Issue
95
November/17

Monthly
Market
Newsletter

GLOVISTA INVESTMENTS

Glovista Global Perspectives

This Issue:

S&P Sector Performance P.2
Ccy and Cmdty Performance P.4
Important Interest Rates P.4

Growth Stocks' Solid 2017 Return Outperformance versus Value Peers Sustained by Accommodating ECB/BOJ Stances and New FED Chair's Dovish Credentials; Glovista Views Risks of G3 Central Bank Policy Mistakes on the Rise

The month of November has witnessed a bifurcation in return performance across the global equities domain. Specifically, MSCI World growth stock prices have rallied 2.13% while MSCI World value stocks have posted approximately flat returns (0.27%) for the month, as of November 27th (Figure 1). The stark November monthly relative return performance differential between growth and value stocks is emblematic of the 2017 year-to-date period. We discuss said dynamics further below, making an effort at incorporating such considerations within our global investment strategy views along with the accompanying risk assessments that condition our outlook.

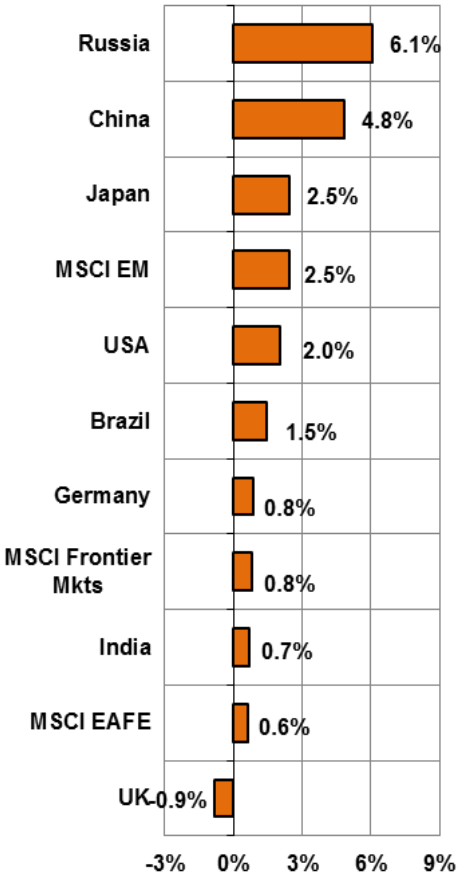
Selected Drivers behind 2017 Growth Stocks' Leadership versus Value Peers

Drawing on the US equity market as a point of reference, a close examination of global growth stocks' strong 2017 relative return outperformance versus value peers offers a number of important observations:

- Relative earnings multiple valuation expansion between growth and value stocks accounts for an inordinately large contribution of this year's solid return performance leadership on the part of growth stocks (Figure 2).

- On a stand-alone basis, growth stocks' P/E FY1 (1 year forward earnings) multiple hovers 28.9 percent above the trailing 10 year average (expensive) while value stocks' P/E FY1 multiple sits at 21.9 percent above their corresponding trailing 10 year average (cheap) – Figure 3.

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



Source: MSCI & Bloomberg

**As of November28th, 2017*

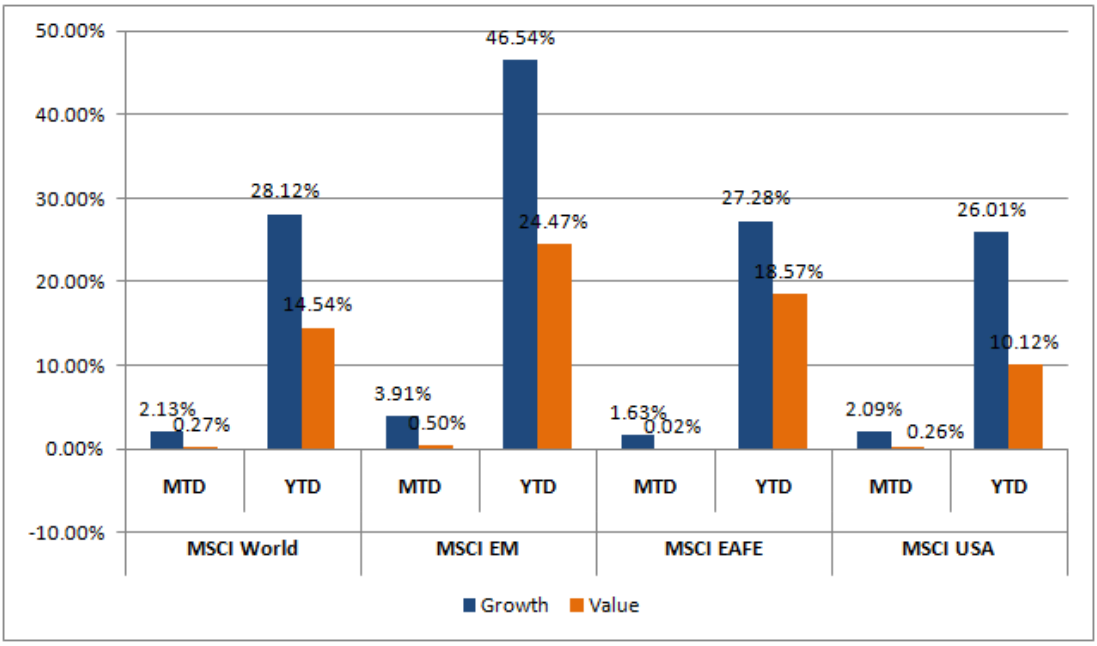
S&P500 Monthly Sector Performance – November MTD 2017*

Sectors	% Change	FY1 PE Ratio
Energy	-0.83%	33.4
Materials	0.05%	20.7
Industrials	1.08%	20.0
Cons Disc	3.98%	21.2
Cons Stap	4.08%	20.4
Technology	2.61%	19.5
Healthcare	1.42%	17.4
Financials	0.92%	16.2
Utilities	1.84%	19.3
Telecom	2.28%	12.0
Real Estate	2.80%	36.4
S&P500	2.01%	19.5

