Issue
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**Monthly Market Newsletter**

# Glovista Global Perspectives

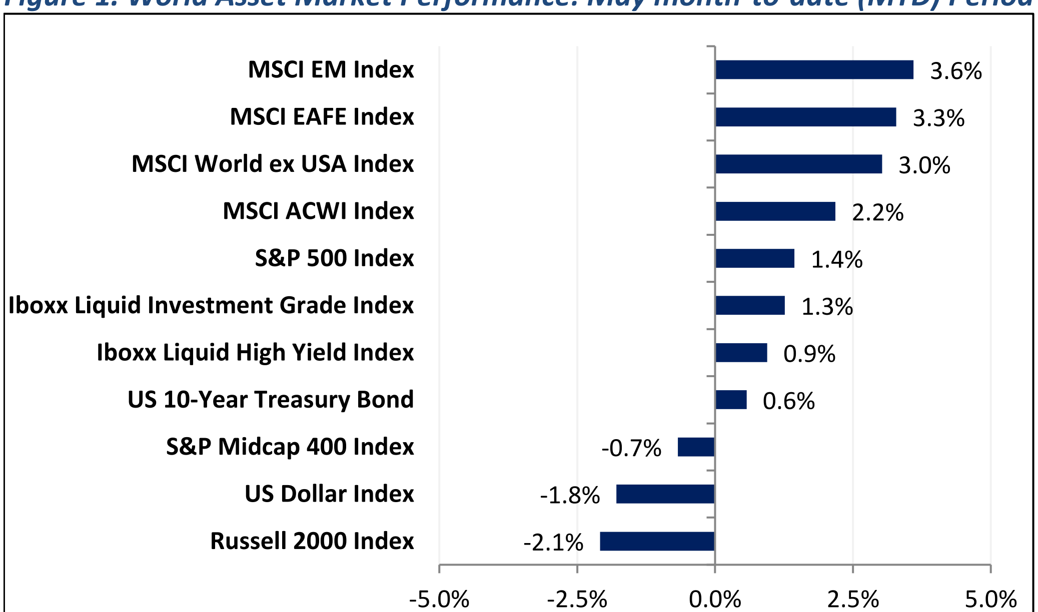
## This Issue:



## *Glovista Further Raises Defensive Sector Tilts as US/China Cyclical Softness Extends; High Grade Corporate Debt Upgraded; US Dollar Weakness and Secular Low Crude Prices Confirmed; Precious Metals Exposure Raised Further*

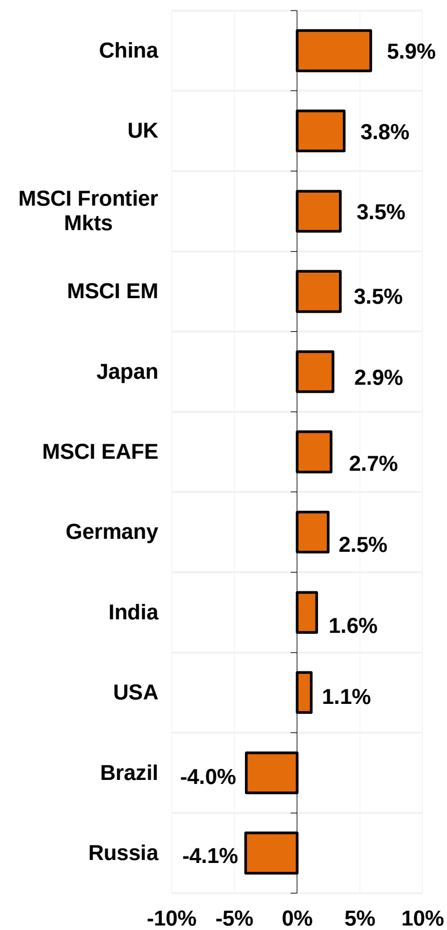
The month of May has witnessed a continuation of the multi-month rise in risk market indices globally. However, as illustrated in Figure 1, the rally in risk indices has become far narrower than in previous months. Specifically, a weaker US Dollar has anchored much of the May positive return performance across a number of asset classes. For example, US small and mid-cap stocks have recorded price declines thus far in May while US large caps have logged modest price gains versus international peers, especially Emerging Market equities.

***Figure 1. World Asset Market Performance: May month-to-date (MTD) Period***




***Source: Bloomberg***

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




***Source: MSCI & Bloomberg***

**As of May 30th, 2017*

We view world markets' changing performance dynamics during the month of May as validating the economic calendar these past several weeks and months, largely in line with some of the global macro themes we have discussed in this column thus far this year. We discuss these macro dynamics further below and attempt at connecting the market and investment portfolio implications emanating from the global macro backdrop.

**S&P500 Monthly Sector Performance – May MTD 2017***

| Sectors | % Change | FY1 PE Ratio |
|---|---|---|
| Energy | -3.58% | 31.1 |
| Materials | -0.60% | 18.6 |
| Industrials | 1.01% | 18.7 |
| Cons Disc | 0.73% | 20.3 |
| Cons Stap | 2.41% | 21.0 |
| Technology | 4.46% | 18.7 |
| Healthcare | 0.17% | 16.4 |
| Financials | -0.61% | 14.0 |
| Utilities | 3.15% | 18.2 |
| Telecom | -1.33% | 13.3 |
| Real Estate | 0.58% | 38.6 |
| S&P500 | 1.20% | 18.4 |

