Issue
71
November/15

Monthly Market Newsletter

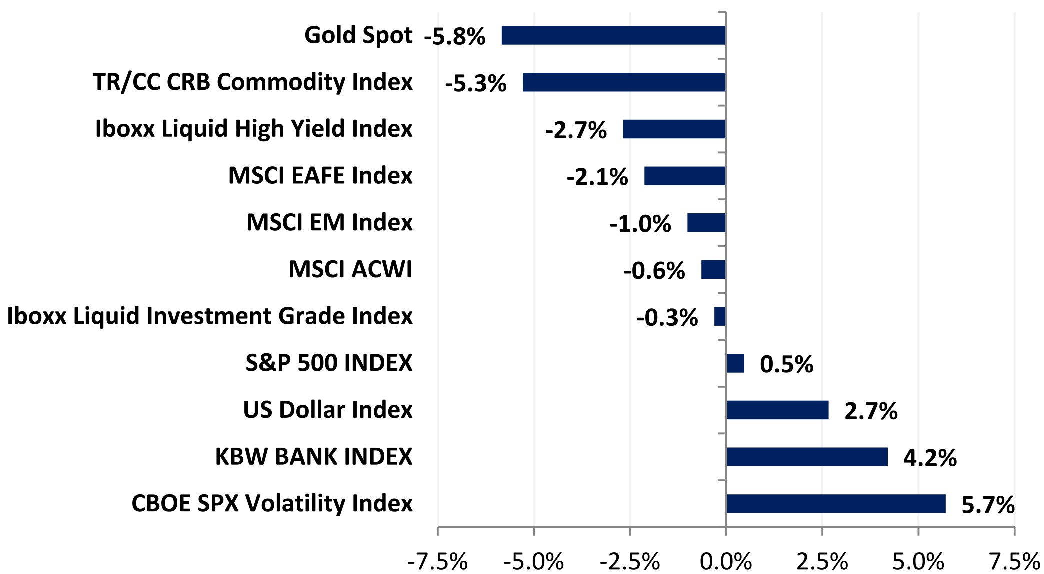
Glovista Global Perspectives

This Issue:

Glovista Sustains Cautious US Equities Stance on Extended Valuations, Challenged Earnings Outlook and Tighter Financial Conditions; Selected Non-US Equities and Intermediate-term Duration Credit Exposures Favored

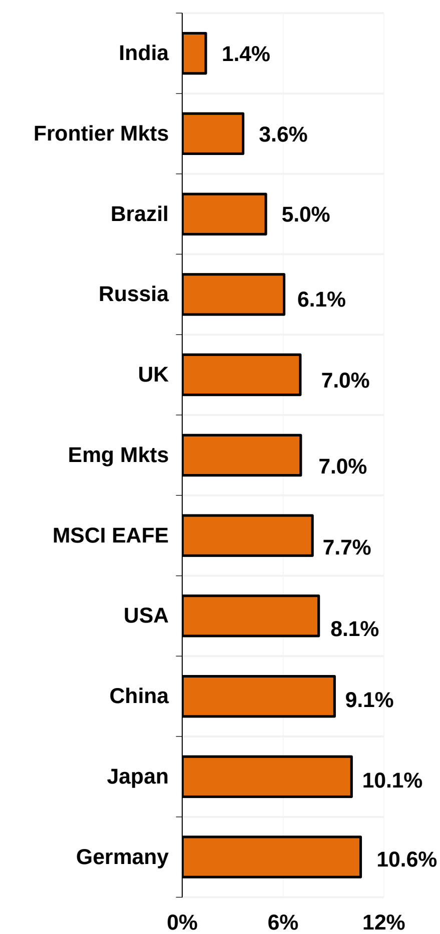
In November, global risk indices consolidated much of the price gains posted during the month of October following the sharp price declines recorded in September. Specifically, thus far in November global equities and credit market indices have recorded approximately flat returns despite the unfolding of a combination of factors statistically unkind to equity price performance: unimpressive US third quarter earnings season, a sharp US Dollar rally, and steep commodity price declines (Figure 1).

Figure 1. November MTD Return Performance across Risk Markets (November 1st 2015 – November 24th 2015)



Source: Bloomberg

Country-wise Monthly Performance in USD terms (October 2015)



Source: MSCI & Bloomberg

GLOVISTA INVESTMENTS

S&P500 Monthly Sector Performance – October 2015		
Sectors	% Change	FY1 PE Ratio
Energy	11.25%	29.4
Materials	13.45%	17.6
Industrials	9.12%	16.5
Cons Disc	8.99%	20.8
Cons Stap	5.63%	20.7
Technology	10.67%	17.1
Healthcare	7.69%	17.2
Financials	6.10%	14.4
Utilities	1.05%	16.1
Telecom	5.79%	12.5
S&P500	8.30%	17.6

Source: S&P

December FED Rate Hike a Virtual Certainty while ECB and BOJ Ratify Commitment to QE Programs; Chinese Economic Data Posts Moderate Upturn while Activist Policy Stance Extended

The past several weeks have delivered increased visibility on a number of fronts, ranging from the contours of what could be a shift in relative economic growth leadership across international regions to the near-term course of monetary and fiscal policy for a number of the world's largest economies, most specifically the US Federal Reserve and the European Central Bank.

First, insofar as the near-term course of monetary policy actions to be embraced by the US Federal Reserve, the recent November 18 release of the FOMC minutes together with unusually blunt statements and speeches delivered by senior Federal Reserve officials these past several weeks virtually guarantee the US FOMC will raise its reference policy rate at its upcoming scheduled December 16 meeting. This would be the first hike in the Federal Funds rate since 2006.

Second, as for the European Central Bank (ECB), the world's second most important central bank, at its recent October 22 meeting, ECB President Draghi telegraphed rather clearly the Bank's strong commitment at both raising the quantum as well as extending the duration of its ongoing quantitative easing (QE) program. Insofar as the Bank of Japan is concerned, at its recent November 18 meeting, Governor Kuroda reiterated the Bank's strong commitment to attaining its 2 percent core inflation target by March 2017 (although the time frame was extended from September 2016 to March 2017).

Third, inasmuch as recent economic releases pertaining to the pace of activity across some of the world's principal regions is concerned, we believe the most consequential set of releases center around the Chinese economy. Specifically, as illustrated in Figure 2, recent economic releases point to a stabilization of domestic sectors of China's economy, including retail sales and housing prices. We credit such stabilization in Chinese economic indicators largely to the considerable intensification of counter-cyclical economic policy measures, both at the monetary and fiscal levels. For example, recent additional policy actions include:

a) A further 25 bps reduction (6th within last 1 year) in 1-Year Lending rate;

