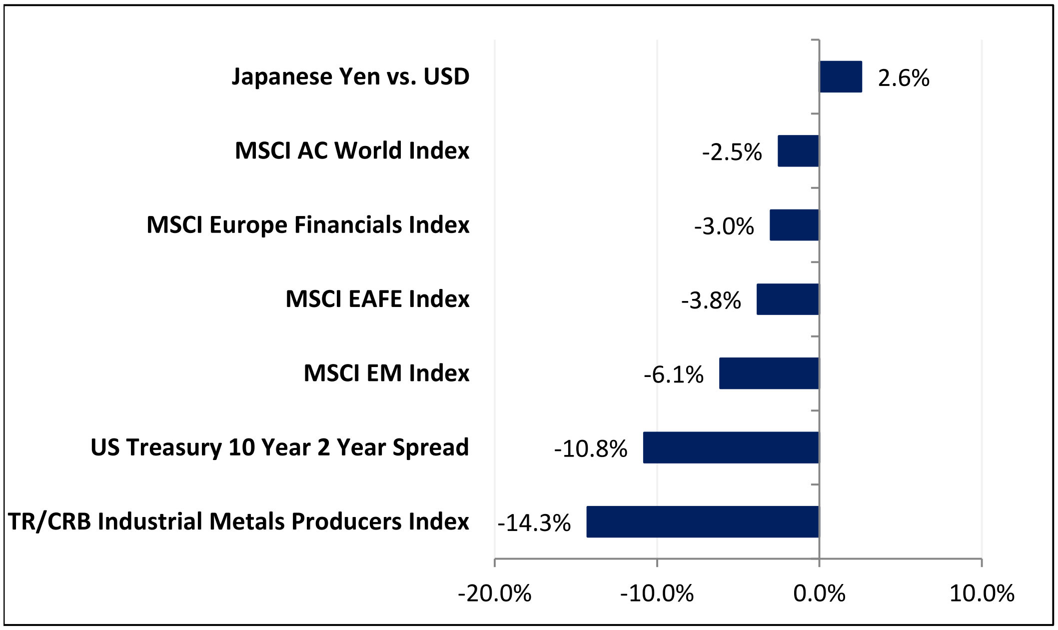
Glovista Global Perspectives

This Issue:

FED Policy Uncertainty Rises as Economic Calendar Weakens and Medium-term Downside Risks to Growth Escalate with Rising Prospects of Trump Presidency; Glovista Sustains Defensive Portfolio Stance

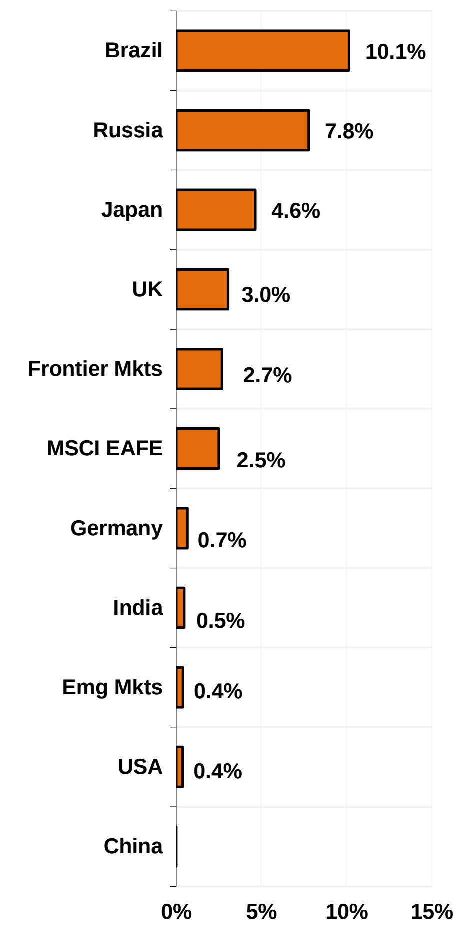
Over the past several weeks, risk markets globally have sold off across the equity currency, credit and commodity domains, as illustrated in Figure 1. We credit the recent sell-off in risk markets to several macro, market and technical factors, including:

Figure 1. Risk Markets Sell Off in May: Month-to-Date Returns thru May 23, 2016



Source: Bloomberg

Country-wise Monthly Performance in USD terms (April 2016)



Source: MSCI & Bloomberg

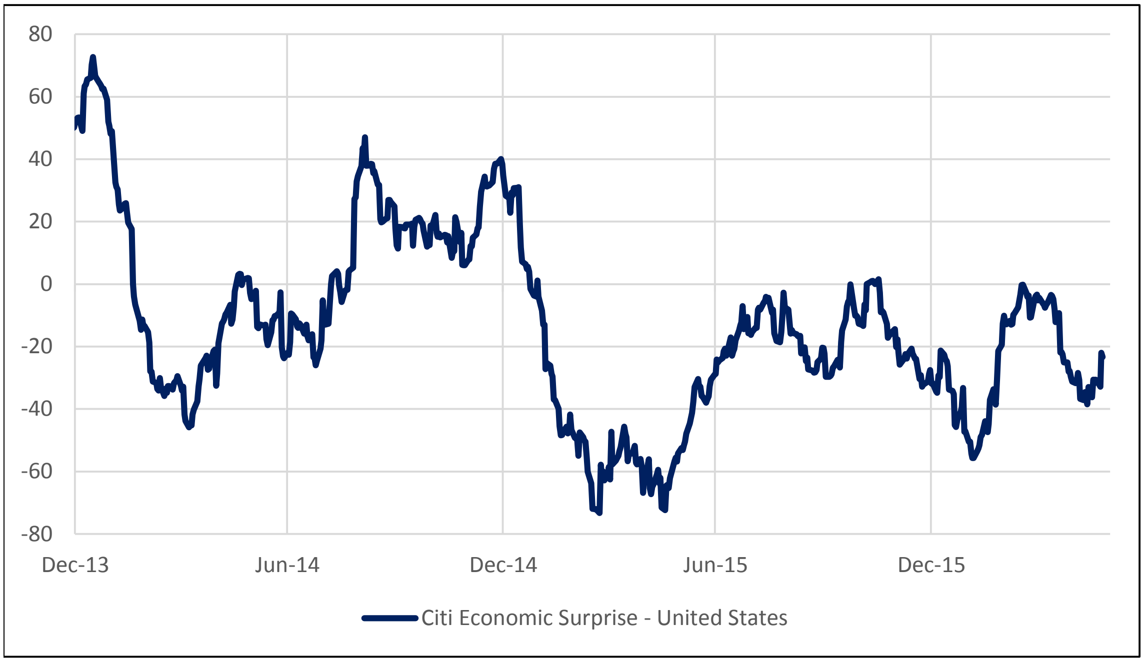
- Weakening economic calendar out of the world's two largest economies (Figure 2 and Figure 3). Over the past several weeks the pace of surprises surrounding economic releases out of the world's largest economy (the USA) has been to the downside while Chinese economic momentum continues to moderate (Figure 3);