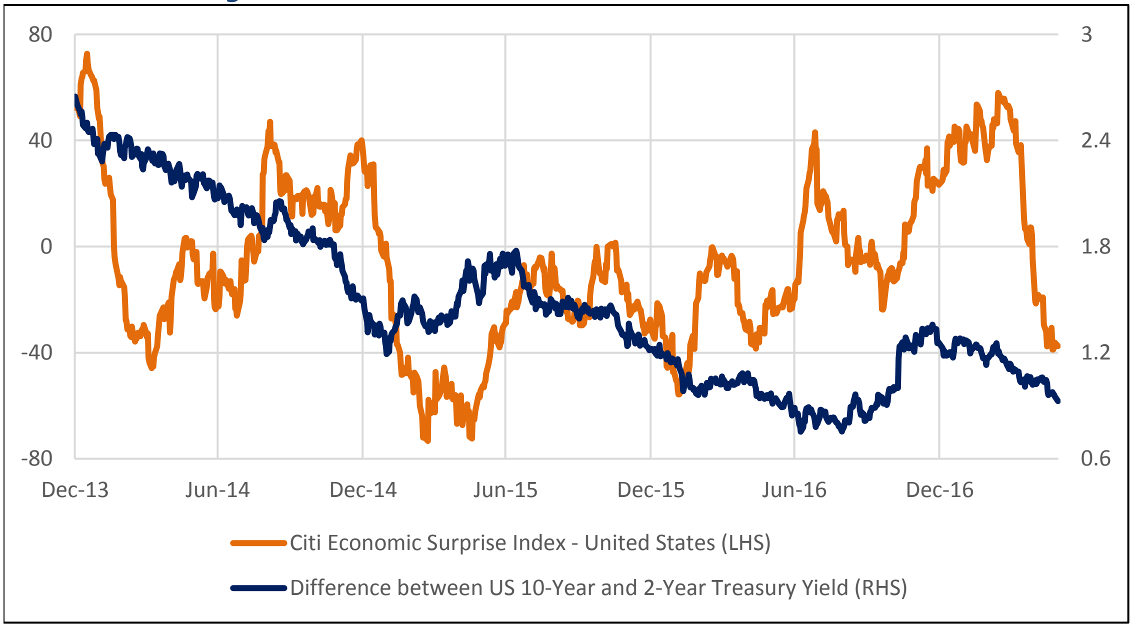
**As of May 30th, 2017*

***Source: S&P***

## *US/China Economic Momentum Softens Further in May while Inflation Expectations Moderate Further: A Macro Cocktail Supportive of Defensive Sector Relative Return Performance*

Over the past several weeks, the world economic calendar has brought about signs of continued economic growth moderation in the world's major economic regions, especially the USA and China. For example, Figure 2 illustrates a continued decline in the economic surprise activity index for the USA along with continued flattening of the US yield curve. A number of major US economic indicators have undershot consensus estimates, including auto sales, capital goods orders, credit growth and revisions to quarterly corporate profit estimates from official government data.

***Figure 2. US Economic Activity Surprise Indicator's Decline and Government Yield Curve's Flattening Point to Further US Economic Weakness Ahead***




***Source: Bloomberg and Citigroup Global Markets***

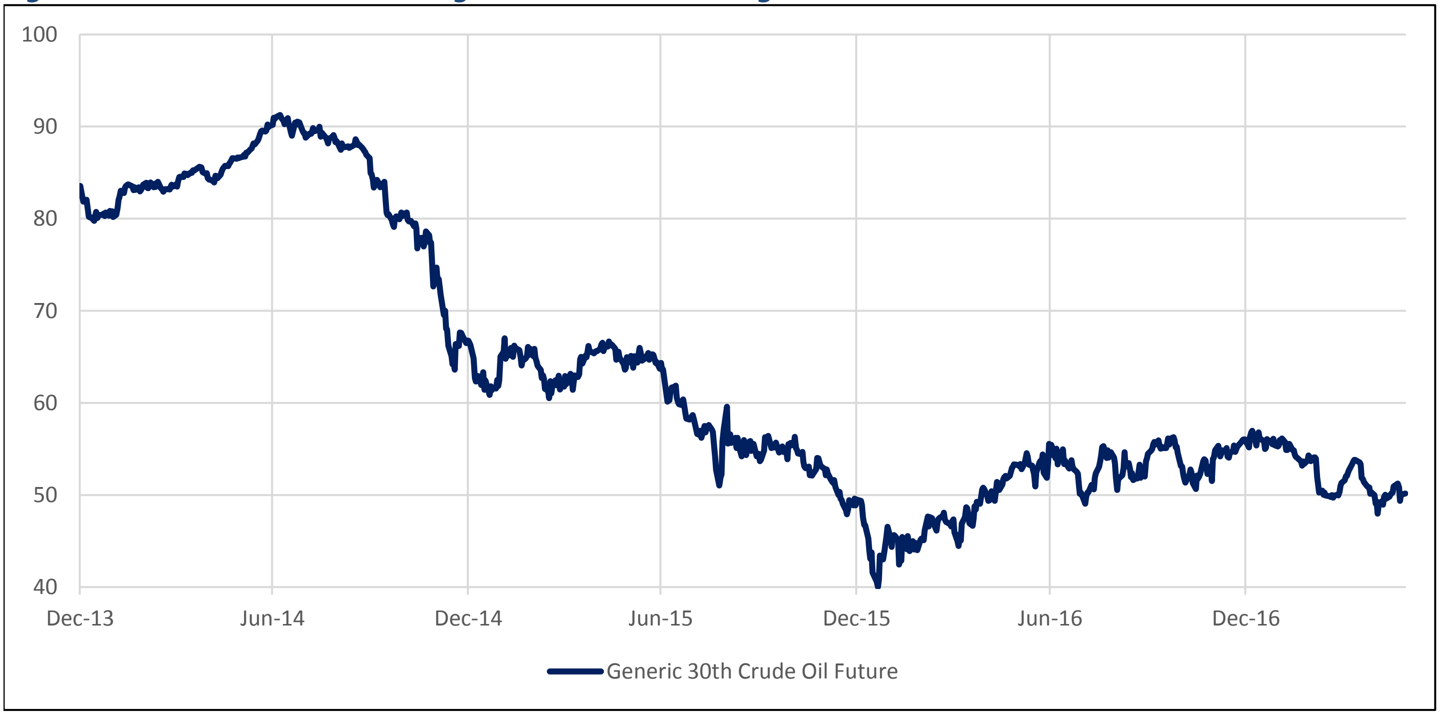
The softening of US economic momentum, along with the limited visibility associated with the Trump administration's chances of putting forth successfully major supply side reforms later this year – ahead of next year's mid-term elections, have helped bring about a decline of inflation expectations (Figure 3).