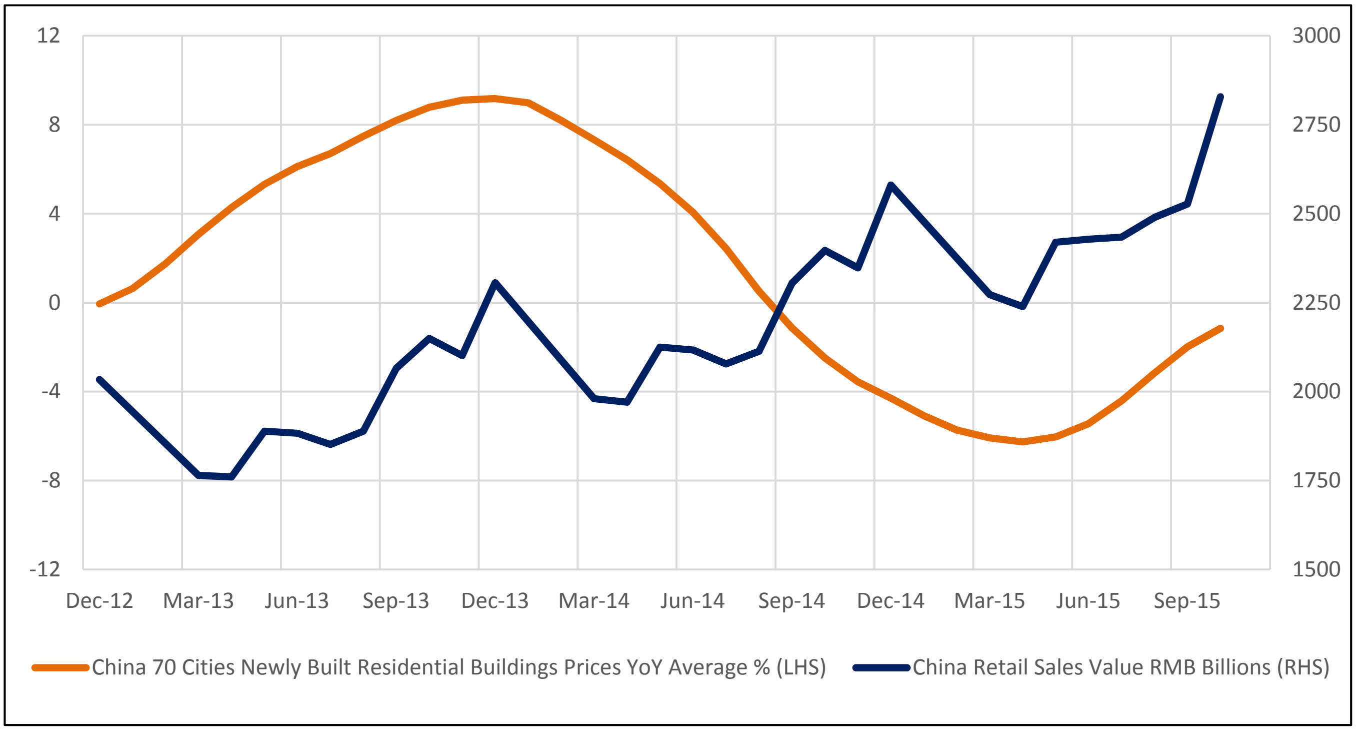
b) Reduction in reserve requirement ratio for banks to 17.50% from 18.0%;

c) A reduction in overnight and 7-day standard lending facility interest rates to 3.25% and 2.75% respectively;

d) A cut in car purchase tax from 10% to 5% for cars with engines smaller than 1.6 liters;

e) A cut in minimum down payment for first-time home buyers from 30% to 20%.

Figure 2. Chinese Retail Sales and Housing Prices Post Significant Upturn in Q3



Source: Bloomberg

US Equities' Diminished Allure versus International Peers Predicated on Weakened Growth Momentum, Rich Valuations, Tightening Financial Conditions and Likely Abatement of Share Buybacks as Support Dynamic: US Q3 Earnings Season Confirms these Concerns

Over much of this year, we have favored non-US equities over US peers on multiple considerations, including valuation, earnings momentum, ownership status and liquidity backdrop. As we look ahead to the intermediate-term, a period extending up to six months into the future, we continue to harbor a strong preference for non-US equities over their US brethren. Specifically, we believe that the most recent stream of economic releases, policy actions, corporate earnings and revenue releases strongly validate our standing investment stance. We list some of these considerations immediately below:

- ***Improving relative economic momentum for EM economies versus Developed peers:*** as illustrated in Figure 3, the past several weeks offer strong indication of an improving economic momentum for the EM block. Admittedly, much of the improving economic momentum derives from strengthening indicators out of China, such as housing price and resilient retail sales data (Figure 3).

- ***US equity valuations hover at historically extended levels versus non-US peers:*** Figure 4 illustrates US equities' historically large valuation premium versus non-US peers. Arguably, such an outsized valuation premium is justified only if US equities' long-term earnings growth versus non-US peers fast outpaces historical average levels. The Glovista investment team is not comfortable in embracing such scenario owing to the configuration of macro factors that is currently in place which in due course is likely to produce a sharp mean-reverting-like compression in US earnings growth differentials with non-US peers. Among others, those macro factors include the direction of the US Dollar and the likely unwinding of the flow of funds backdrop which has proved to be especially supportive of the US equity market.

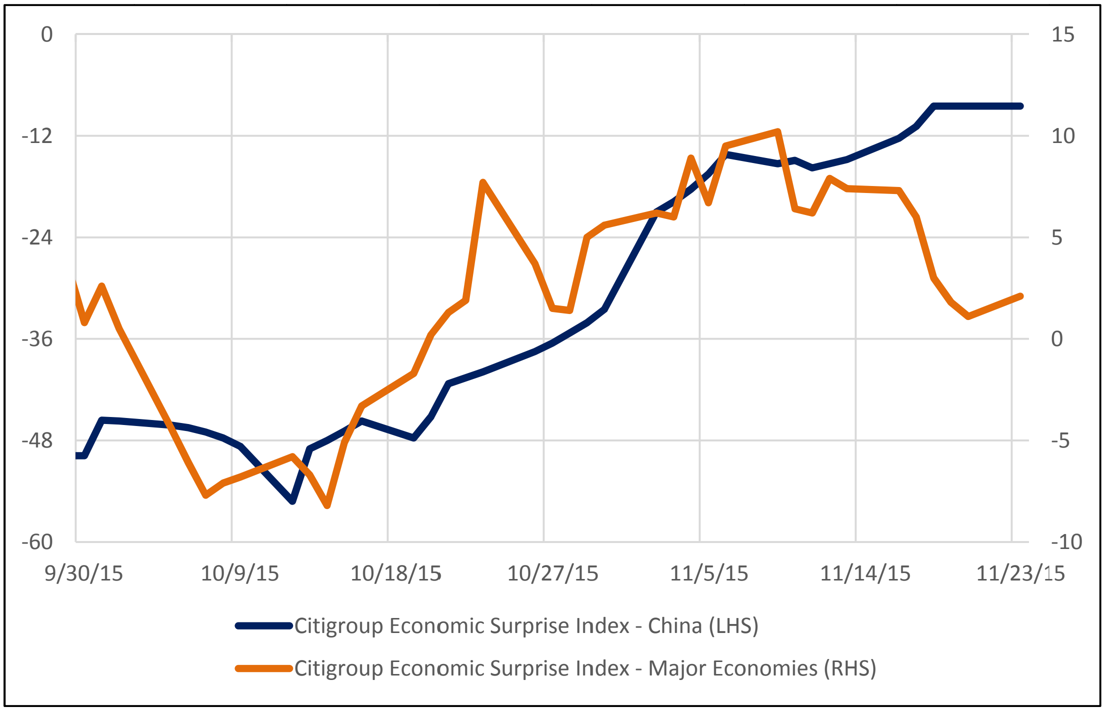
	October 2015	October Change
Gold	1142.16	2.4%
Silver	15.549	7.1%
Oil	46.59	3.3%
EUR	1.1006	-1.5%
JPY	120.62	-0.6%
GBP	1.5428	2.0%
CHF	0.9879	-1.5%
CAD	1.308	1.8%
AUD	0.7138	1.7%
BRL	3.8558	2.3%
MXN	16.5021	2.5%