S&P500 Monthly Sector Performance – April 2016

Sectors	% Change	FY1 PE Ratio
Energy	8.65%	102.2
Materials	4.90%	18.4
Industrials	0.83%	16.6
Cons Disc	0.05%	18.3
Cons Stap	-1.46%	21.3
Technology	-5.47%	16.5
Healthcare	2.87%	15.7
Financials	3.27%	14.1
Utilities	-2.4%	17.5
Telecom	-3.14%	13.7
S&P500	0.27%	17.6

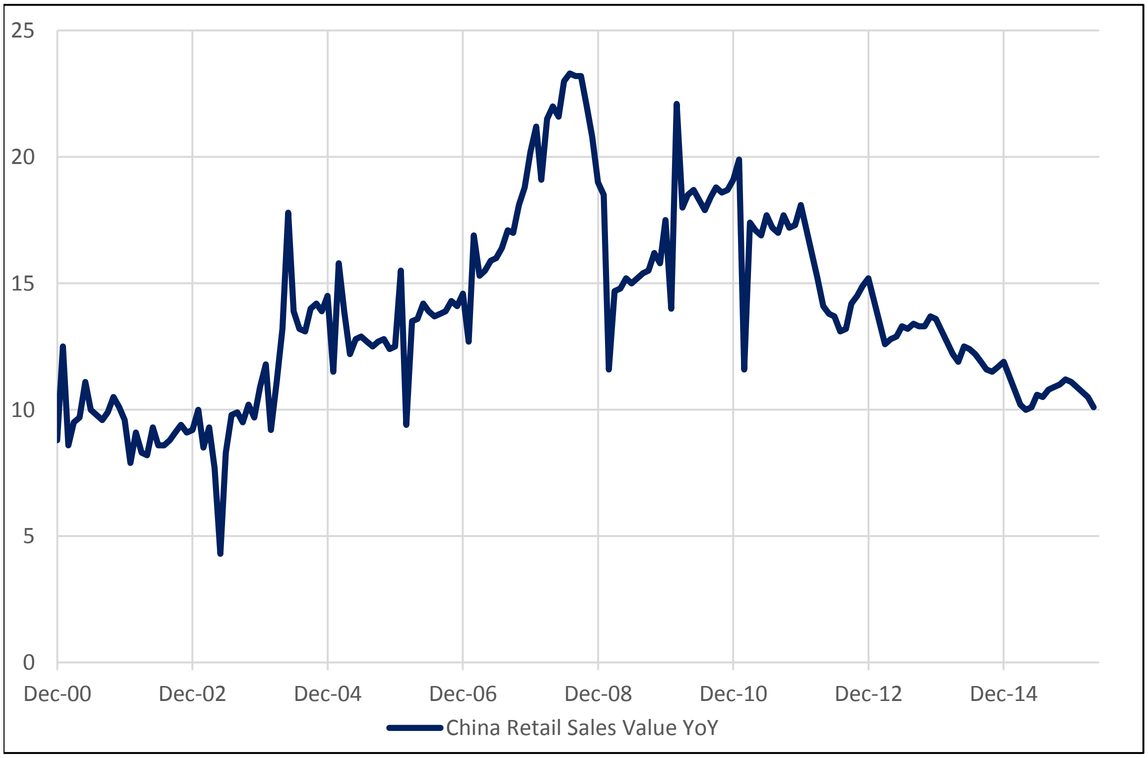
Source: S&P

Figure 2. Economic Activity Surprise Index: United States



Source: Citigroup Global Markets

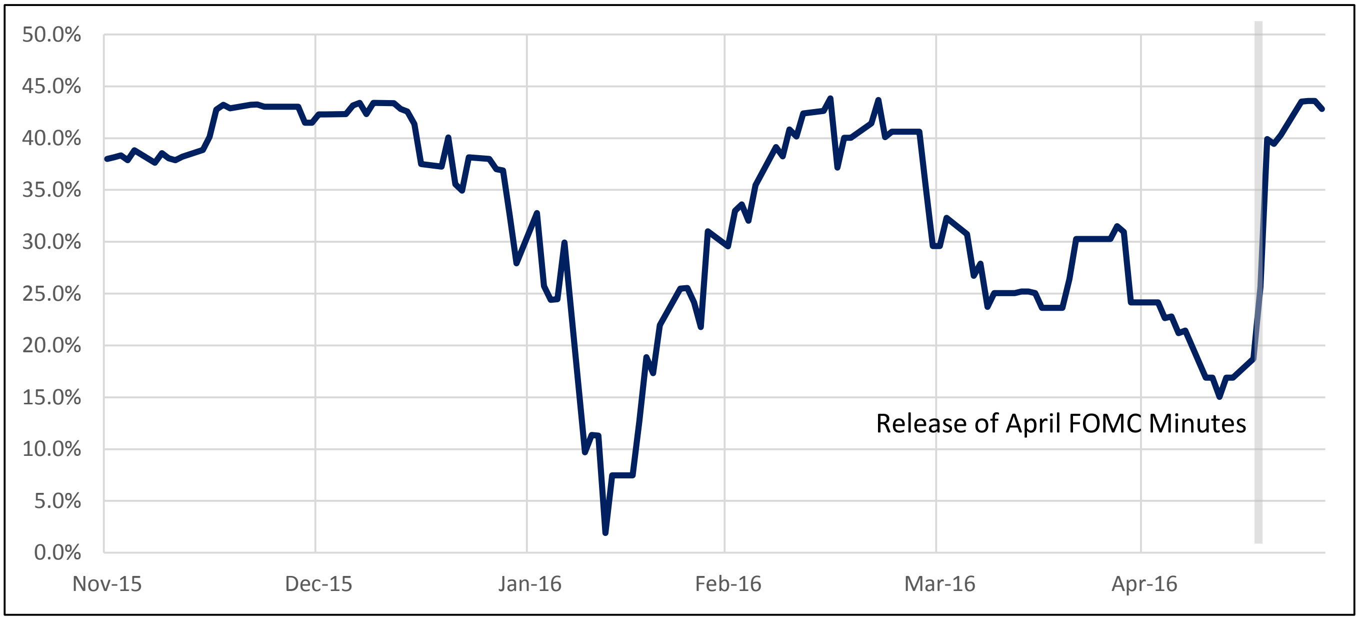
Figure 3. Chinese Consumption Expenditure Momentum Continues to Moderate: Retail Sales YoY Percentage Growth



Source: National Bureau of Statistics of China

- Heightened FED policy uncertainty surrounding the timing and quantum of future adjustments to the Federal Funds rate. In particular, the May 18 release of the minutes corresponding to the April 26-27 FOMC meeting jolted interest rate, currency and commodity markets (Figure 4). As illustrated by Figure 4, the May 18 release of the April FOMC minutes reset higher the probability of a 25 basis points hike in the Fed Funds rate at the June/July meetings from a previous 25.7 percent to a current 42.8 percent;

Figure 4. May 18 Release of Minutes for April FOMC Meeting Jolt Risk Markets by Resetting Implied Probability of Rate Hikes in 2016



Source: Bloomberg