**As of November28th, 2017*

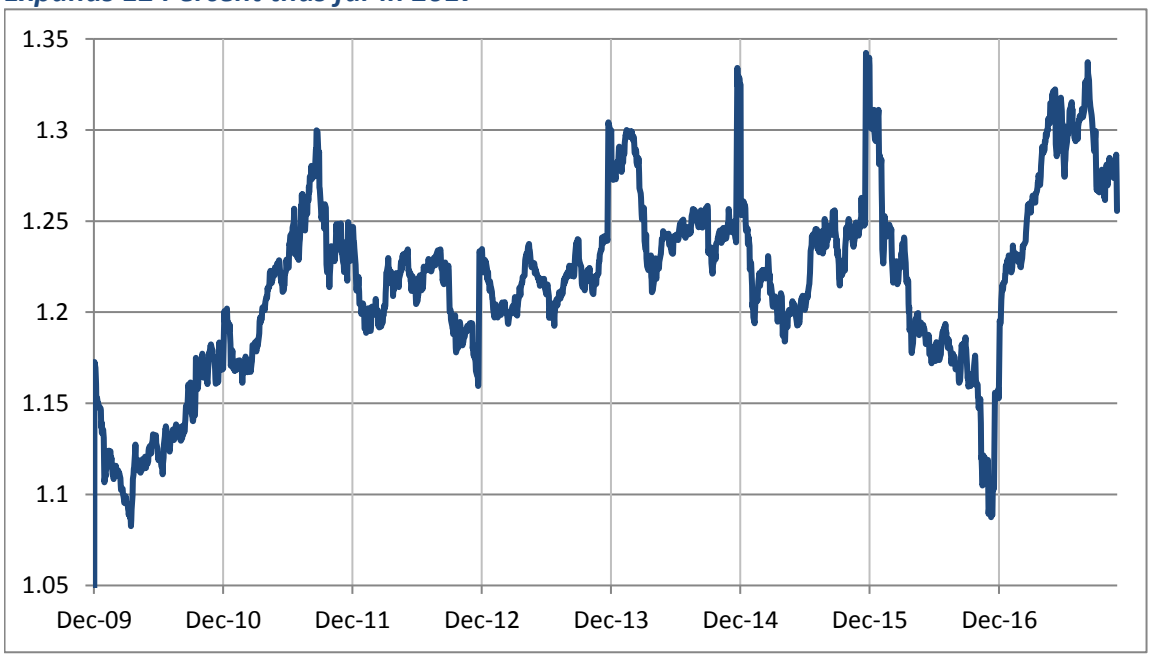
Source: S&P

Figure 1. Growth Stocks' 2017 Return Outperformance versus Value Peers Extends Further in November



Source: Bloomberg, MSCI & Glovista Calculations

Figure 2. US Growth Stocks' P/E Multiple Valuation Premium versus Value Peers Expands 12 Percent thus far in 2017

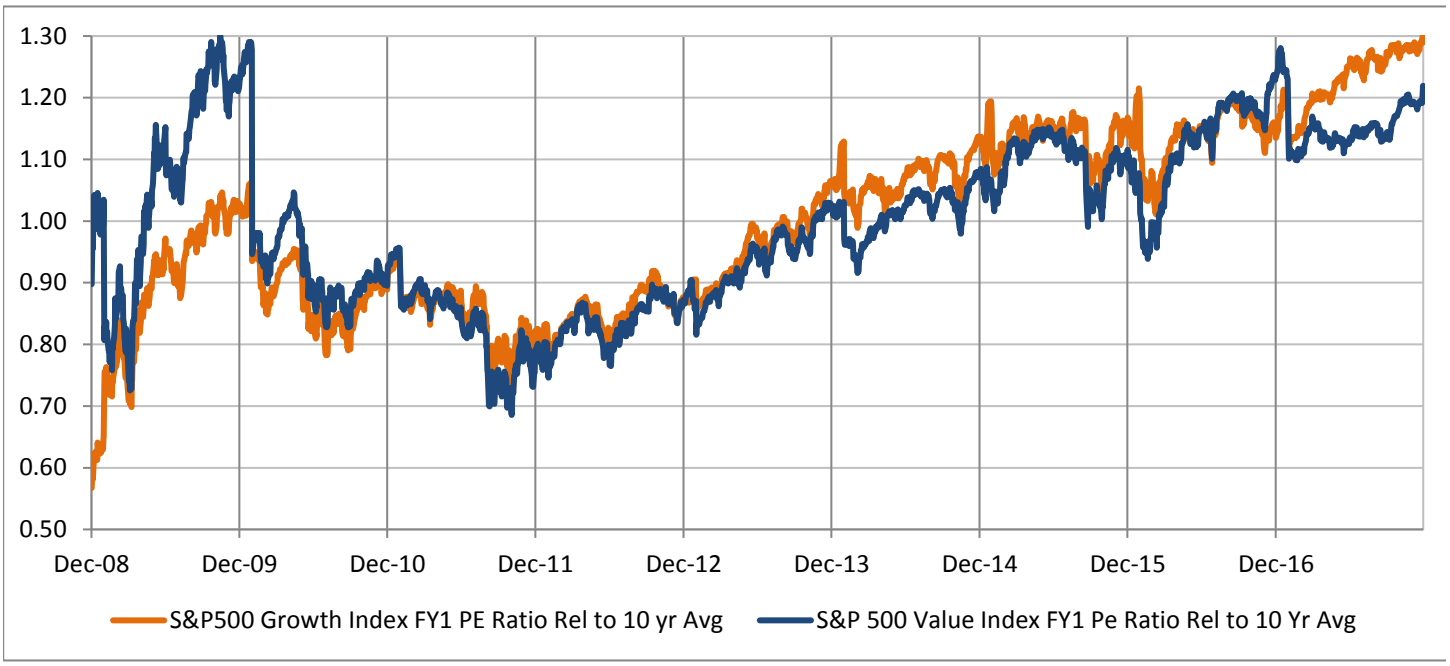


Source: Bloomberg & Glovista Calculations

Overly Loose G3 Liquidity Conditions, especially the ECB's, at Odds with Fundamentals; Policy Excess Fuels Bubble at Long Maturities, Distorting Relative Valuations between Value and Growth

As we have discussed at length in prior monthly comments, the prolonged application, by G3 central banks, of unprecedented monetary policy stimulus on global financial markets has resulted in long-lasting distortions of equilibrium relative and absolute asset valuations. Specifically, we believe some important asset valuation domains that have been impacted materially by excessively large and protracted monetary stimuli include: term premium, liquidity premium, equity premium, credit premium and volatility, among others.