Source: Bloomberg

Rates	October 30th Level
1 Yr CD	0.64%
5 Yr CD	1.48%
30 Yr Jumbo Mortgage	4.26%
5/1 Jumbo Mortgage	3.76%
US Govt. 10 Year	2.14%
10 Yr Swap Spread	-0.083%

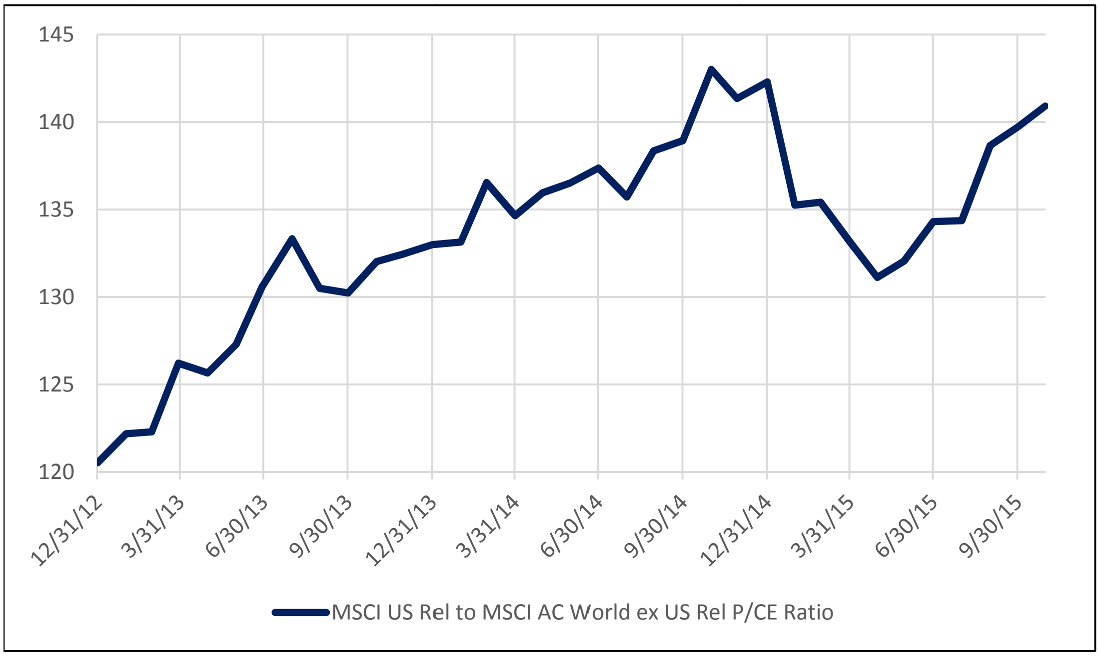
Source: Bloomberg

Figure 3. Chinese Economic Momentum Picks Up versus Developed Peers



Source: Citigroup Global Markets

Figure 4. US Stocks Discount Extraordinary Growth Outperformance versus Non-US Equity Peers: Relative Price to Cash Earnings Multiple

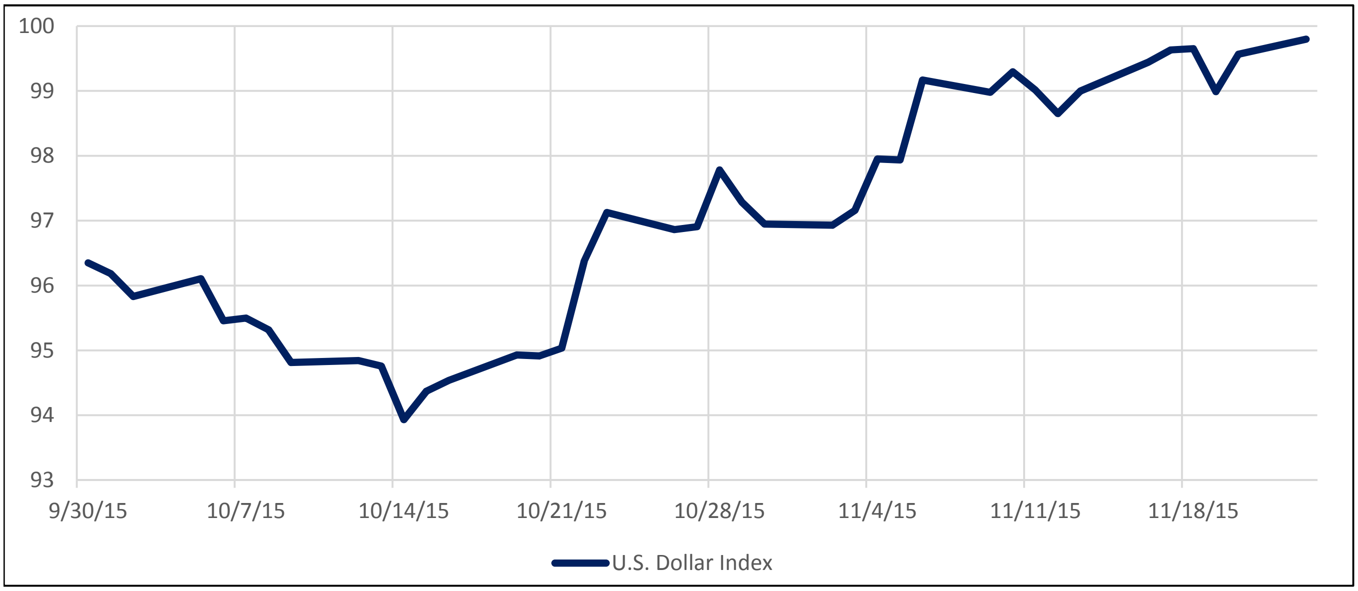


Source: MSCI, Bloomberg and Glovista calculations

- ***Incipient signs of mean-reverting drift in US corporate profit margins to lower levels:*** the third quarter corporate earnings season points to ongoing deceleration in US top-line and bottom-line performance owing to several factors including:

    - Lagged adverse effects of strengthening US Dollar on revenue growth and profit margins (Figure 5)

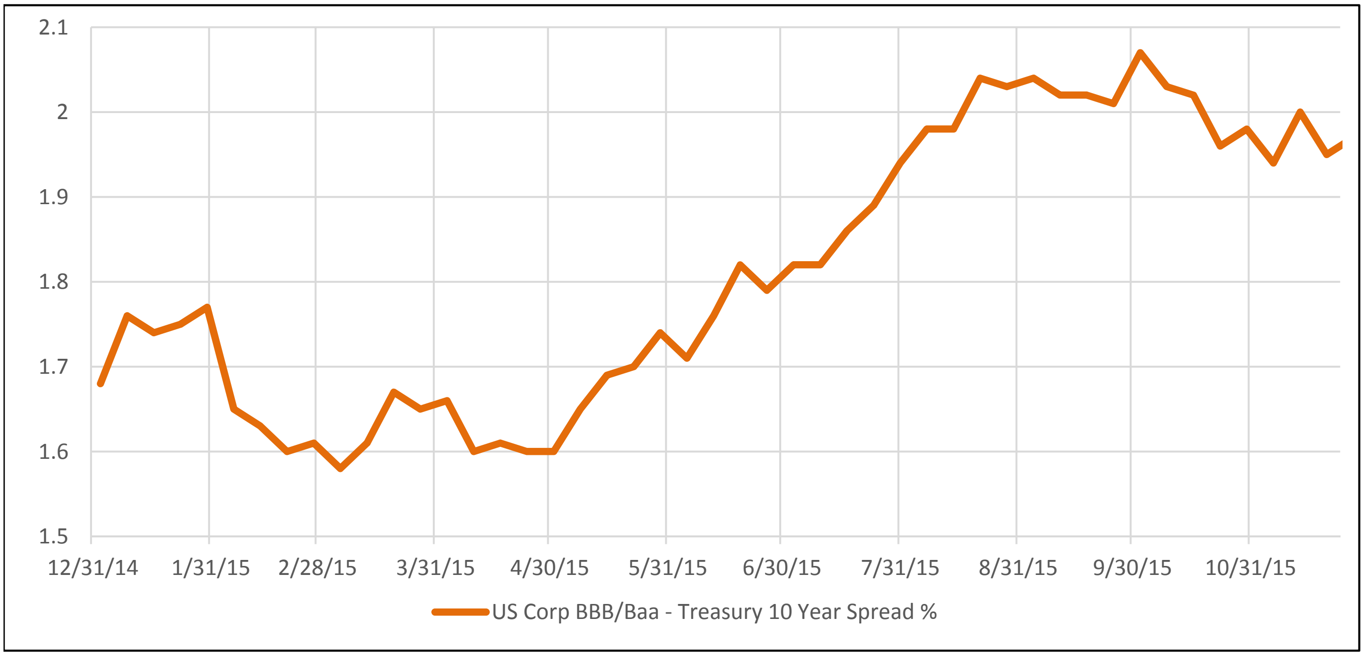
Figure 5. US Dollar Bull Phase Extends during Q3, Resulting in Adverse FX Translation Effects and Weakened Competitive Position for US Multinationals