- Likely adverse market implications emanating from a Trump victory at a juncture in which Mr. Trump has become the de-facto GOP presidential nominee and attained front-runner status in some elections polls versus Democratic Party de-facto nominee Hillary Clinton. Specifically, a Trump presidency could pose important headwinds for global equities to the extent to which Mr. Trump follows through on his long-held election promise to unwind a number of important trade agreements, including the TPP. The economic relevance of such scenario follows on the observation that global trade has been the world economy's major growth engine over the past three decades (Figure 5);

- Weak US and Eurozone first quarter corporate earnings season, including a marked 3.8 percent year-on-year contraction in US EPS (Figure 6). The sustained deceleration in US corporate earnings trends alongside weakening top line and profit margin growth raises the specter of a sustained deceleration in business fixed investment and employment conditions (Figure 7);

- Rekindled Eurozone financial sector concerns, evidenced in European financial stocks' continued downward spiral versus the broader market index (Figure 8).

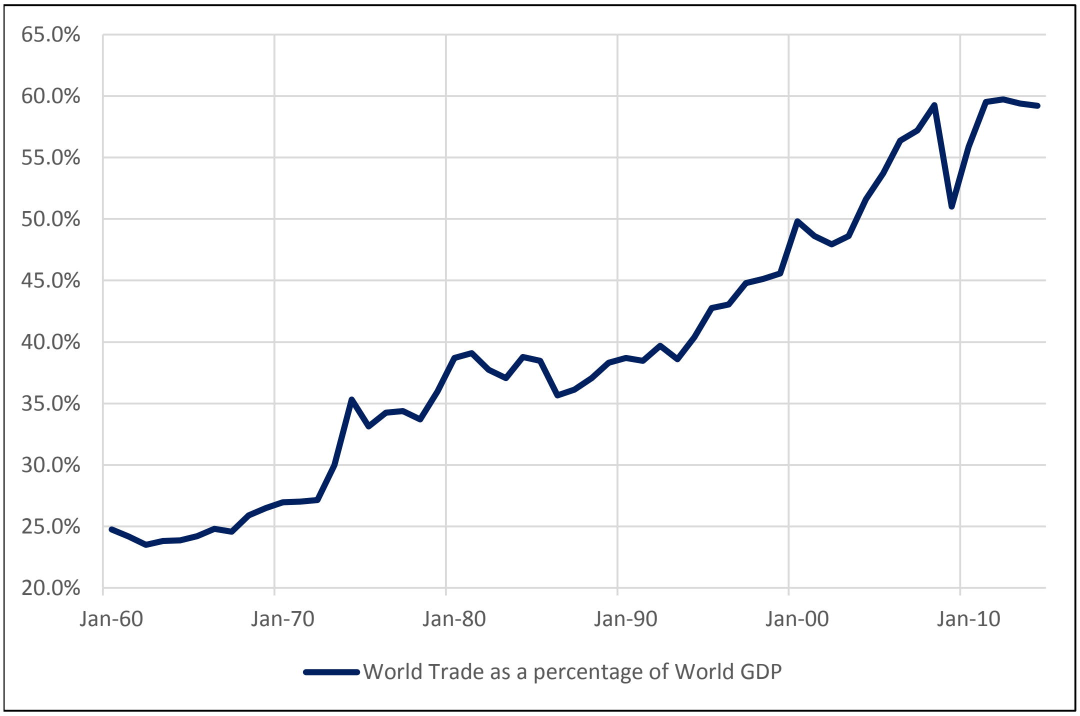
	April 2016	April Change
Gold	1292.99	4.9%
Silver	17.84	15.6%
Oil	45.92	19.8%
EUR	1.1451	0.6%
JPY	106.5	5.4%
GBP	1.4612	1.8%
CHF	0.9599	0.2%
CAD	1.2556	3.4%
AUD	0.7603	-0.7%
BRL	3.4358	4.4%
MXN	17.177	0.6%