***Figure 3. US Inflation Expectations Moderate Further in May on Soft Calendar and Continued Opacity surrounding Prospects for Supply-side Reforms in 2017***


***Source: Bloomberg***

The abatement of US long-term inflation expectations is likely the result not only of an underwhelming US economic calendar and opaque policy outlook but also of recent developments in the energy market confirming an indefinite period of secular low energy prices (Figure 4). OPEC's inability to bring about tighter production cutbacks in the light of continued gains in energy consumption efficiency world-wide and the ascendancy of shale energy production are the likely culprits behind the secular period of low energy prices.

***Figure 4. Sustained Decline in Long-dated Crude Prices Signal Secular Low Price Period***




***Source: Bloomberg***

| | May 30th 2017 | May MTD Change |
|---|---|---|
| Gold | 1263.15 | -0.4% |
| Silver | 17.3964 | 1.1% |
| Oil | 49.66 | 0.7% |
| EUR | 1.1186 | 2.7% |
| JPY | 110.85 | -0.6% |
| GBP | 1.2859 | -0.7% |
| CHF | 0.9746 | -2.0% |
| CAD | 1.3459 | -1.4% |
| AUD | 0.7465 | -0.3% |
| BRL | 3.2579 | 2.6% |
| MXN | 18.6987 | -0.6% |

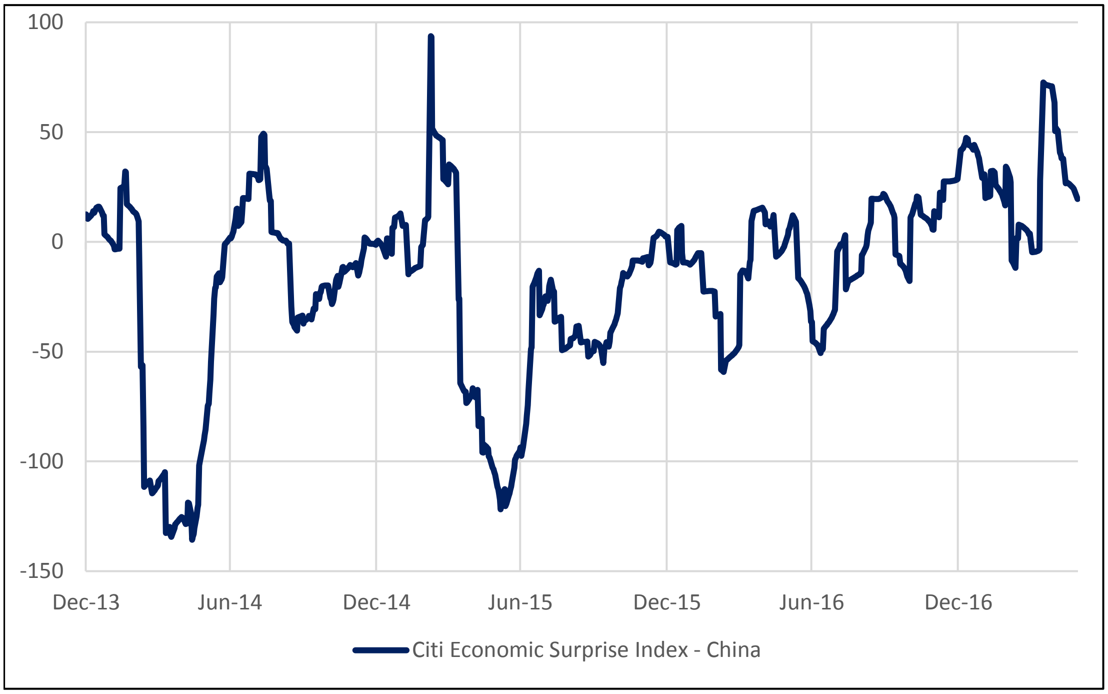
*Source: Bloomberg*

| Rates | May 30th Level |
|---|---|
| 1 Yr CD | 0.66% |
| 5 Yr CD | 1.33% |
| 30 Yr Jumbo Mortgage | 4.26% |
| 5/1 Jumbo Mortgage | 3.39% |
| US Govt. 10 Year | 2.2098% |
| 10 Yr Swap Spread | -0.0594% |