Source: Bloomberg

    - US financial conditions tighten measurably over the past several quarters, impacted by strengthening US Dollar and rising credit spreads (Figure 6).

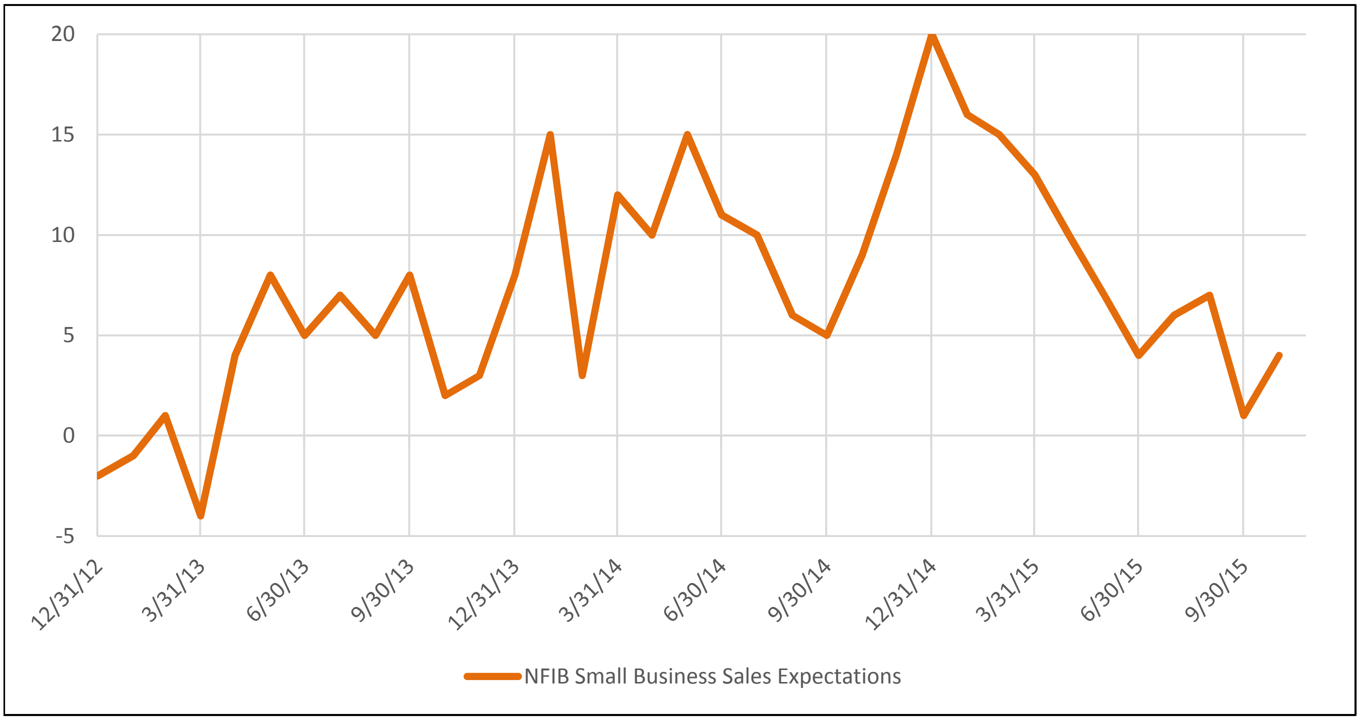
Figure 6. US Financial Conditions Tighten Measurably throughout 2015



Source: Bloomberg

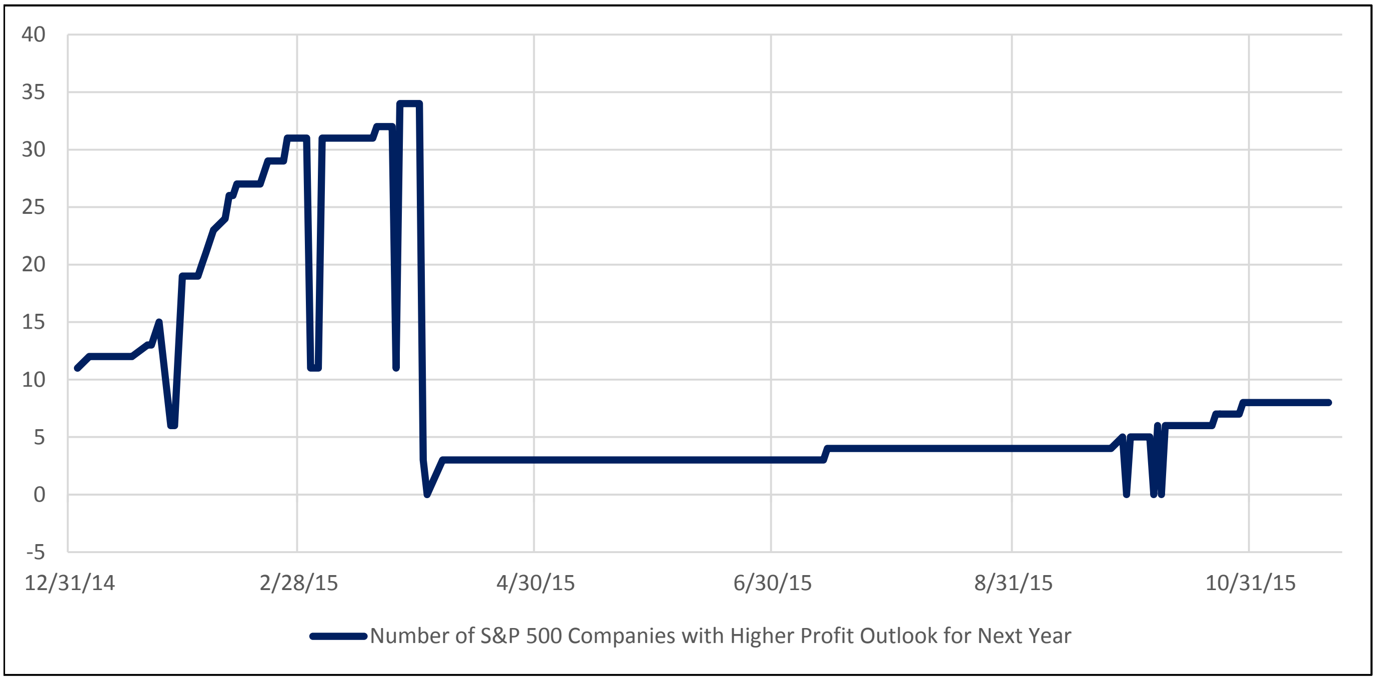
- Business sector survey data and corporate earnings guidance suggestive of potential for profit margin compression and subpar earnings growth in 2016.