Source: Bloomberg

Rates	April 30th Level
1 Yr CD	0.54%
5 Yr CD	1.26%
30 Yr Jumbo Mortgage	4.07%
5/1 Jumbo Mortgage	3.16%
US Govt. 10 Year	1.8333%
10 Yr Swap Spread	-0.1175%

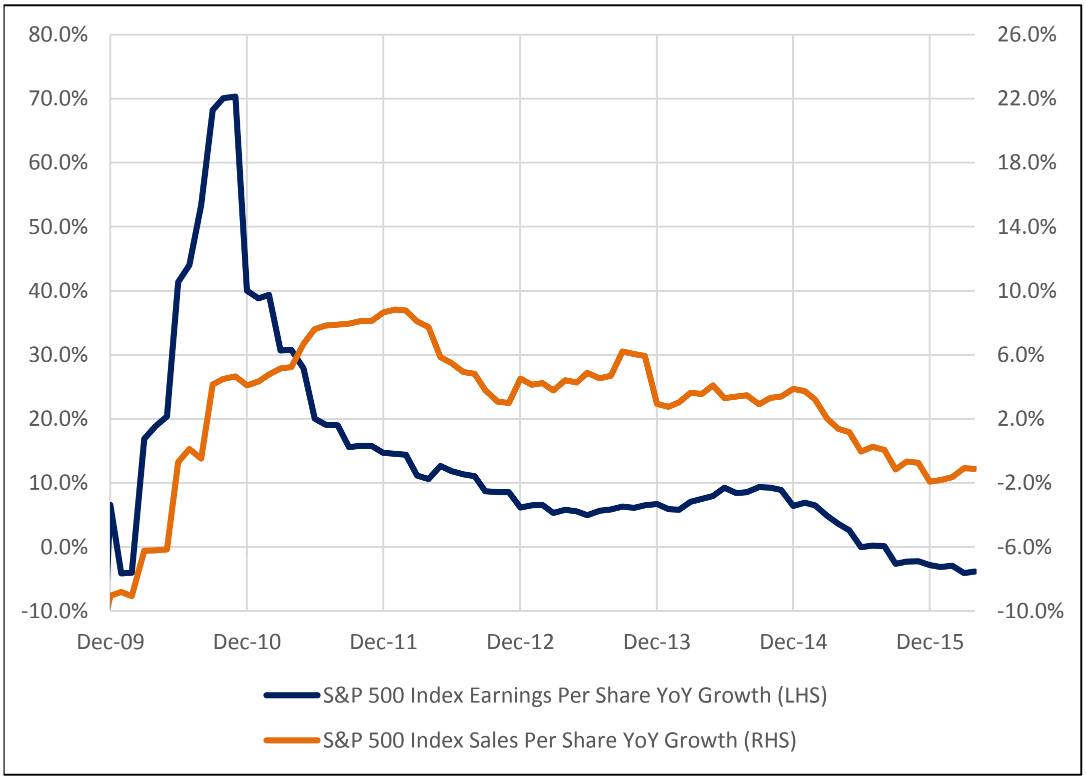
Source: Bloomberg

Figure 5. Global Trade share of World GDP: A Trump Presidency Could Trigger a Reversal in Decades-long Uptrend



