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Glovista Global Perspectives

This Issue:

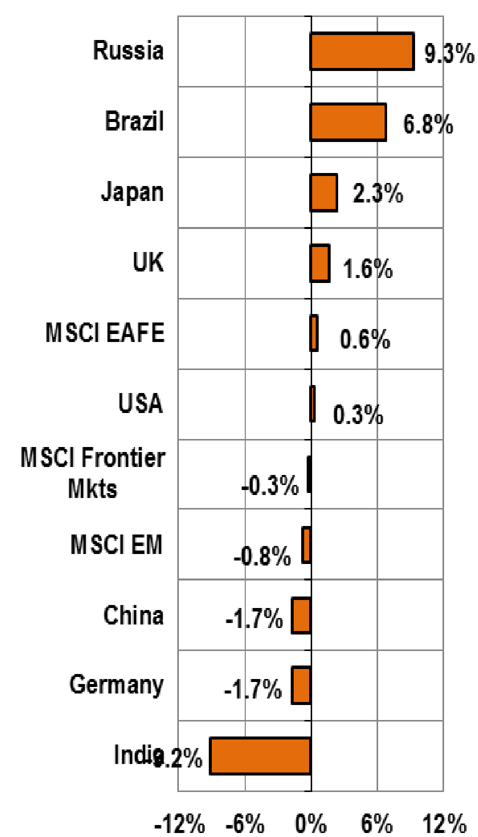
Glovista Sustains Solid Equities Exposure on Economic Momentum, Valuations and Seasonality, Raising Non-US Value Stocks Exposure

In September, risk markets have edged marginally higher, outperforming fixed income markets as (a) the month's global macro calendar has firmed up following a multi-month long period of softness outside the USA fueled by trade war concerns, and (b) energy prices have bounced strongly, impacted by the broader than expected compliance of Western nations to US-led trade sanctions on Iran. Figure 1 highlights September month-to-date and year-to-date return performance levels across a number of major asset class categories while Figure 2 illustrates the September break-out in crude prices. As indicated in Figure 1, global equity prices have outpaced bond peers while commodity prices, particularly in the energy space, have trounced equity and bond returns during the month.

The Glovista investment team attributes the September back-up in government bond yields to several developments including (a) the break-out in crude prices (b), the reduction in risk premium levels following the strengthening of economic indicators during the month of September, and (c) the growing potential for stabilization and possibly strengthening in China's economic momentum following the recent introduction of counter-cyclical policy measures, both at the monetary and fiscal levels.

Notwithstanding the above mentioned developments concerning crude price dynamics, we believe that (a) recent FED policy announcements; (b) lower than expected US inflation expectations out of consumer survey data; and (c) Japanese political developments support a 2019 scenario of gradual policy rate hikes in the USA and a still highly accommodating Bank of Japan (Figure 3). We continue to expect the European Central Bank's policy rate trajectory to be the main source of upside surprise – in rate terms – in 2019 owing to considerations discussed further below.

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



Source: MSCI & Bloomberg

**As of September 28th, 2018*

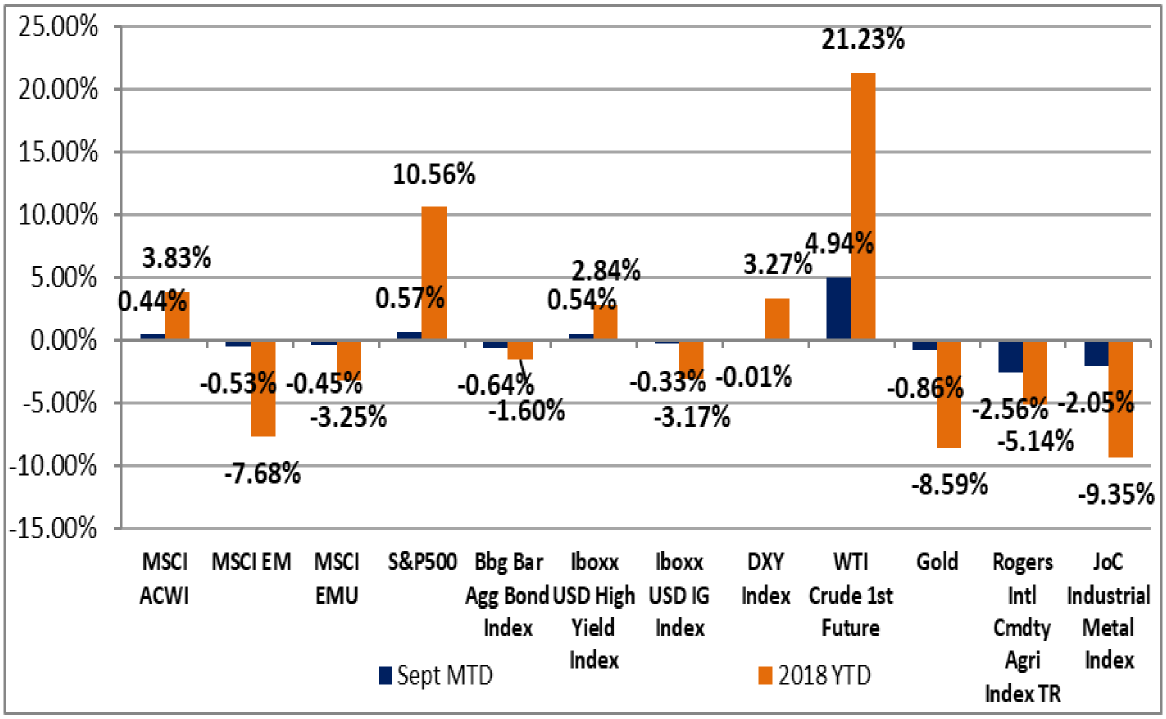
S&P500 Monthly Sector Performance – September MTD 2018*