Figure 7. Declining NFIB Small Business Sales Expectations as Potential "Canary in Coal Mine" Sign of Slow Sales, Earnings Growth Scenario for 2016



Source: Bloomberg

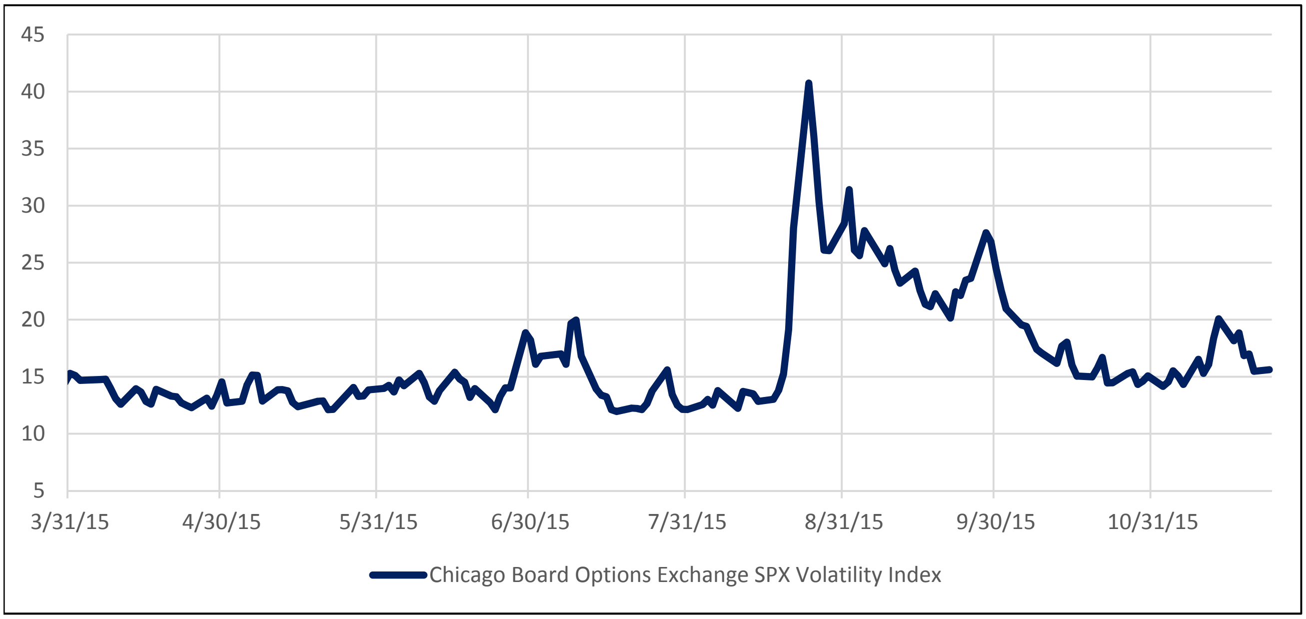
Figure 8. Number of SP500 Companies Expecting Higher Profit Outlook for Next Year Sits at Stark Low Levels: Sign of Caution



Source: Bloomberg

- ***Investor stance towards potential for downside risks to earnings, sales and margins remains one of complacency*** as illustrated in Figure 9.

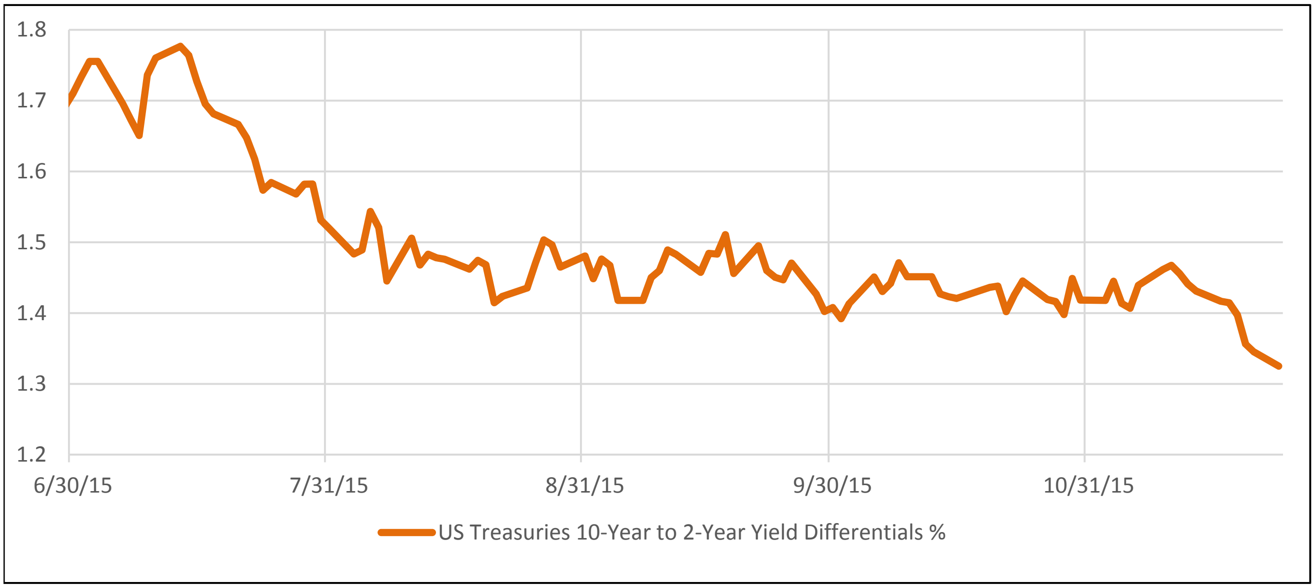
Figure 9. Investor Concerns over Potential for Downside Risks to Impact 2016 Investment Outlook Remain Mute: VIX Implied Volatility Index



Source: Bloomberg

- ***Continued flattening of US yield curve:*** one of the historically most reliable predictors of business cycle turns, raises the specter of impending economic deceleration in 2016.