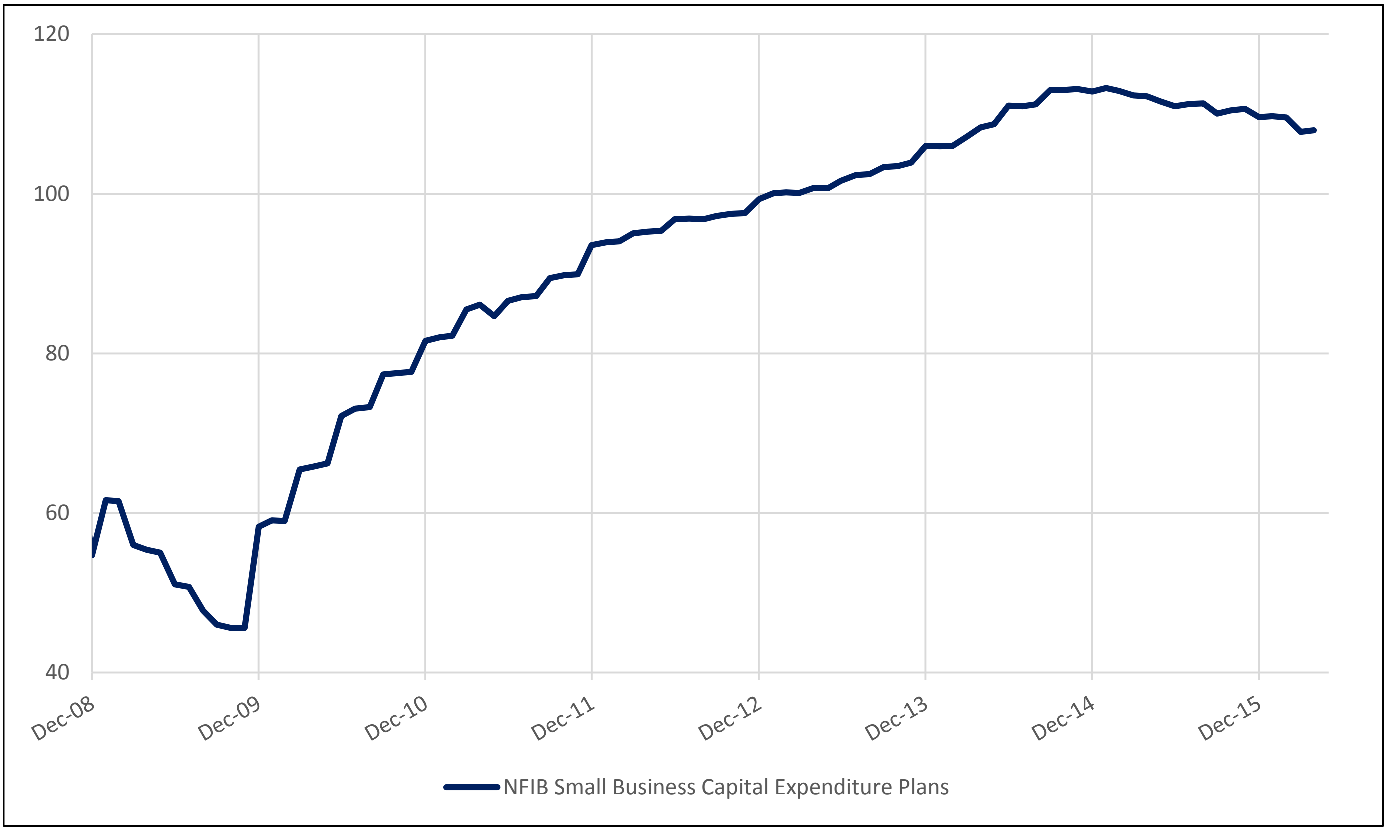
Source: World Bank Data

Figure 6. US Corporate Earnings Record Sizable 3.8 Percent Year-on-Year Decline along with 1.1 Percent Year-on-Year Revenue Decline: SP500 Universe



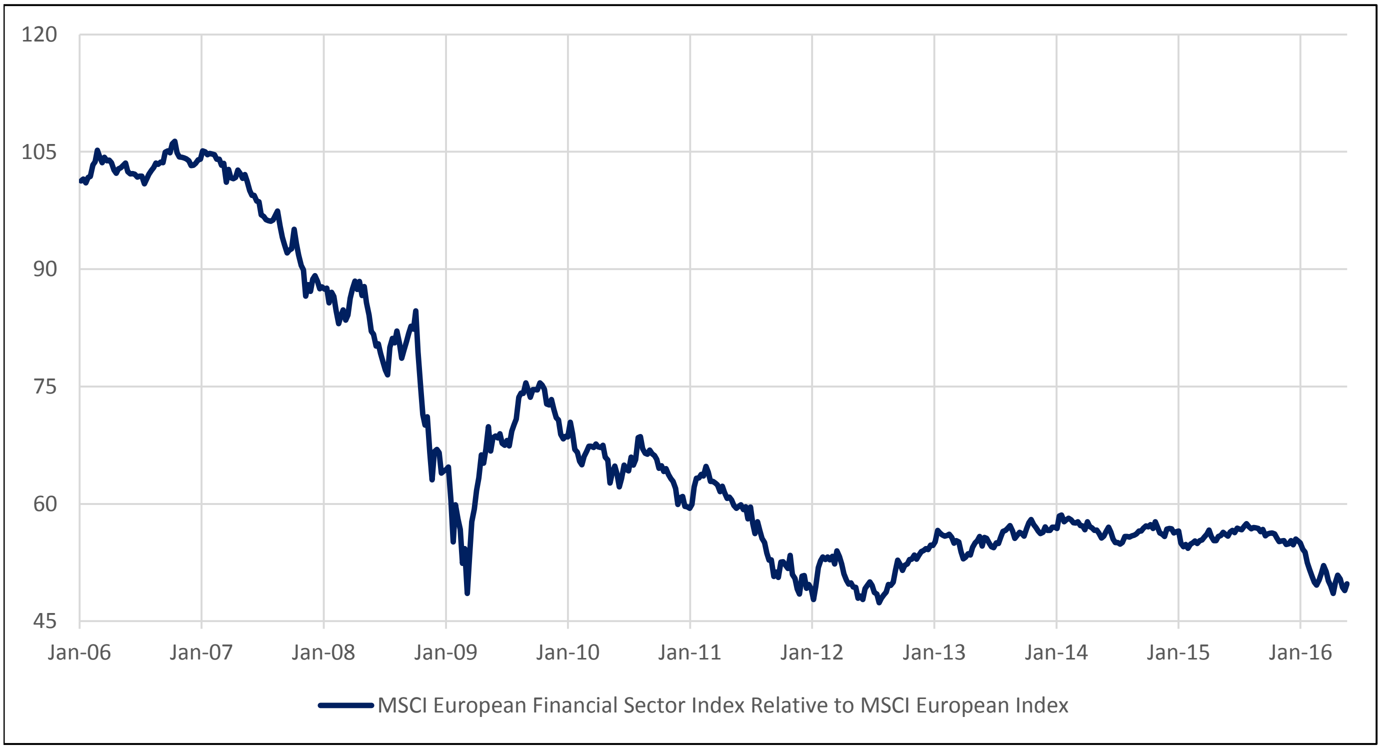
Source: Bloomberg

Figure 7. Signs of Impending Deceleration in Business Investment Spending? NFIB Small Business Capital Expenditure Plans