*Source: Bloomberg*

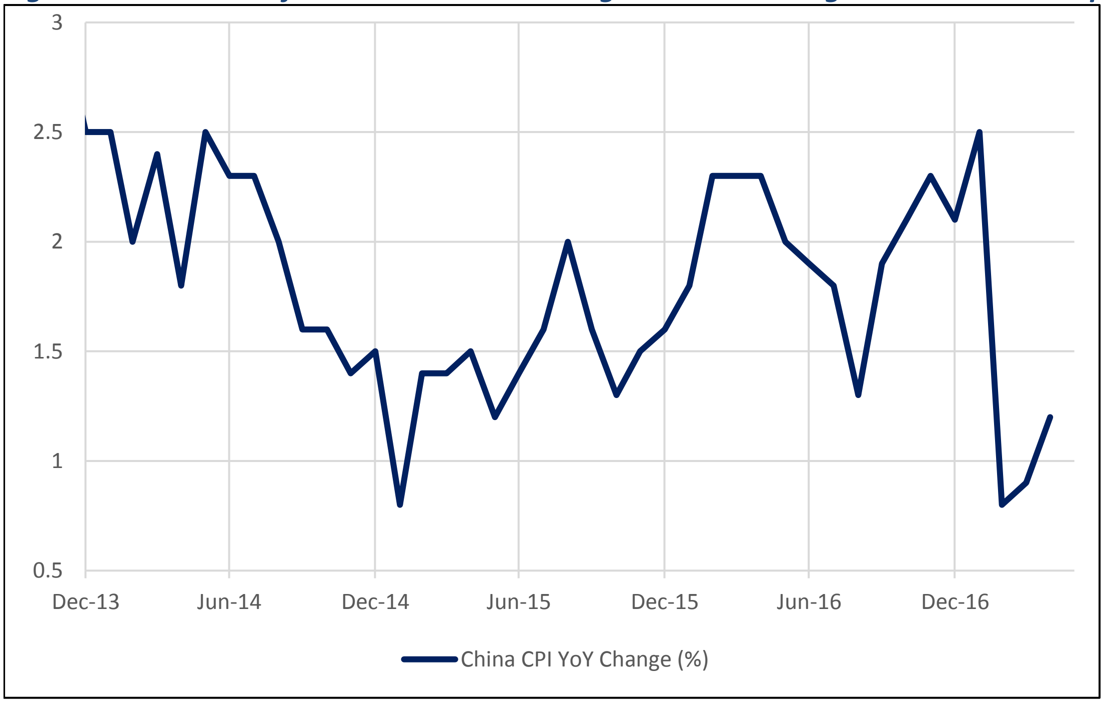
Over the past several weeks, China's economic calendar has shared similar price and activity dynamics to those in the USA. For example, Figure 5 illustrates the Chinese economy's weakened economic momentum while Figure 6 highlights the decline in annual CPI inflation momentum.

***Figure 5. China's Economic Activity Surprise Indicator Weakens to December 2016 Low Levels***




***Source: Citigroup Global Markets***

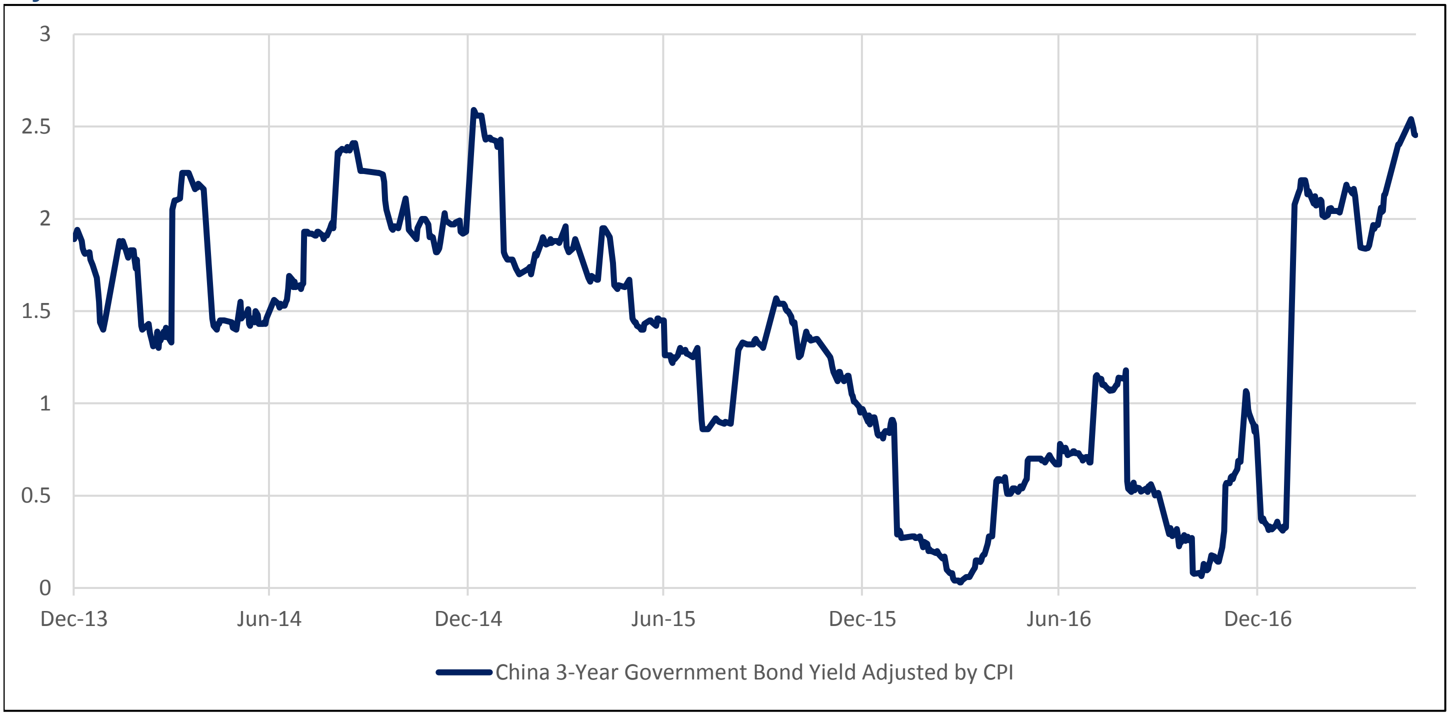
***Figure 6. China CPI Inflation Decelerates along with Weakening Economic Backdrop***