Figure 3. Earnings Valuation Multiples (P/E) for US Growth and Value Stocks versus Trailing 10 Year Average Levels: Growth Expensive versus Value Cheap



Source: Bloomberg and Glovista Calculations

We believe the long-lasting largesse in monetary policy stimulus has served to depress value stocks' allure versus growth stock peers. More specifically, we firmly believe that in 2017 the European Central Bank (ECB) has erred fundamentally in having decided against an initiation of normalization conditions in money and debt markets. Similar to the 2010-2012 period in which the ECB erred on the side of pursuing an overly tight monetary policy stance, resulting in the Eurozone economy's experience of a double dip recession during that period, at present the ECB arguably is erring on the side of pursuing an overly loose monetary policy stance.

In our view, the most straightforward manner in which to ascertain the validity of our claim that present ECB policy is misguidedly loose is simply to focus on the real and price dynamics permeating the Germany economy, the locomotive of the Eurozone region. Specifically, the data (not our views) shows the following:

- Lowest unemployment rate in 25 years (Figure 4);
- Wage inflation has begun to pick up throughout Germany, posting the fastest acceleration since 2010 (Figure 5);
- German Government Bond Yields at Negative Levels Up Through 7 Year Maturities (Figure 6);
- Euro currency valuations hover below multi-year average levels, a stimulant to the real economy's export-driven sectors (Figure 7);
- Eurozone current account surplus sits close to multi-year high levels (Figure 8) at a juncture in which unemployment sits at historical low levels and wage inflation is picking up;
- Eurozone fiscal fundamentals have strengthened considerably these past several years, with deficits vanishing almost fully versus the high levels recorded in the aftermath of the financial crisis. Figure 9 highlights a close to balanced fiscal position for the Eurozone region;

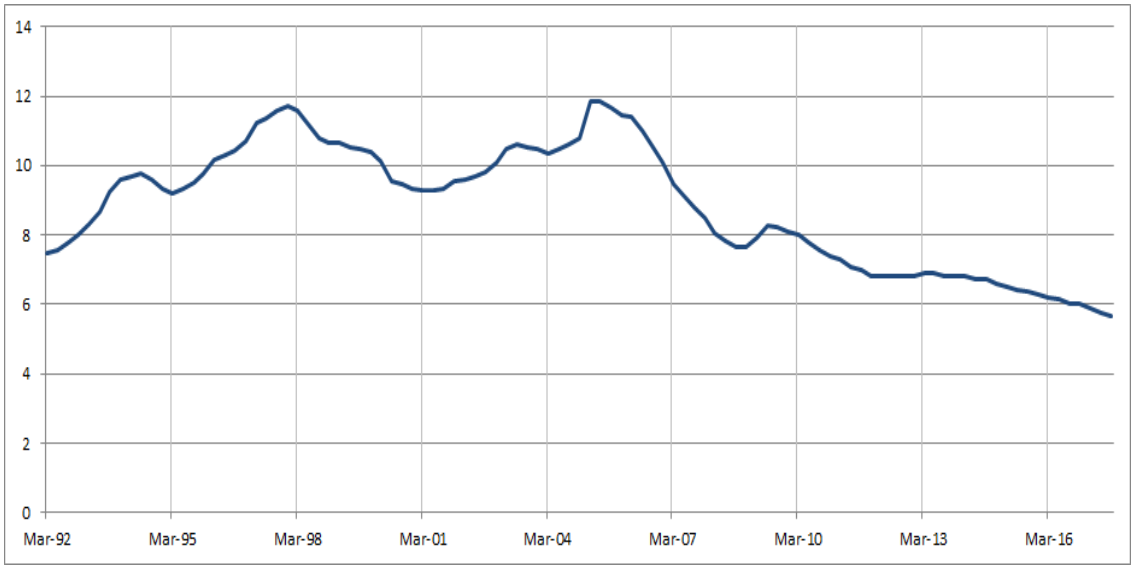
	November 28th 2017	November MTD Change
Gold	1293.96	1.8%
Silver	16.8705	0.9%
Oil	57.99	6.6%
EUR	1.184	1.7%
JPY	111.48	-1.9%
GBP	1.3339	0.4%
CHF	0.9842	-1.3%
CAD	1.2815	-0.6%
AUD	0.7595	-0.8%
BRL	3.2135	-1.8%
MXN	18.5415	-3.2%