Source: National Federation of Independent Business

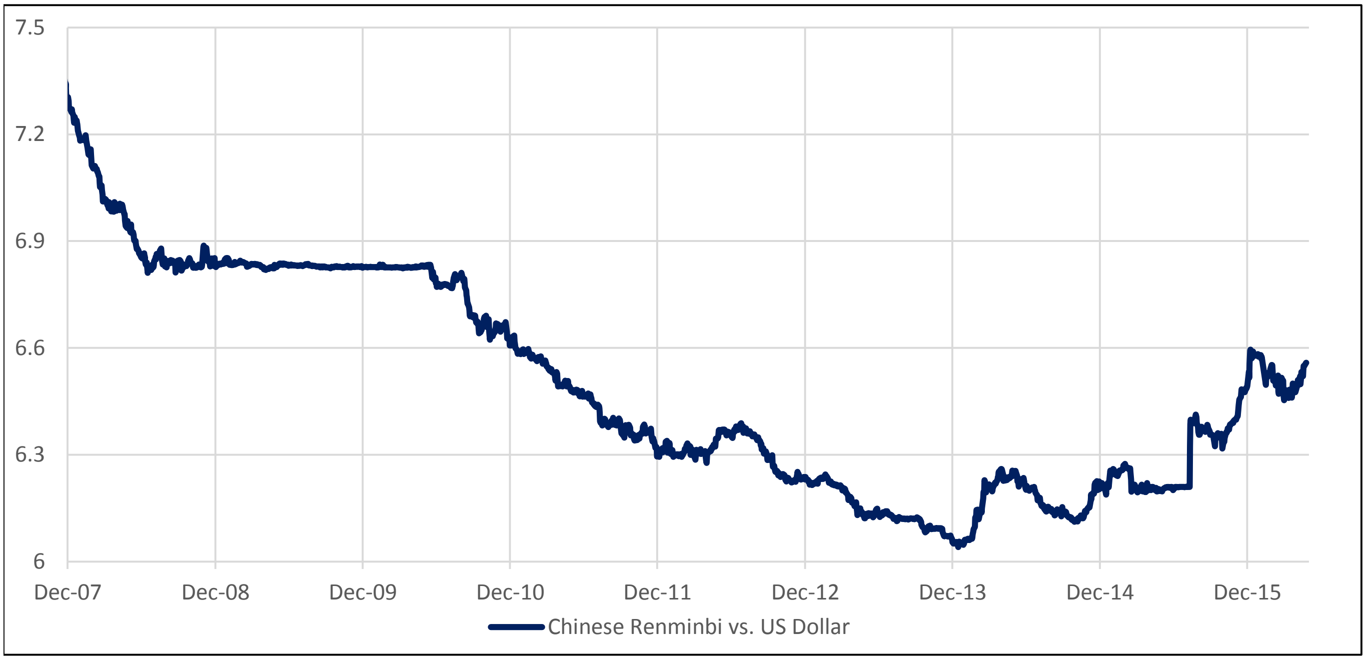
Figure 8. European Financial Stocks' Continued Downward Price Spiral versus Broad Market Benchmark Signals Lingering Deflation Concerns



Source: MSCI, Bloomberg and Glovista Calculations

- Renewed Chinese currency weakness (Figure 9). That the recent weakening of the Renminbi coincides with decelerating economic momentum in China signals the potential for further currency weakness in the months ahead. In turn, under such scenario, powerful disinflationary effects are likely to ensue in the global economy, further pressuring corporate profits growth across advanced economies.

Figure 9. China's Renminbi Resumes Weakening Trend versus US Dollar



Source: Bloomberg

Increasingly Uncertain US Policy Outlook and Signs of Maturing US Business Cycle Suggest US Rate Hikes in 2016 Could Prove Pernicious for the Economy and Market

As we look ahead, the Glovista investment team believes a defensive portfolio stance is warranted on multiple considerations, including current stretched US equity valuations, extended US profits cycle, US equities' over-owned status and the potential for policy mistakes out of the USA and Europe. Amongst those considerations, the one that has gained the greatest relevance these past several weeks is the latter: potential for policy mistakes out of the USA and Europe.

As noted above, the May 18 release of the April FOMC meeting minutes has fueled a material reset in the implied probability of near-term interest rate hikes by the US Central Bank. In our view, there is little economic merit for the US Federal Reserve to raise the Federal Funds rate in 2016. Such non-consensus view is predicated on the following observations:

- Most year-to-date economic releases of aggregate demand conditions out of the USA and Europe have been unimpressive despite the globe's northern hemisphere having experienced the mildest winter in over three decades. To us, such divergently weak economic releases signal an underlying softness in the economy, likely the result of tightening credit conditions in the USA, persistently high indebtedness levels across most of the advanced economies and overextended business cycle / profits cycle expansion in the USA.

- While broad measures of US wage pressures have recorded signs of incipient upward pressure (e.g. Atlanta Fed wage indicator), a considerable portion of such wage pressure reflects knock-on effects from one-off increases in minimum wages across a number of high profile states after a number of years of no increase. Consequently, we expect recent wage pressure to abate over the coming months. Moreover, the wage cycle lags the employment and capex cycle. In turn, the capex cycle lags the profits cycle. A simple observation of the current state of affairs defining US profit dynamics strongly suggests a medium-term abatement of wage pressures in the USA.

As a consequence of the above, we believe any additional interest rate hikes by the US Federal Reserve in 2016 are likely to prove pernicious to the economic and market outlook. That the US election campaign has attained a degree of polarization not seen in many decades raises the potential for the US Federal Reserve to opt for an interest rate hike in June or July simply to prevent the appearance of meddling in the election campaign closer to the November voting date.

Glovista Sustains Defensive Portfolio Stance

The Glovista investment team continues to embrace a defensive portfolio strategy stance, entailing underweight equity allocations (particularly in the USA) and overweight allocations to high quality corporate debt instruments along with exposure to selected commodity groups and non-US equities. Such defensive portfolio strategy stance is predicated on the concatenation of macro, market and policy factors laid out above. Specifically, in equities, we continue to hold selected exposure to high quality international equities. In fixed income, we continue to favor intermediate-term US corporate debt while on the commodities front, we favor selected exposure to agriculture and precious metals.