***Source: National Bureau of Statistics of China***

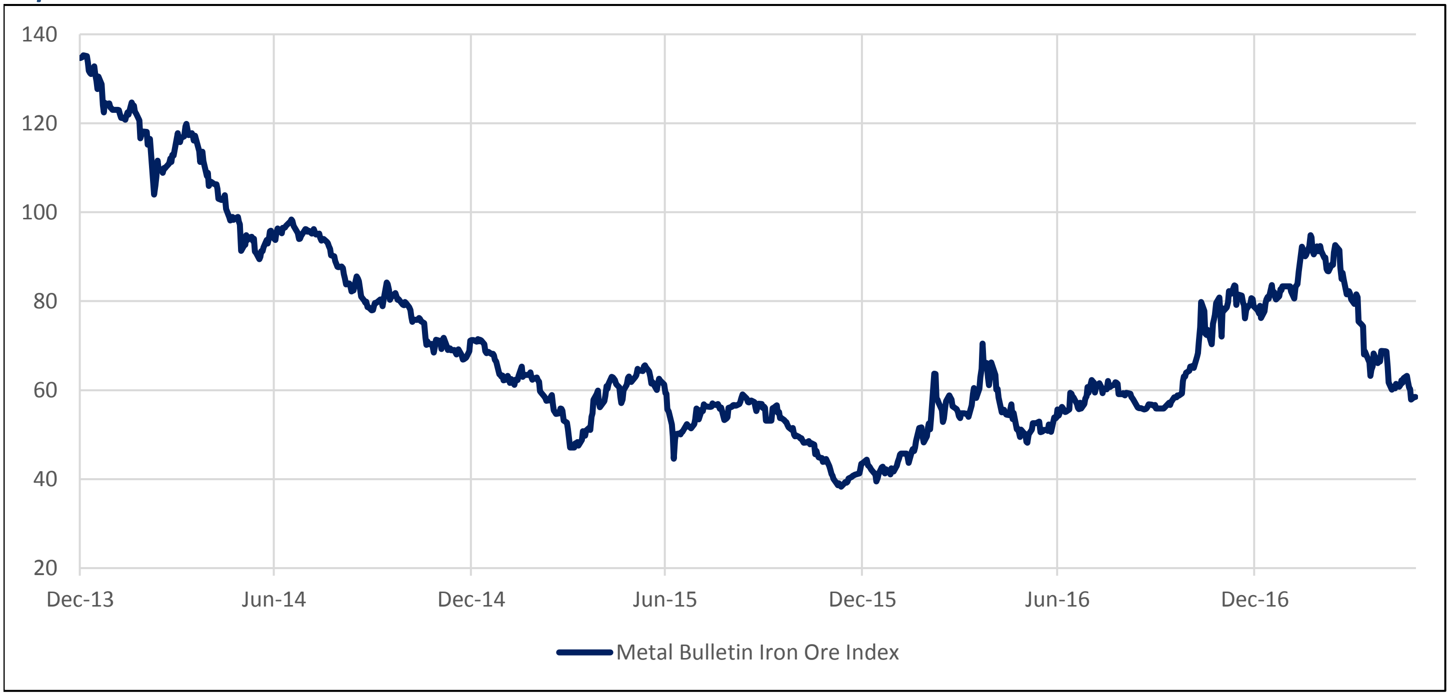
It is of concern to the outlook that the ongoing economic deceleration in China has been accompanied by a rise in implied real cost of debt capital, as shown by Figure 7. Such dynamics carry the potential of resulting in an accelerated deceleration over the coming months. Arguably, said investor concerns underlie the recent sharp downward price acceleration in a number of industrial metal commodities, such as iron ore (Figure 8).

***Figure 7. Chinese Government Real Bond Yields Rise Measurably through the Recent Period of Economic Softness***




***Source: Bloomberg***

***Figure 8. China's Iron Ore Price Decline Accelerates as Economic Momentum Softens and Real Debt Cost of Capital Increases***