Source: Bloomberg

Rates	November 28th 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	-5.94%

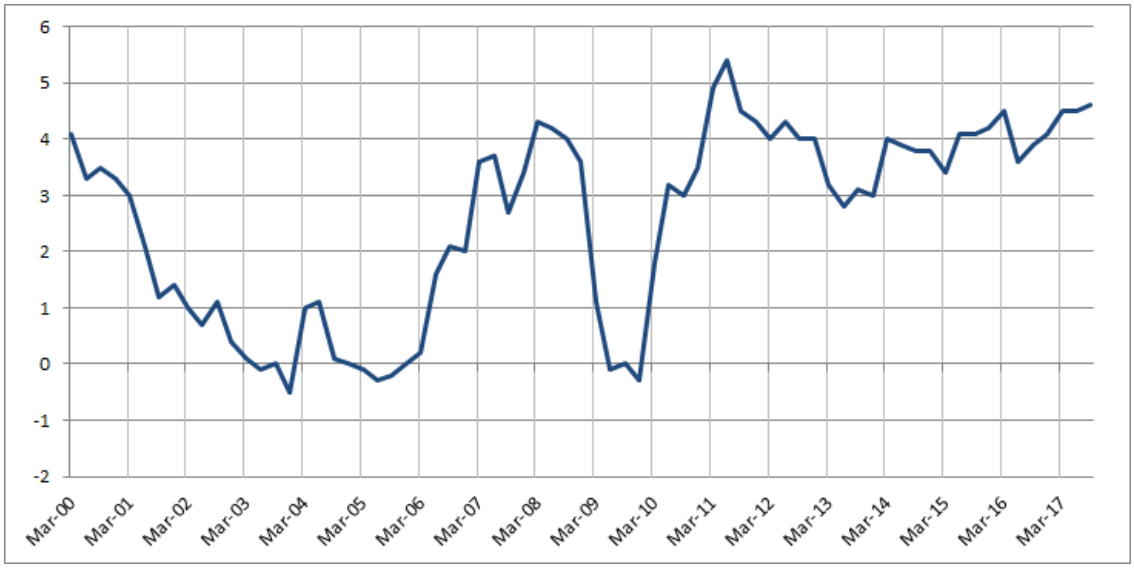
Source: Bloomberg

Figure 4. German Unemployment Rate at Lowest Levels in 25 Years (%)



Source: Bloomberg

Figure 5. German Wage and Salary Inflation (YOY %) at Highest Levels since 2010



Source: German Federal Statistical Office

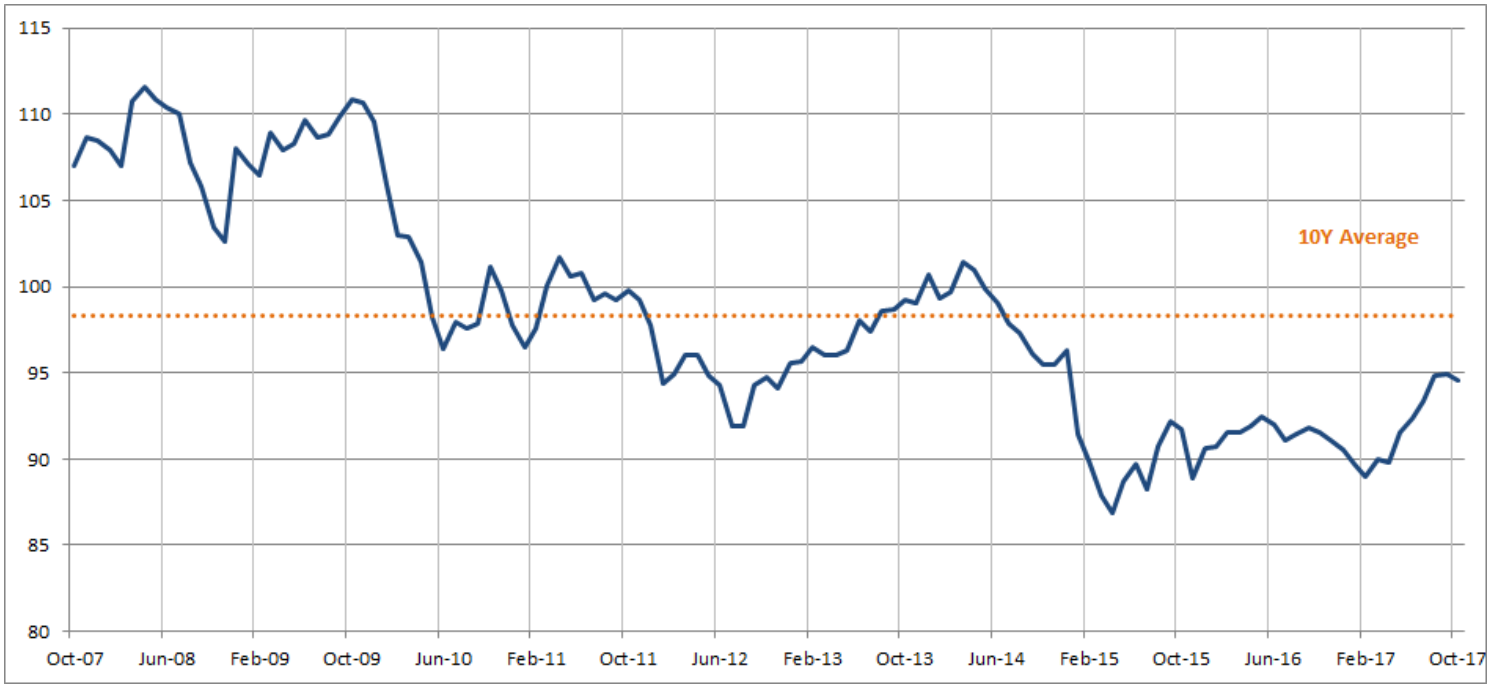
- Massive compression of political risk premium across the Eurozone following the widely investor friendly outcomes to the multiple election campaigns held throughout 2017, including Austria, Netherlands, France and Germany, as well as the successful implementation of Italian electoral law reforms and banking sector policy actions. Such compression in political risk premium is best seen in the compression in sovereign CDS differentials between Eurozone region periphery countries and Germany (Figure 10);

- Germany's medium-term economic growth visibility has been enhanced considerably by the lagged expansionary effects stemming from the large wave of immigrants entering the country over the past two years. Said dynamics strongly suggest the potential for inflationary pressures is likely underestimated by the consensus;

Figure 6. German Government Funds itself at Negative Nominal Yields thru 7 Years Maturity