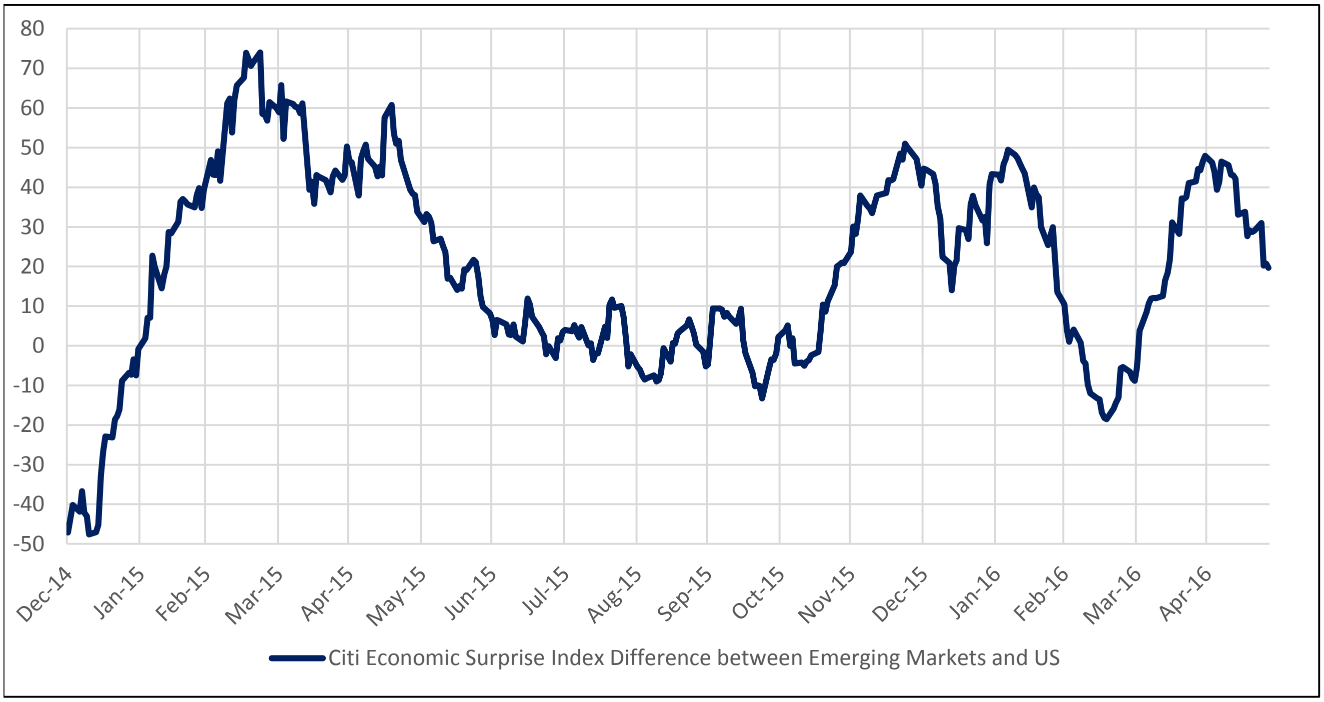
Emerging Market Perspectives

Case for Sustained EM Equities' Outperformance versus DM Peers Reinforced by Strong Q1 Earnings Outperformance, Resilient Commodity Price Strength, Abating Inflation Dynamics and Lower Funding Costs; Recent Underperformance Driven by US $ Strength to Prove Short-lived

The past several weeks have offered a number of confirming fundamental developments reinforcing our standing investment thesis calling for a period of sustained return outperformance by EM equities versus their developed market (DM) peers. Said developments include the following:

- Solid earnings outperformance by EM companies of their DM peers in the first quarter of the year. Specifically, EM Q1 EPS contraction proved far lower (around 4 percent on a year-on-year basis) than those recorded by peers in the USA (8 percent year-on-year contraction), Europe (13 percent year-on-year contraction) and Japan (18 percent year-on-year contraction), according to information tallied by JPMorgan strategists. At a macro level, EM economies' strengthened cyclical stance versus DM peers as illustrated in the sustained improvement in high frequency economic readings such as economic surprise index - Figure 10.

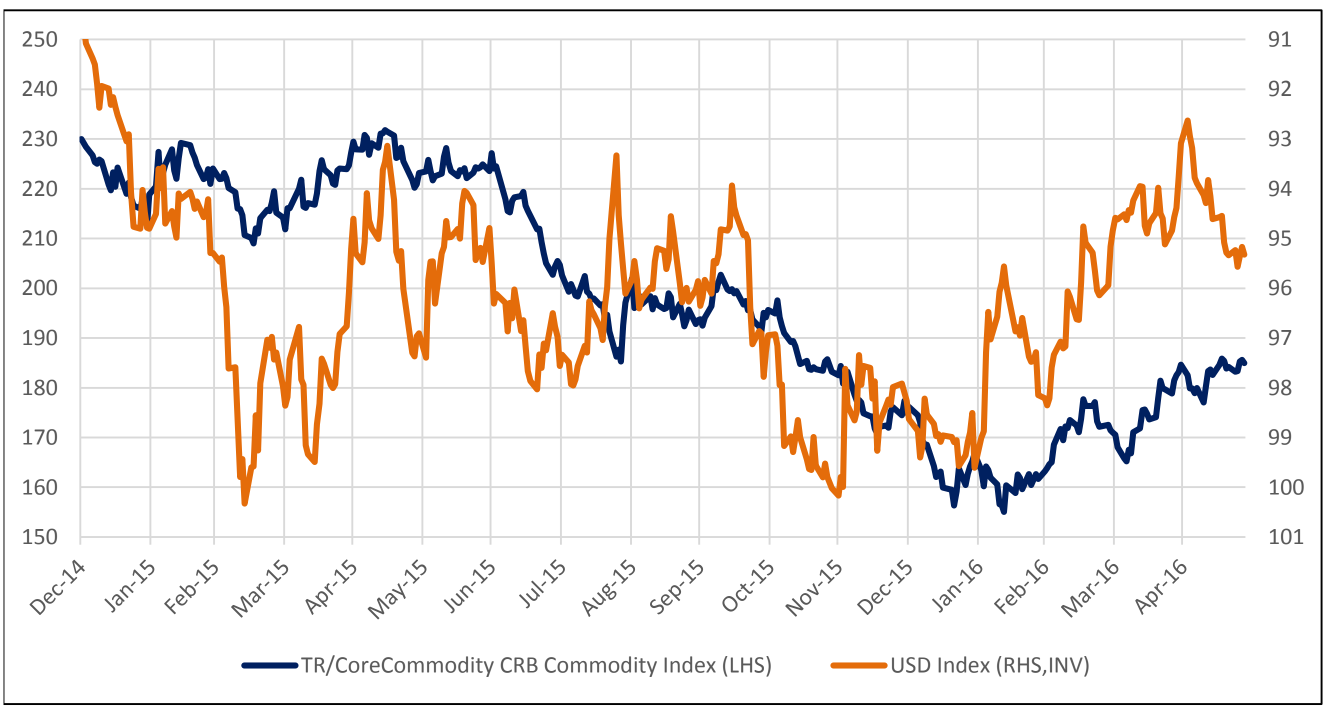
Figure 10. EM Economies' Economic Surprise Momentum versus Major Economies: Sustained Uptrend Despite Recent Moderation