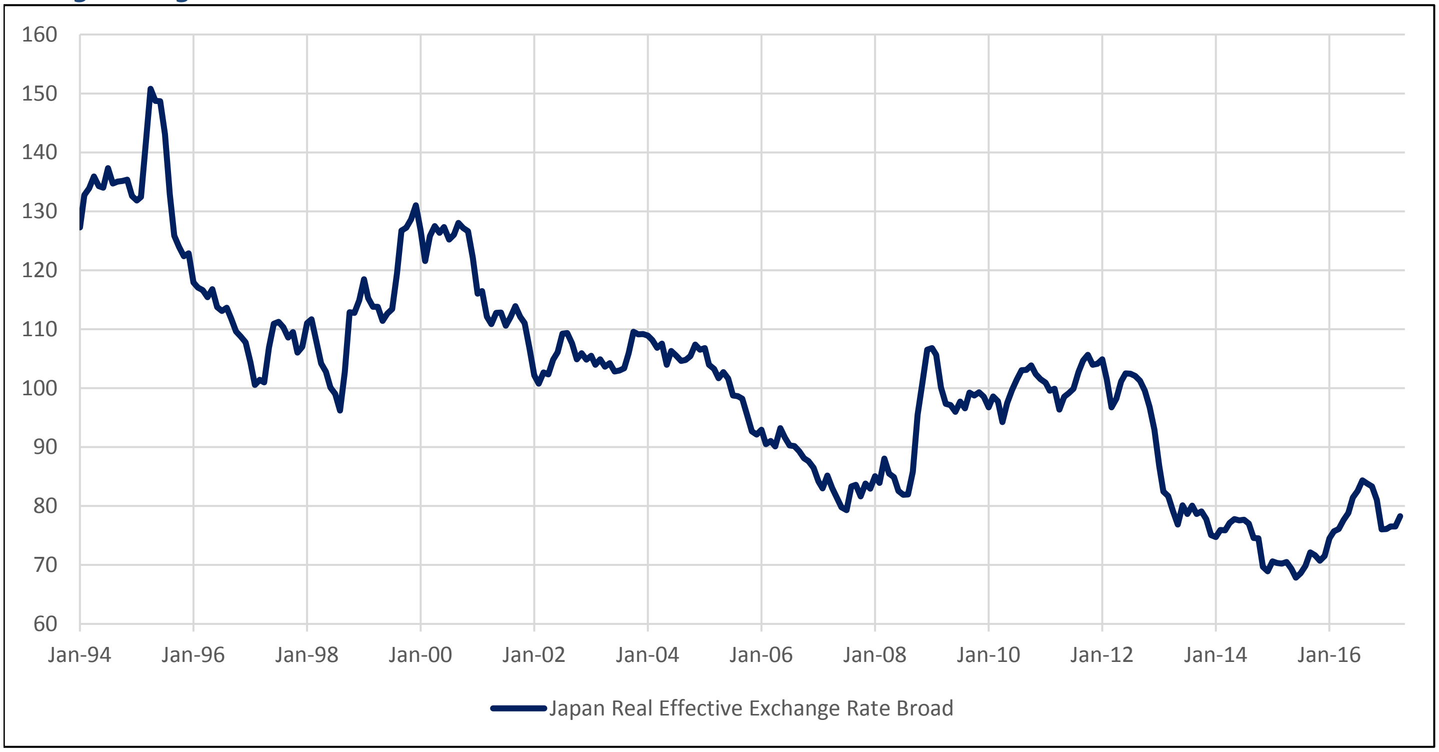





***Source: Metal Bulletin***

Outside the world's two largest economies (the USA and China), Japan – the world's third largest – does not yet appear ready to pick up any of the activity slowdown stemming from its two larger peers. Specifically, while recent Japan economic releases have been solid, the Japanese economic outlook is likely to be adversely affected by the probable strengthening of its currency from current cheap levels (Figure 9).

***Figure 9. The Japanese Yen Sits at Close to Multi-year Low Levels, in Real Terms, Raising Prospects for Strengthening Period Ahead***