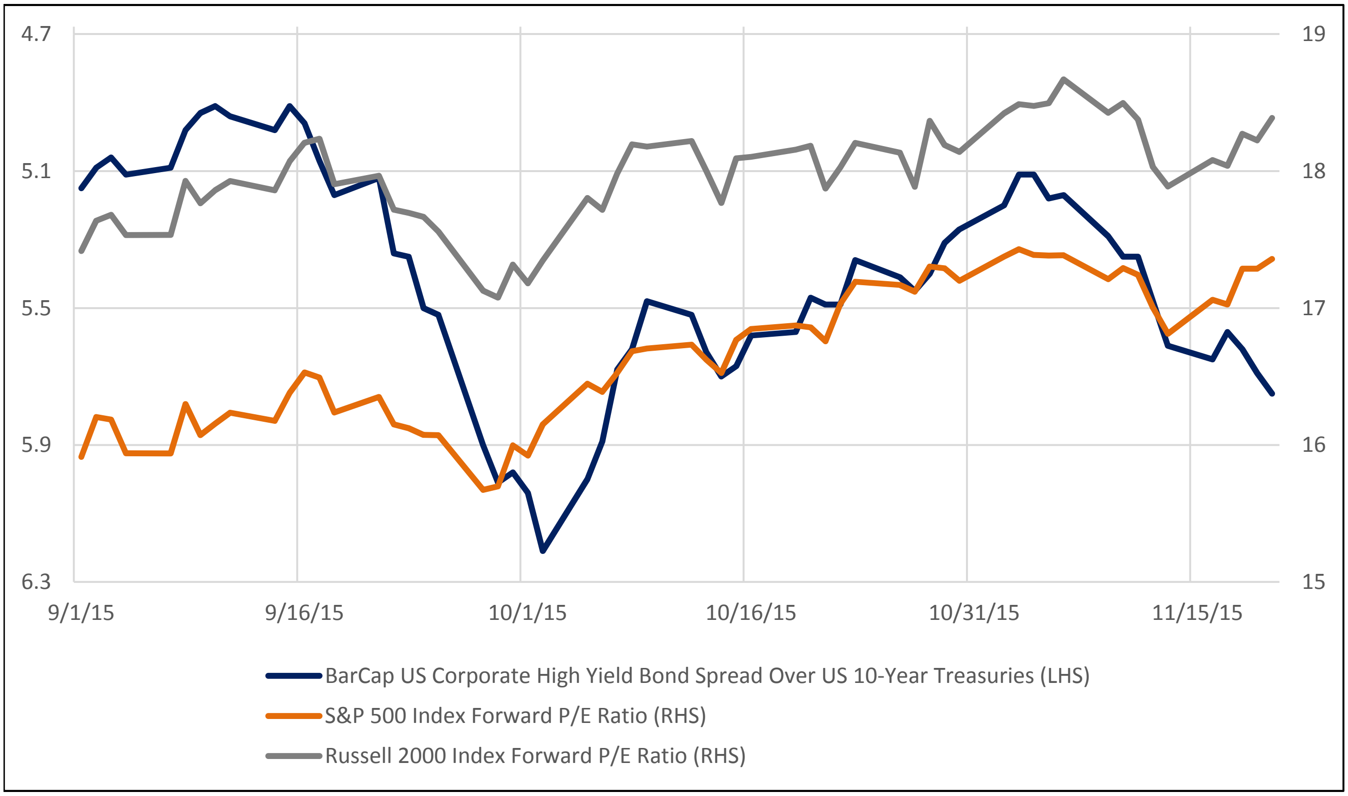
Figure 10. Ongoing US Yield Curve Flattening Dynamics Raises Specter of Economic Deceleration Scenario in 2016: 10 year to 2 year Yield Differentials



Source: Bloomberg

- ***Divergence between widening US credit spreads and expanding (up until middle of year) equity valuations:*** Figure 11 illustrates the highly unusual combination given by the continued spread widening in US credit and the accompanying expansion in corporates' earnings valuation multiples. Prior historical episodes displaying such divergences have been followed, in almost all instances, by periods of outsized equity return underperformance both in absolute and relative terms versus credit indices. In that regard, history is instructive in showing that periods witnessing performance divergence between credit and equities, two asset classes extraordinarily close in the capital structure 'totem pole', correspond to monetary environments characterized by overly abundant liquidity conditions. In the current juncture, we believe the divergence between credit and equities owes much to the unusual support provided to US equity valuations by an overly generous liquidity environment, including the monumental share buyback programs run by US corporates over the past several years at the tune of almost 175 billion US Dollars per year, by far the largest net buying segment for US equities. As liquidity conditions and policy rates revert to normalcy, such distortions in the price mechanism are likely to fade.

Figure 11. Coexistence of Widening Credit Spreads and US Stocks' Expanding Earnings Valuation Multiples: Implications behind Said Divergence?



Source: Bloomberg

Glovista Favors Eurozone and Japanese Equities together as well as Selected EM Indices, High Quality Large Cap US Stocks and Intermediate-Duration US Dollar Credit Instruments

Against the global macro environment delineated above, including the specific market considerations outlined above, the Glovista investment team favors equity exposure to the Eurozone and Japanese markets, on a currency hedged basis, owing to their: (a) attractive relative valuations; (b) superior earnings visibility resulting from beneficiary status tied to the strengthening US Dollar and stronger liquidity backdrop stemming from ongoing quantitative easing programs in Japan and Europe. Outside Eurozone and Japanese equities, the Glovista investment team is attracted to selected EM equity segments, particularly growth style plays in North Asia, and high quality large capitalization US stocks in the consumer staples and healthcare sectors.

In the currency space, we continue to overweight exposure to the US Dollar as we expect the Bank of Japan and the European Central Bank to sustain their standing QE programs well into 2017 while the US FOMC is most likely to embark upon its first rate hike in almost ten years this coming December 16th. In the commodities space, we continue to avoid exposure to the sector altogether after having taken profits in our precious metals positions a little over a month ago.

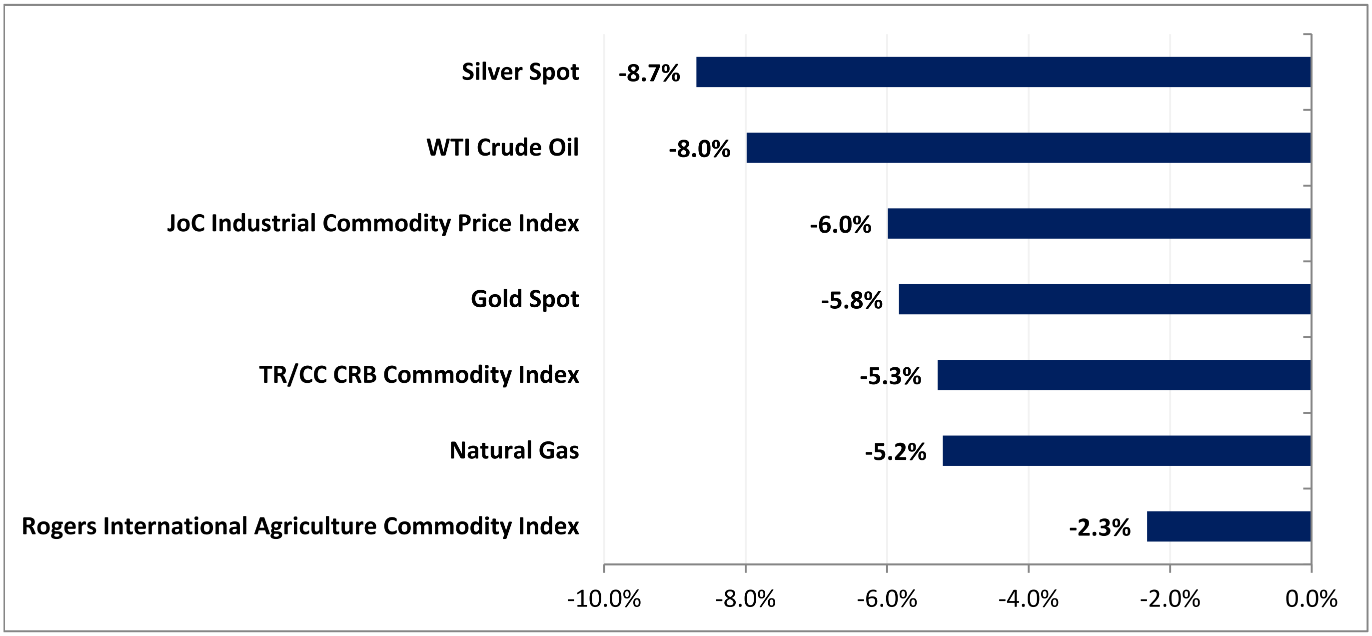
In fixed income markets, we favor exposure to US Dollar denominated intermediate-term duration credit both as a reflection of the asset class' attractive valuations versus equities and in absolute terms given our expectation of no-recession scenario in 2016. In the space, we continue to avoid exposure to energy sector names owing to our continued cautious stance to commodity markets in general, largely a reflection of our continued US Dollar bullish outlook.