Source: Citigroup Global Markets

- Resilience of terms of trade facing a large number of EM economies, including those in the much adversely impacted commodities space (e.g. Brazil, Indonesia, Russia, among others), as the powerful year-to-date recovery in commodity prices has been sustained over the past several weeks despite a sharp counter-trend bounce in the US Dollar (Figure 11)

Figure 11. Commodity Price Recovery Proves Resilient in May Despite Powerful Counter-trend Bounce in the US Dollar Index

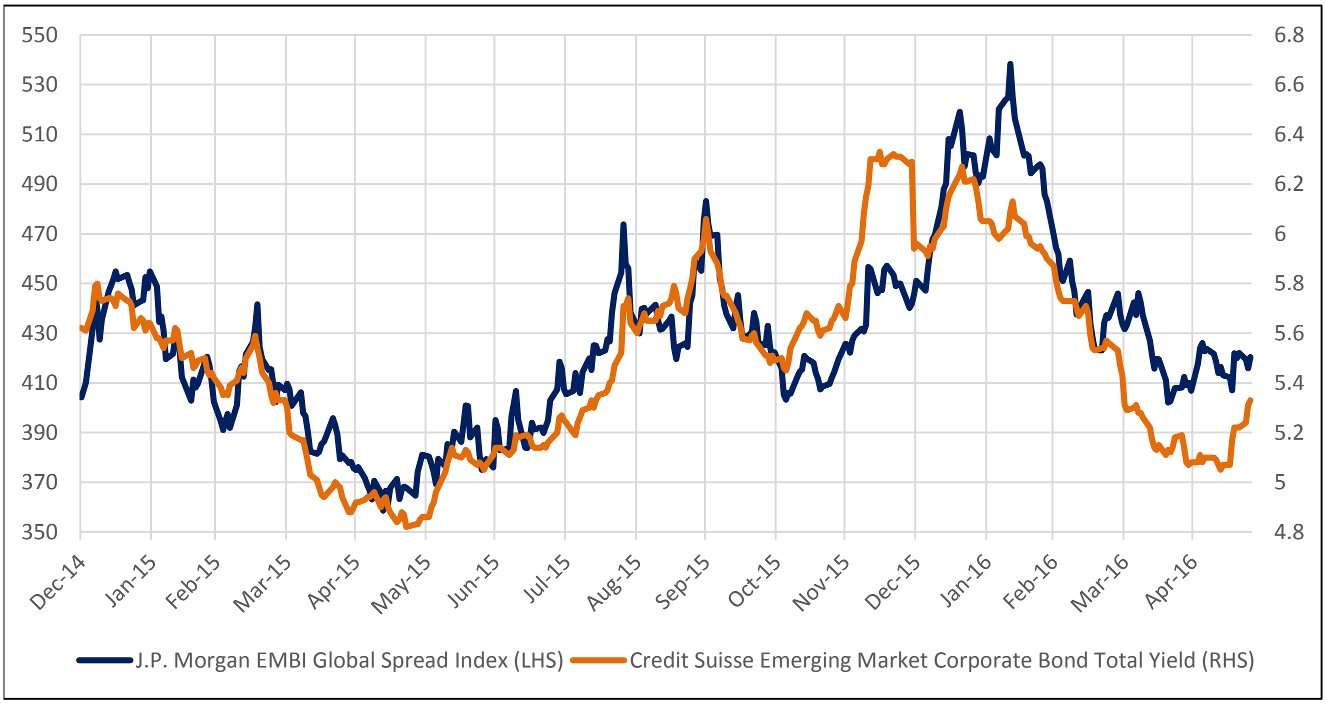


Source: Bloomberg

- Abating inflation momentum across a number of large Emerging Market economies at a juncture in which the balance of payments position continues to heal even for a number of fragile economies (e.g. Brazil, whose April monthly current account balance swung into surplus following 83 months of protracted deficit readings). Such developments herald an environment in which local interest rates are likely to come down over the coming months as has indeed begun to be the case, as highlighted by the following list of EM countries whose central banks have implemented policy rate cuts thus far in 2016: China, India, Indonesia, Turkey and Hungary.

- Continued reduction in EM economies' and corporates' debt cost of capital thus far in 2016, lending further support to EM equities valuation (Figure 12).

Figure 12. EM Corporates' and Sovereigns' Debt Spreads Remain at Considerably Lower Levels in 2016 versus 2015 Year-End Levels, Lending Support to EM Equity Valuations



Source: J.P. Morgan and Credit Suisse

Given the above cyclical considerations highlighting EM equities' much improved stance versus DM peers at a juncture in which the valuation case in favor of EM equities versus DM peers remains exceedingly compelling (Figure 13), Glovista's investment team strongly believes that the recent pullback in EM equities' relative return performance versus DM fueled by the bounce in the US Dollar index provides an highly attractive entry point for global asset allocators to raise exposure to the EM equities asset class.

Figure 13. EM Equities' P/CE Valuation Discount versus DM Peers at Close to Multi-year Low Levels

Source: MSCI, Bloomberg and Glovista Calculations

Finally, over the past several weeks we have implemented a number of country- and sector-level rebalancing actions on the back of shifts in fundamental sector earnings and valuation dynamics as well as the incipient counter-trend rally in the US Dollar. These include reducing our allocations to Russia, India, Malaysia, China technology sector and Turkey while increasing allocations to Taiwan, China and Chile.

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GLOVISTA INVESTMENTS

1 Evertrust Plaza Suite 1102
Jersey City NJ 07302
Tel: 212-336-1540
Website: www.glovista.net