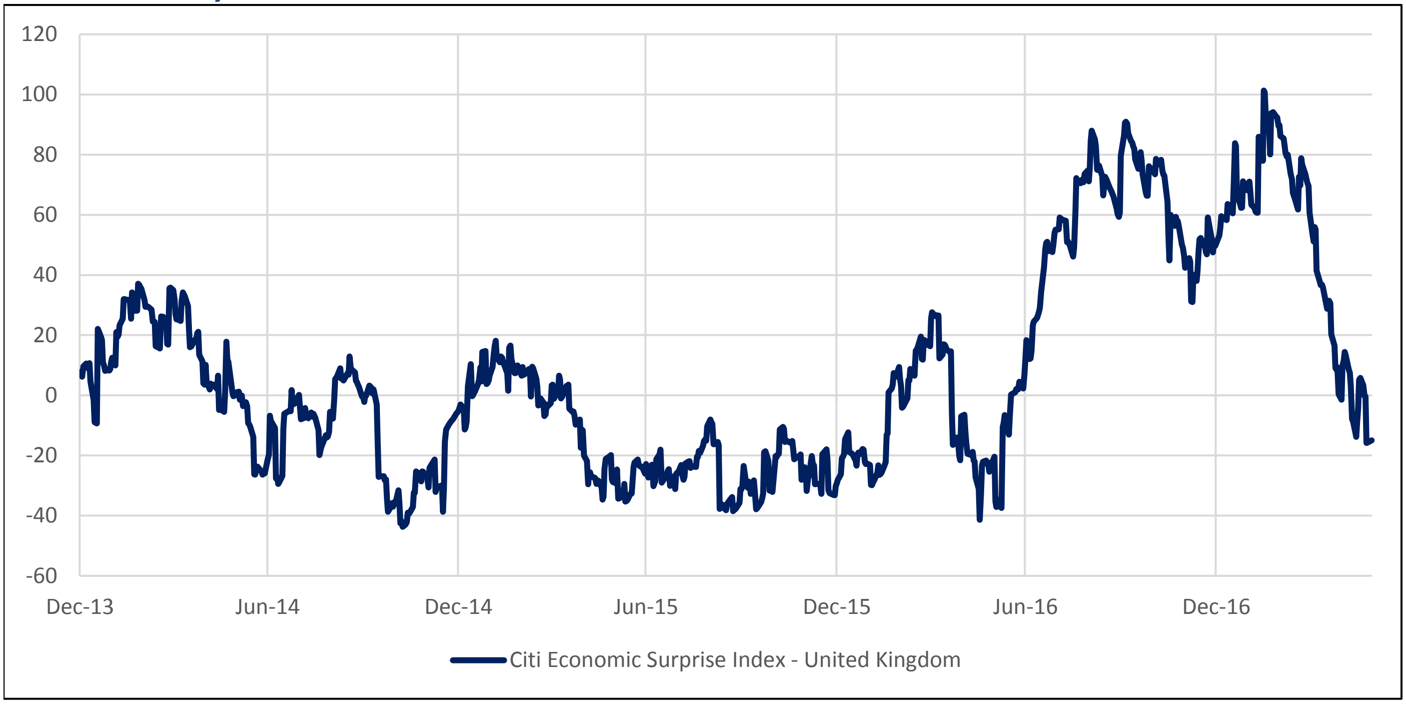

***Source: Bank for International Settlements***

Outside of the G3 economies, whose activity outlook remains underwhelming as discussed above, it is hard to identify islands of strength at a global level. For example, the United Kingdom economy continues to show signs of softness as the domestic economy rebalances to the new economic reality post-BREXIT (Figure 10). Likewise, the Gulf (Middle East) region economies remain mired in a protracted period of economic deceleration as a result of the persistently low price levels of crude.

On a more constructive note, the Eurozone region together with a selection of Emerging and Frontier regional economies remain the world's sole locomotives of economic growth surprise. However, such pockets of strength are insufficient in magnitude to offset the decelerating momentum out of the world's other regions.

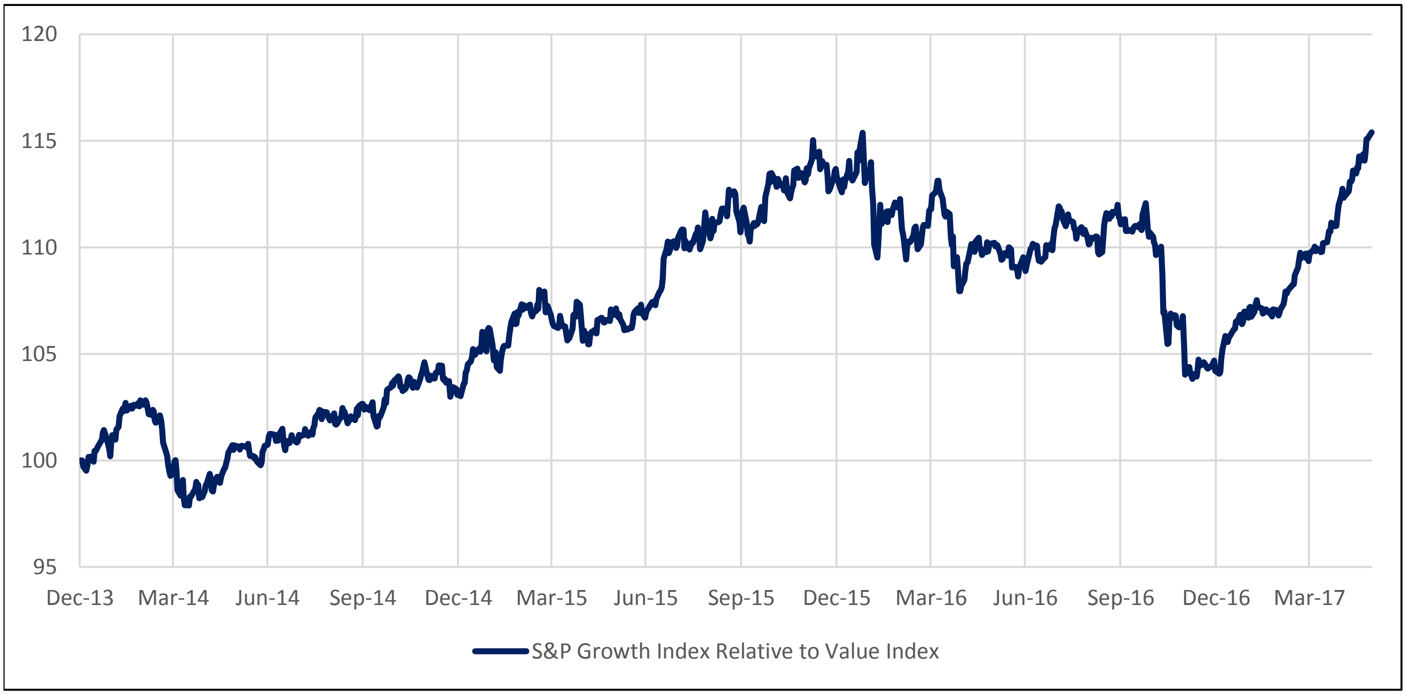
The above delineated global macro backdrop suggests an environment of weak economic activity and controlled inflation. Moreover, there is the potential for policy mistakes to come out of both China and US central banks as these embark on a continuation of monetary policy tightening. We believe such macro risks accord with the recent sharp relative outperformance commanded by growth stocks over their value peers (Figure 11). More specifically, US equities – as represented by the SP500 index – are up only 1.5 percent for the year excluding technology sector stocks from the calculation. Likewise, investor portfolio flows into technology funds are running at close to 15 year high levels, another sign of the narrow nature of the year-to-date rise in headline market indices.

*Figure 10. UK Economic Momentum Decelerates Sharply as Local Economy Rebalances to Post-BREXIT Vote Economic Reality*




***Source: Citigroup Global Markets***

*Figure 11. Growth Stocks' Outperformance versus Value Peers Reflect Rising Concerns over Economic Outlook*




***Source: Bloomberg***

## *Glovista Raises Portfolios' Defensive Sector Tilts along with Exposures to Precious Metals and High Grade Corporate Bonds*

Against the global macro backdrop discussed above, in which inflation and economic momentum lack sufficient upward pressure while China's PBOC and the US' FED remain on course to raise policy rates further, earlier this month the Glovista investment team chose to further raise our managed portfolios' defensive sector tilts including (a) increased exposure to consumer staples and selected utilities; (b) precious metals, particularly via gold miners; (c) Eurozone equities, and; (d) increased exposure to high grade corporate debt, with such purchases funded with a reduced exposure to high yield corporate debt paper.