Source: Bloomberg

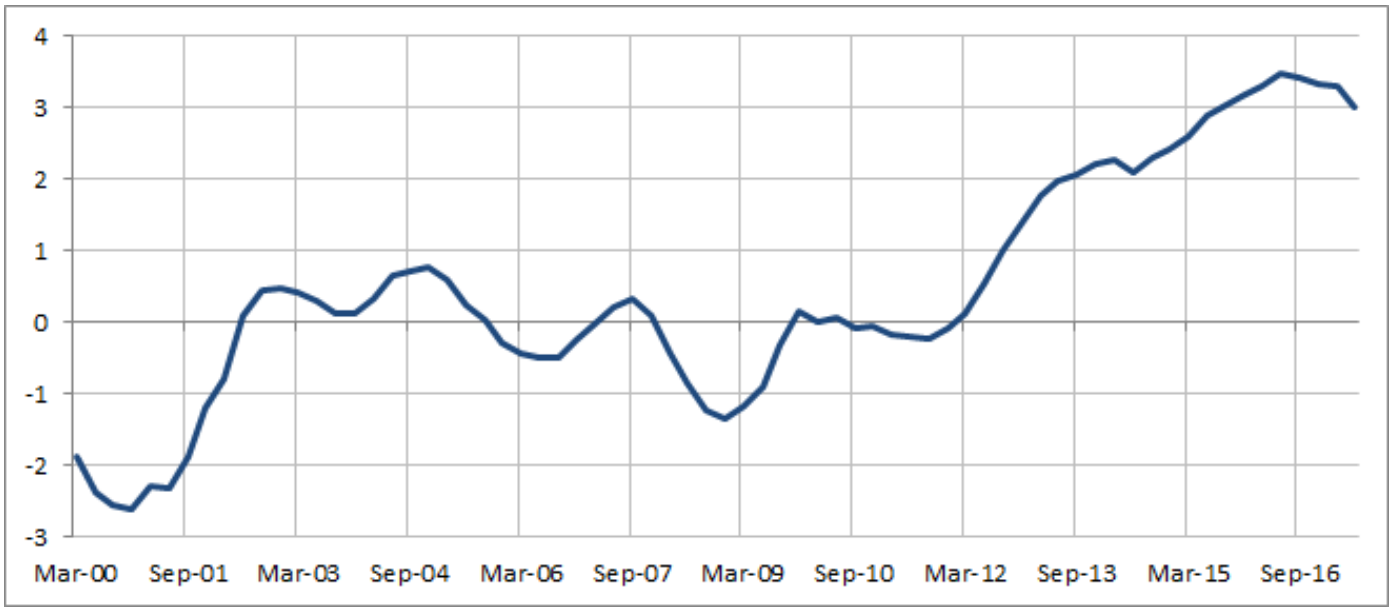
Figure 7. Euro Currency Real Effective Exchange Rate Sits Below Historical Average Levels (Cheap)



Source: Bank for International Settlements

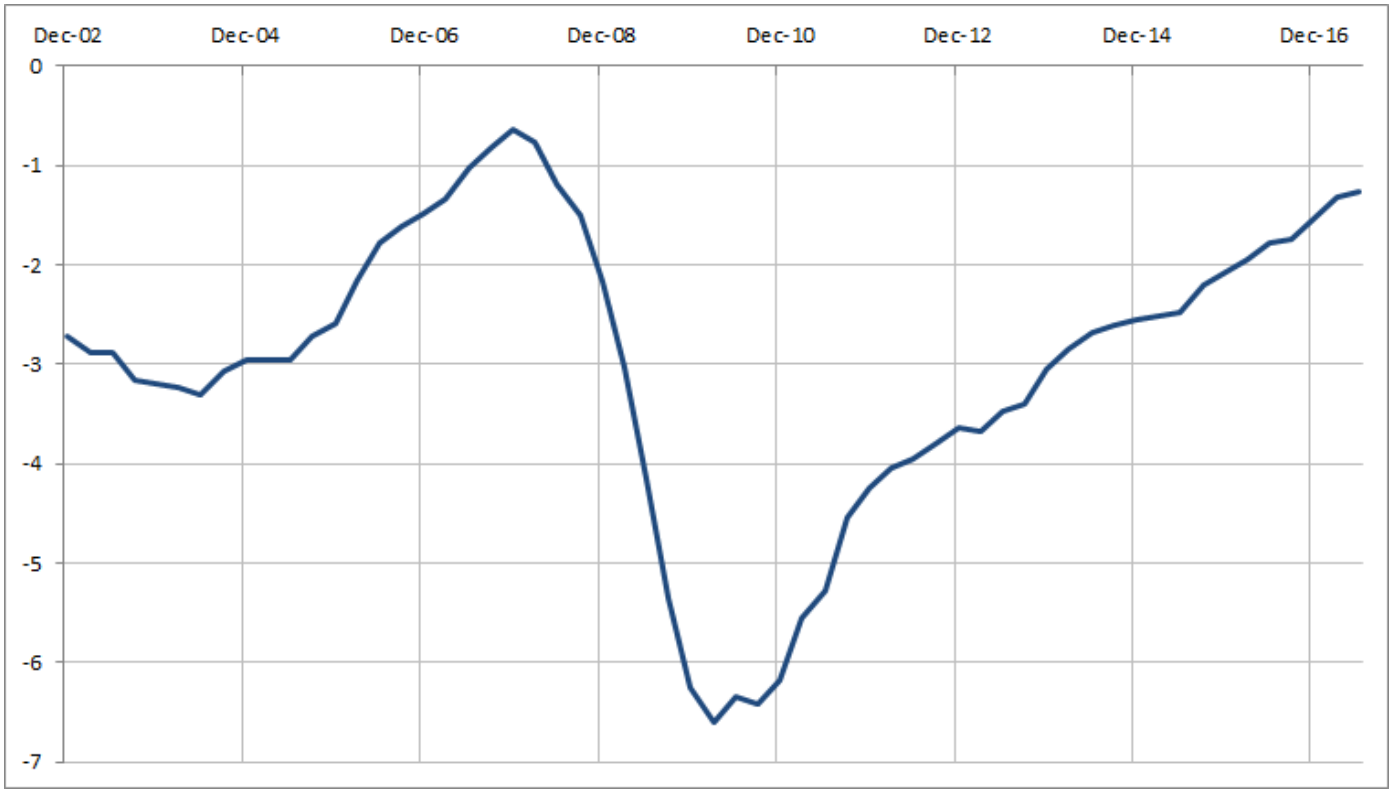
Against the backdrop delineated above, we find ourselves unable to validate the ECB's decision not to normalize liquidity conditions this year, at a juncture in which the economy's fiscal, credit, economic growth, and competitiveness fundamentals have become the strongest in years while inflation pressures are beginning to mount. The artificial suppression of long-term bond yields on the part of the ECB makes such development not only a European but also a US affair given the globalized nature of financial markets. Specifically, the globalized nature of financial markets sets off powerful transmission channels between the Eurozone and the US via portfolio effect dynamics. This is especially true in a world economy still plagued by lingering high levels of debt and aging demographics.