Emerging Markets Perspectives

Glovista Raises EM Asia Overweight Tilt on Cyclical Bounce, Resilience of Consumer Growth Plays, Attractive Relative Valuations and Benign Inflation Outlook

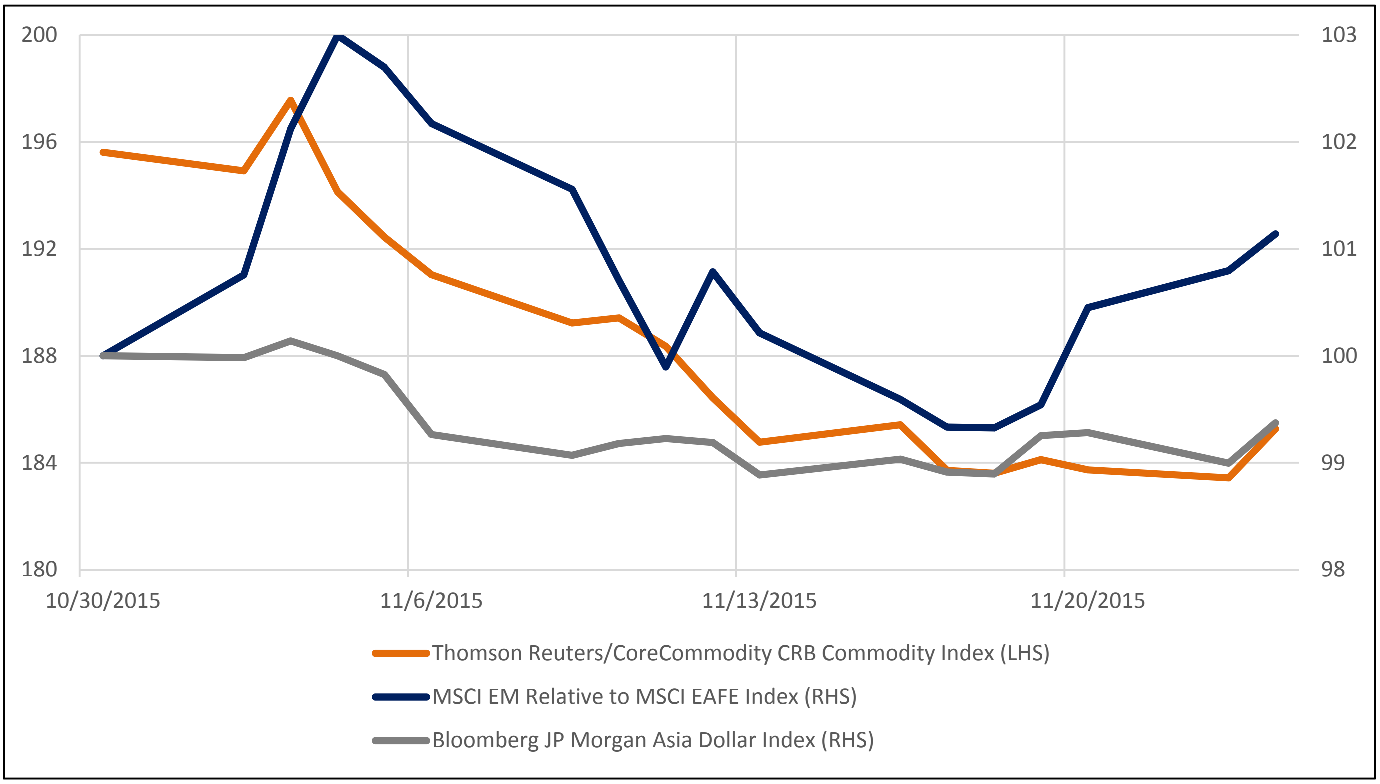
Over the past several weeks, Emerging Market equities have performed approximately in line with Developed Market peers despite continued (a) commodity price declines, of first-order importance to a number of commodity export-oriented countries represented in the EM index (Figure 12), and (b) US Dollar strength ahead of the upcoming December 16th FOMC meeting at which the Federal Funds rate is widely expected to be raised for the first time in almost ten years (Figure 13).

Figure12. Commodity Price Declines Extend Further in November (November 1st 2015 – November 24th 2015)



Source: Bloomberg

Figure 13. EM Equities' November MTD Performance versus EAFE: Resilience Despite Continued US Dollar Strength and Commodity Price Declines (November 1st 2015 – November 24th 2015)



Source: MSCI, Bloomberg and Glovista Calculations

We attribute much of the recent resilience in EM equities' relative return performance versus EAFE peers to a number of encouraging developments impacting the EM equities space, particularly Asia regional equity markets. Among such recent developments, the firmer economic momentum in China stands out in order of importance. Within an EM equities portfolio setting, we believe the recent upturn in absolute and relative economic momentum for China is significant and likely to sustain the EM asset class' near-term relative outperformance on account of several considerations, including:

- The Chinese economy as epicenter of global investor concerns towards the EM asset class these past several quarters;

- Global investors' longstanding interest in the EM asset class for its growth characteristics;

- High quality (low correlation to global cycle) nature of recent upside economic surprises emanating from the EM Asia region as a considerable share of recent upside growth surprises have centered on the consumer sector. For example, the powerful succession of outsized positive earnings and revenue surprises and guidance coming out of the 'new' Chinese consumer sector (e.g. IT consumer names) represents an illustrative example in that regard;

- Asia regional economy's beneficiary status from continued commodity price weakness further raise the prospects of additional policy rate cuts across a number of regional countries;