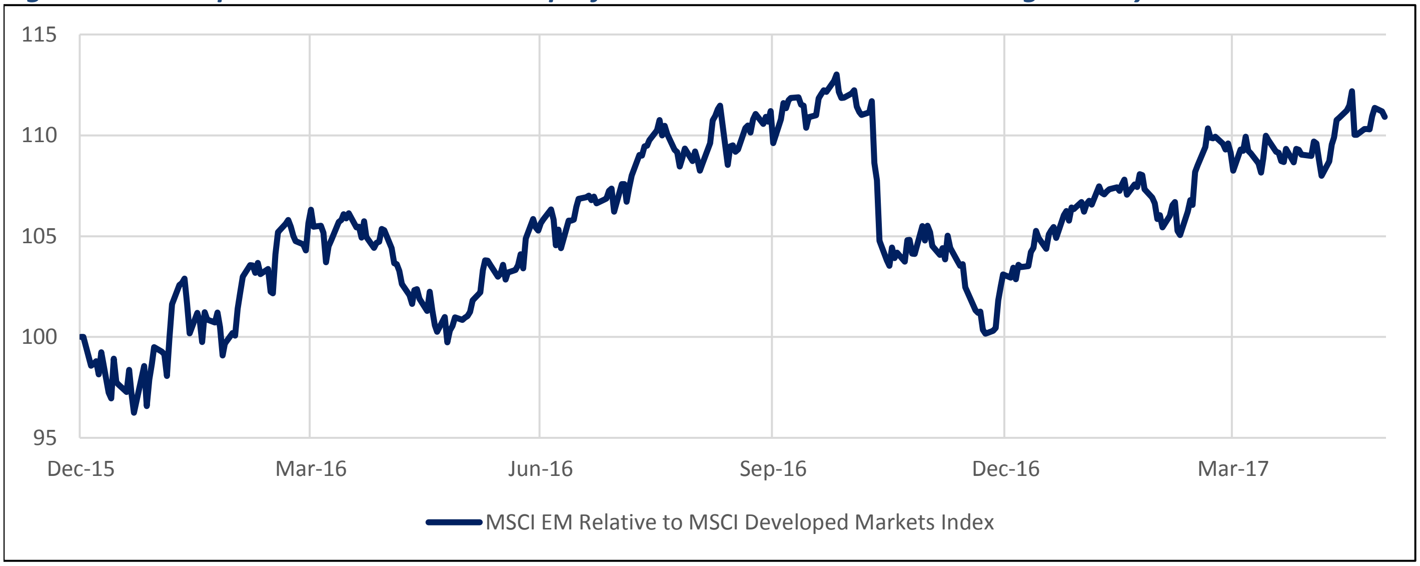
In equities, we remain constructive Eurozone and Emerging Market equities as well as a number of defensive sectors in the USA and Japan.  In commodities, we continue to favor exposure to gold miners while in fixed income we have implemented a rebalancing away from high yield to high grade US corporate debt.

## *Emerging Markets Perspectives*

## *EM Equities Extend Return Outperformance versus DM Peers, Led by Asia Growth Stocks; OPEC's Failure at Reversing Secular Low Price Backdrop together with China's Economic Deceleration Constrains Outlook for EM Value-oriented Country Indices*

In May, Emerging Market equities extended the multi-quarter long period of return outperformance versus Developed Market peers that begun early in 2016 (Figure 12).  Recent EM equity return outperformance of DM peers has been led by growth stocks, primarily by North Asia IT sector stocks. Value-oriented country indices, such as Brazil and Russia, have recorded sizable return underperformances versus their EM peers thus far this year.

*Figure 12. EM Equities Extend Return Outperformance versus DM Peers dating to Early 2016*




***Source: MSCI, Bloomberg and Glovista Calculations***

While country-specific developments have underpinned recent relative underperformance by some value-oriented EM country indices, most notably Brazil following a rekindled political crisis tied to accusations of obstruction of justice by President Temer, the broad softness in EM value oriented country index performance owes much to the adverse commodity price impact resulting from the ongoing China economic deceleration. Specifically, China's economic deceleration is being fueled by the marked tightening of financial conditions and increased banking sector regulation that began earlier this year. In particular, China's massive shadow banking system is under significant pressure as policymakers target an arrest of the sector's uncontrolled growth these past several years. In the process, the formal banking system is coming under pressure as funding costs are escalating sharply for corporate issuers, both in nominal and real terms.

China's economic deceleration has impacted the price of industrial commodities as well as, indirectly, energy commodities. Thus, it is not at all surprising that Russian, Brazilian, Chilean and other commodity-oriented EM country indices have underperformed meaningfully these past several weeks.

The above considerations have led the Glovista investment team to maintain an underweight EMEA regional allocation while holding overweight allocations to EM Asia and Latin America, particularly growth oriented country and sector indices within those two regions.

As we look ahead to the balance of the year, we maintain a bullish outlook towards the EM asset class despite the presence of risk factors conditioning the outlook, most notably a faster economic slowdown out of China. As for the latter, we continue to steer our China market exposure towards growth sectors, especially IT, given the secular nature of the IT sector's growth outlook as well as the sector companies' clean balance sheet status. Within the EM universe's value-oriented subset, we continue to favor Chile, given attractive valuations and increased prospects for policy change, and increasingly Russia given improving valuations following a period of strong relative underperformance.

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