Figure 8. Eurozone Current Account Records Strongest Surplus Levels in Years (% of GDP)



Source: Bloomberg

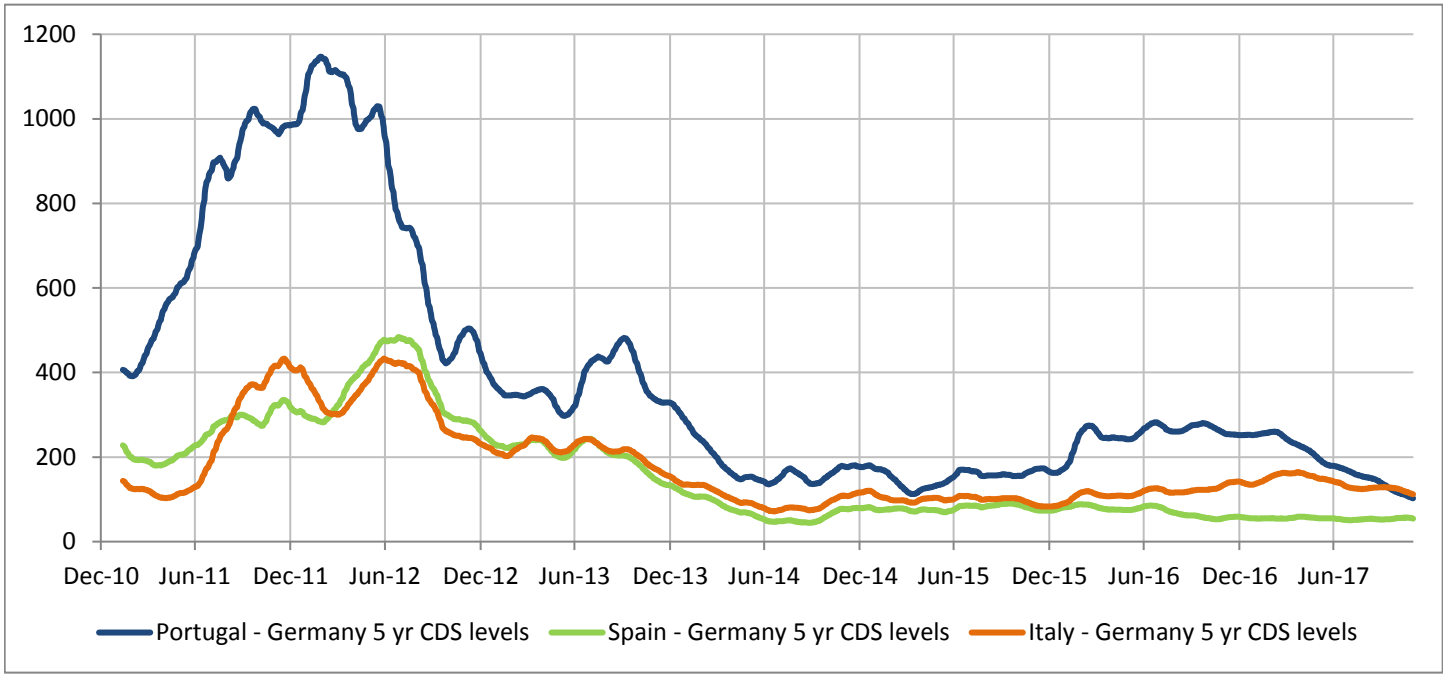
Figure 9. Eurozone Fiscal Fundamentals at their Strongest Levels since 2007 (% of GDP)



Source: Bloomberg

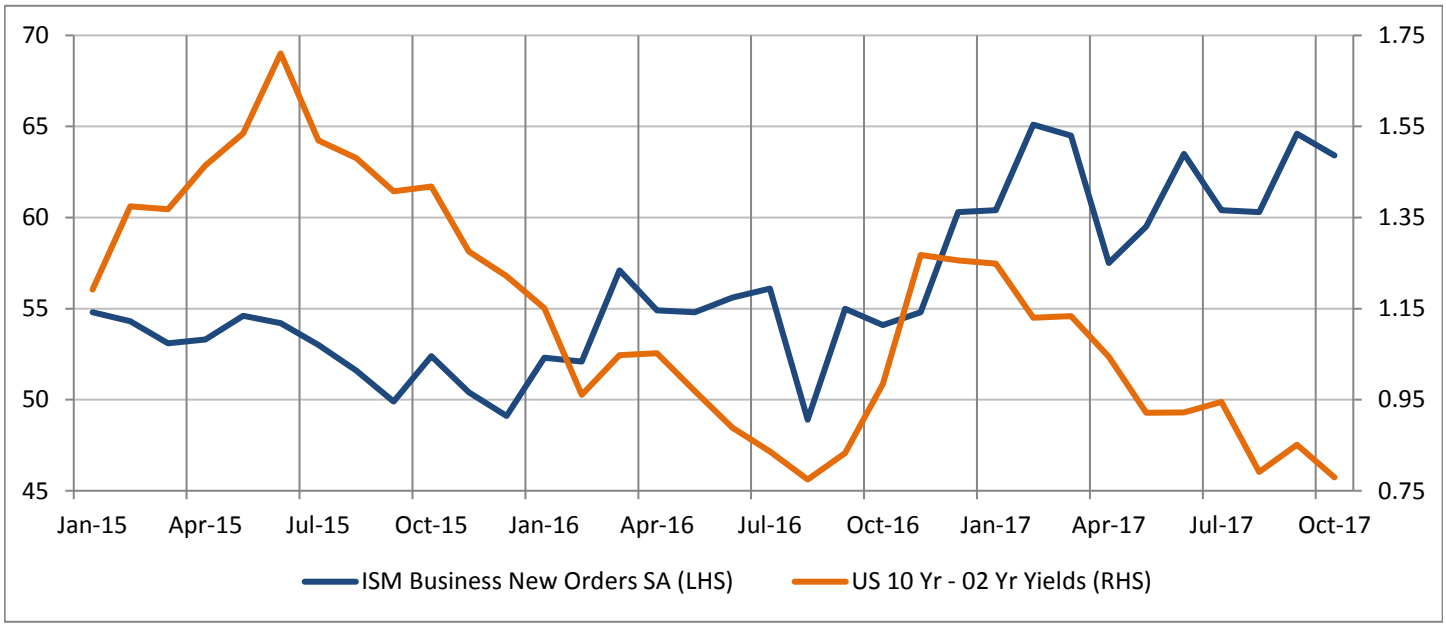
The artificial suppression of term premia in Europe and the USA has prevented a normalization of government yield curve dynamics this year, especially in the USA where the central bank (the FED) is currently in the midst of a rate hike cycle. As a result, thus far in 2017 the US yield curve has flattened considerably at a juncture in which business confidence diffusion indicators have been on an upswing. Figure 11 highlights the significant divergence recorded these past six months, versus average historical relationships, between the new order ISM readings and the US (10 year versus 2 year) yield differential.