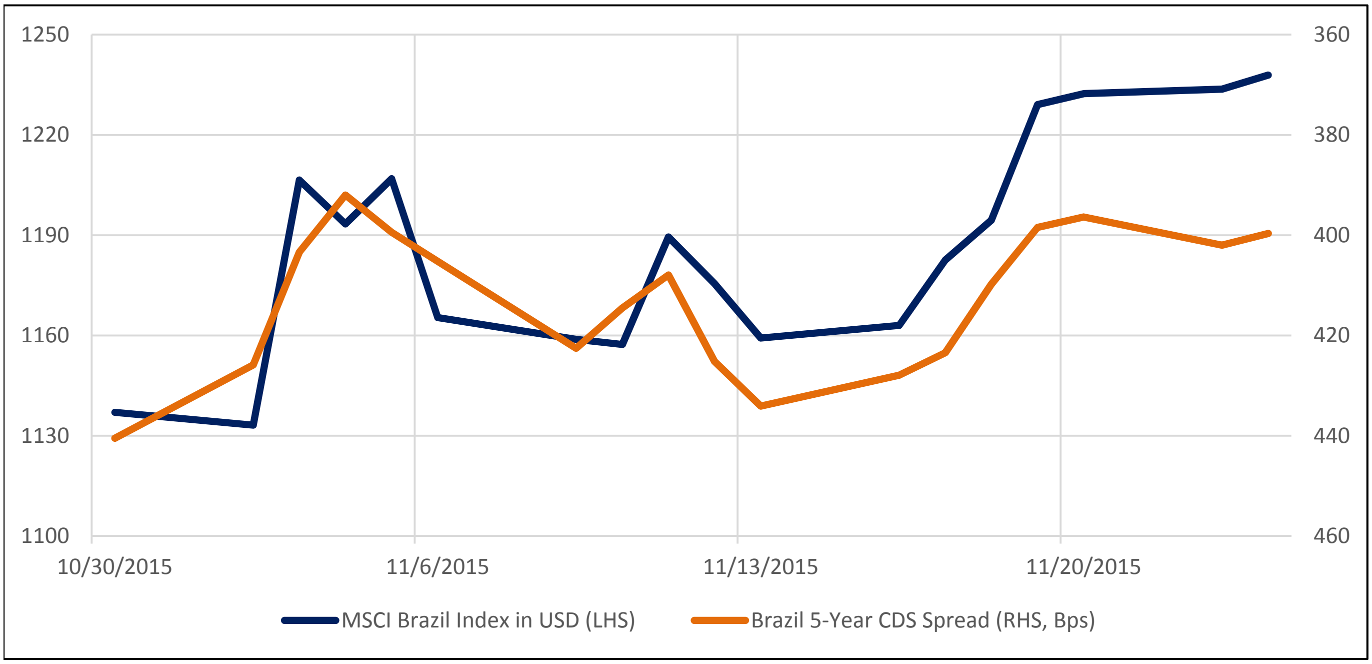
- Emerging Asia's improving cyclical momentum coincides with growing signs of a maturing profits cycle for US equities owing to a number of macro factors discussed at length above including lagged adverse effects from strengthening US Dollar. Against such backdrop, we believe that EM Asia's improved earnings and economic momentum, together with its highly attractive equity valuations versus developed peers, raises the prospects of sustained relative outperformance versus developed peers in the months and quarters to come.

While our outlook towards EM Asia equities has improved considerably these past several weeks, we maintain a bearish outlook towards a number of EM regional markets, including Brazil, South East Asia and the Middle East. Our continued bearish disposition towards those markets is predicated on different considerations:

- Brazilian equities lack long-term valuation support owing to (a) persistent currency overvaluation (Brazilian Real), (b) continued governance issues surrounding the future course of economic policy, (c) Brazilian economy's detrimental status in an environment of continued commodity price weakness (our standing baseline case, particularly vis-à-vis industrial metals). Evidently, powerful counter-trend bull phases supporting Brazilian equities cannot be ruled out as attested as recently as the past several weeks. Quite often, such powerful counter-trend rallies stem from powerful reversals in sovereign credit premium levels (Figure 14).

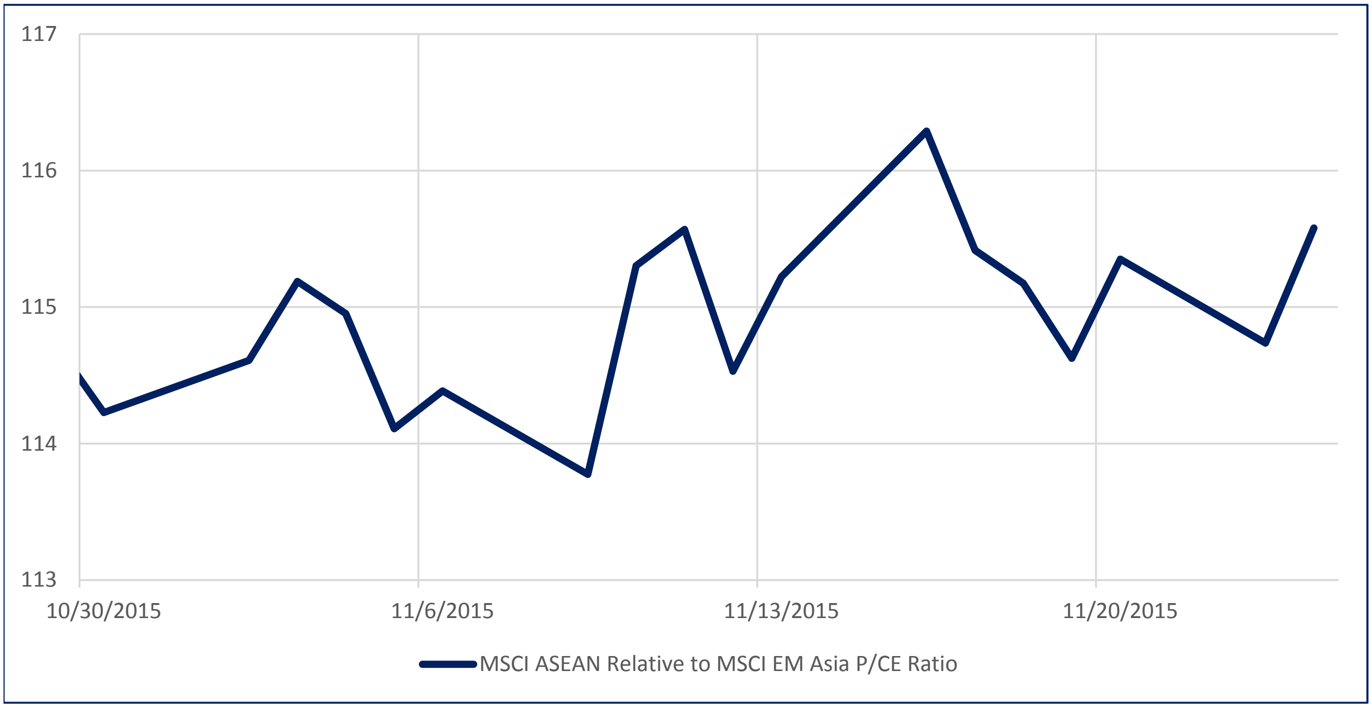
- ASEAN equities lack sufficient valuation support versus EM peers at a juncture in which deleveraging dynamics are likely to take hold across a number of ASEAN countries following a multi-year period of excessive credit expansion (Figure 15).

Figure 14. Reversals in Sovereign Credit Premium Underpin Majority of Counter-trend Rallies in Brazilian Equities: Case of November MTD (November 1st 2015 – November 24th 2015)



Source: Bloomberg

Figure 4. ASEAN Price to Cash Earnings Valuations versus EM Asia Peers: Extended



Source: MSCI, Bloomberg & Glovista Calculations

- Middle Eastern markets' valuations versus EM peers lack sufficient allure owing to a number of factors, including: (a) regional index's heavy real estate sector weighting at a juncture in which domestic credit dynamics are likely to come under pressure in the coming quarters and years; (b) persistent challenges facing the crude price outlook. While the Glovista investment team identifies highly attractive investment opportunities across a number of Middle Eastern markets, particularly Egypt, the limited visibility facing the regional economy's medium-term outlook together with the illiquidity characteristic of such regional markets precludes our investment team from favoring exposure to the region at this time.

Finally, over the past several weeks we have implemented a number of material country-level rebalancing actions, reflective of (a) sector-level views and (b) risk management considerations. Some recent rebalancing actions include the trimming of China 'new' consumer sector exposure, taking profits in the process. Second, risk management considerations together with confirmation of the resumption of powerful commodity price downtrends, extending to the copper market, led us to cut Chilean equities exposure, in the process realizing relative underperformance versus the MSCI EM index. Finally, over the past several weeks we have raised India country exposure from small underweight to small overweight on the back of the resumption of powerful negative commodity price trends that benefit India's economic and earnings outlook in terms of disposable personal income, fiscal outlook, current account performance and increased prospects of further policy rate cuts by the Reserve Bank of India in the near-term.

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, however, 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