Figure 10. Eurozone Regional Political Risk Premium Compresses Sharply in 2017 following Investor-friendly Election Results (Chart: 30 Day Moving Average of Difference between 5 yr CDS levels)



Source: Bloomberg & Glovista Calculations

Figure 11. ECB's Overly Loose Policy Stance Sets Off 2017 Disconnect between US Yield Curve Response to Improving Real Economy Conditions (ISM New Orders)

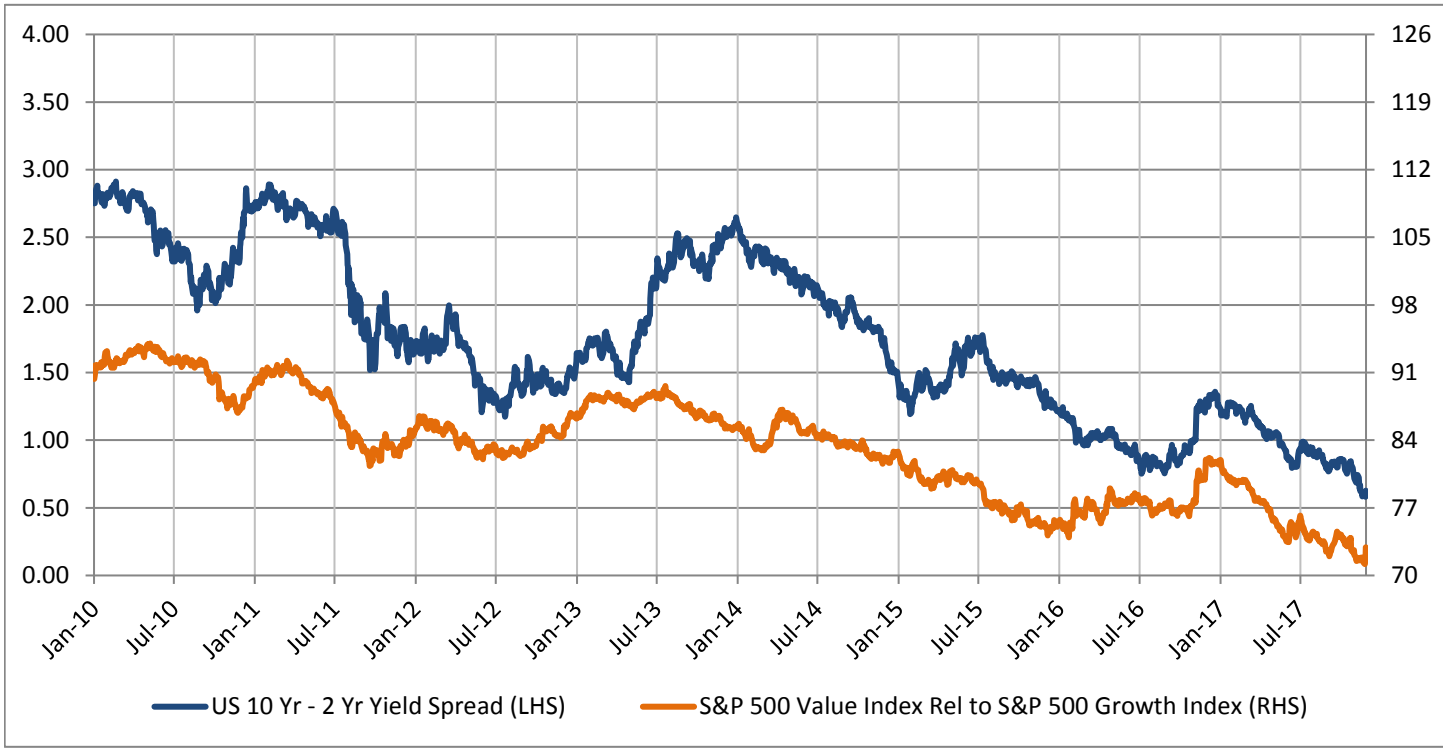


Source: Institute for Supply Management and Bloomberg

We believe the recent divergence between the state of the real economy (e.g. ISM new orders index) and the yield curve (a financial variable) represents a distortion caused largely by a misguided ECB policy stance. In turn, under such interpretation said distortion sets off a mispricing between growth and value stocks owing to the tight historical

sensitivity between the relative performance between value and growth stocks with the relative costs of debt capital between the long- and short-terms (partly as a result of the varying balance sheet factor exposures between growth and value stocks). Figure 12 highlights said tight historical relationship between yield curve dynamics and the relative performance between value and growth stocks.

Figure 12. Value Stocks' Relative Outperformance Periods versus Growth Peers Usually Coincide with Steepening Yield Curve Environments



Source: Bloomberg & Glovista Calculations

We believe the above dynamics largely explain the considerable outperformance recorded by growth stocks this year, via the relative valuation multiple expansion versus value peers. In the process, the US economy's resource allocation process has become far less than optimal, setting off excess lending to certain sectors of the economy while falling short in others.

As we look ahead to 2018, the ECB is likely to respond to an even stronger acceleration of the nominal and real economies. In said capacity, we believe the ECB will initiate a normalization process of liquidity conditions, lending support to a rotation of performance leadership away from growth to the benefit of value.

Glovista Sustains Underweight Duration Exposure and Overweight Allocations in Emerging Markets, US Mid-Caps and Eurozone Equities, primarily on Valuation Considerations

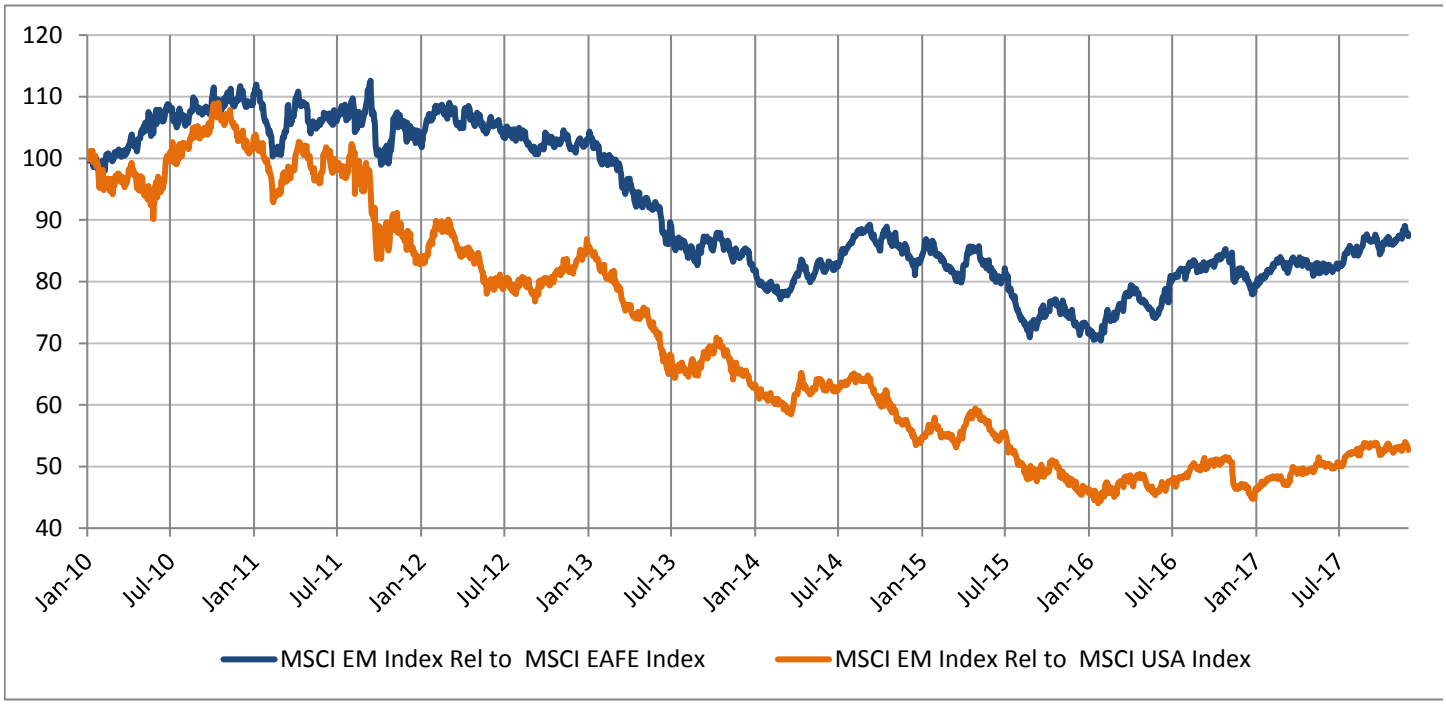
Against the macro and market outlook delineated above, the Glovista investment team continues to hold underweight duration exposure in our portfolios' fixed income sleeves. In equities, we continue to favor Eurozone and emerging market equities primarily on valuation and visibility of top-line growth as we look ahead to 2018. Within the US equity market, we favor selected exposure to secular US IT stocks as well as US mid-cap stocks on valuation grounds and their beneficiary status from the likely legislative passage of corporate tax cuts later this year.

Emerging Markets Perspectives

EM Equities Extend 2017 Relative Outperformance versus EAFE Peers on Growth Stocks' Leadership, Attractive Valuations and Currency Revaluation; Glovista Raises Value Sector Exposures

In November, emerging market equities have extended their strong 2017 year-to-date relative outperformance versus international developed (EAFE) peers – Figure 13. The breadth of EM return outperformance versus EAFE peers during the month of November has strengthened markedly as shown by a number of large outperforming growth sector-oriented markets such as China and Korea as well as a number of large outperforming value sector-oriented markets such as India and Russia.

Figure 13. EM Equities Extend 2017 YTD Return Outperformance versus DM Peers



Source: MSCI, Bloomberg& Glovista Calculations

We also find impressive that EM equities managed to outperform EAFE peers during a month in which a number of emerging market countries have experienced considerable political noise, especially Turkey and Chile, adversely impacting those countries' asset prices. We believe such bullish divergence dynamics offer a powerful testimony of emerging market equities' strong medium-term fundamentals, attractive valuations, growth momentum and favorable investor positioning.

In November, we have rebalanced our EM portfolios at several levels, entailing most notably a downgrade of some of our more growth-sector oriented country tilts (especially China, Korea and Taiwan) to the benefit of a number of value sector-oriented country tilts such as South Africa, Brazil, Russia and India. Such rebalancing actions respond primarily to increasingly more attractive relative valuations associated with value-oriented sectors.

We continue to expect emerging market equities to extend materially the period of strong relative return outperformance versus developed peers that begun early in 2016. Such investment views are predicated on emerging market equities' considerably more attractive relative valuations, stronger organic top line revenue growth, under-invested positioning particularly on the part of US institutional investors, and favorable currency outlook. At a regional level, we continue to favor overweight exposure to North Asian markets (though more moderately than before), India, Chile, Russia against underweight allocations to ASEAN markets, Mexico, Turkey, the Middle East region and Central European markets.

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, 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