Sectors	% Change	FY1 PE Ratio
Energy	2.43%	19.5
Materials	-2.28%	15.7
Industrials	2.07%	18.0
Cons Disc	0.97%	23.3
Cons Stap	0.62%	18.4
Technology	-0.39%	19.5
Healthcare	2.80%	17.7
Financials	-2.37%	13.1
Utilities	-0.90%	17.0
Telecom	4.26%	18.2
Real Estate	-3.17%	36.6
S&P500	0.43%	18.1

**As of September 28th, 2018*

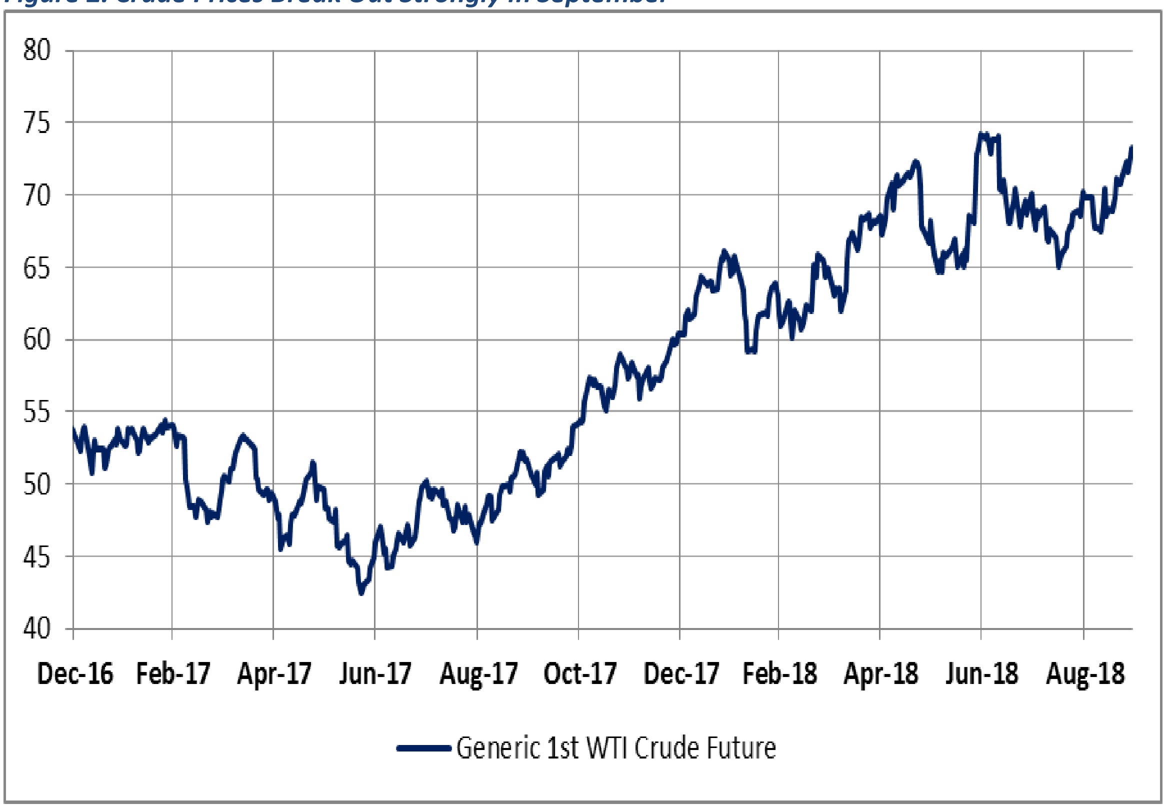
Source: Bloomberg

Figure 1. September Asset Market Returns Point to Strengthening in Demand for Risk Assets



Source: Bloomberg & Glovista Calculations

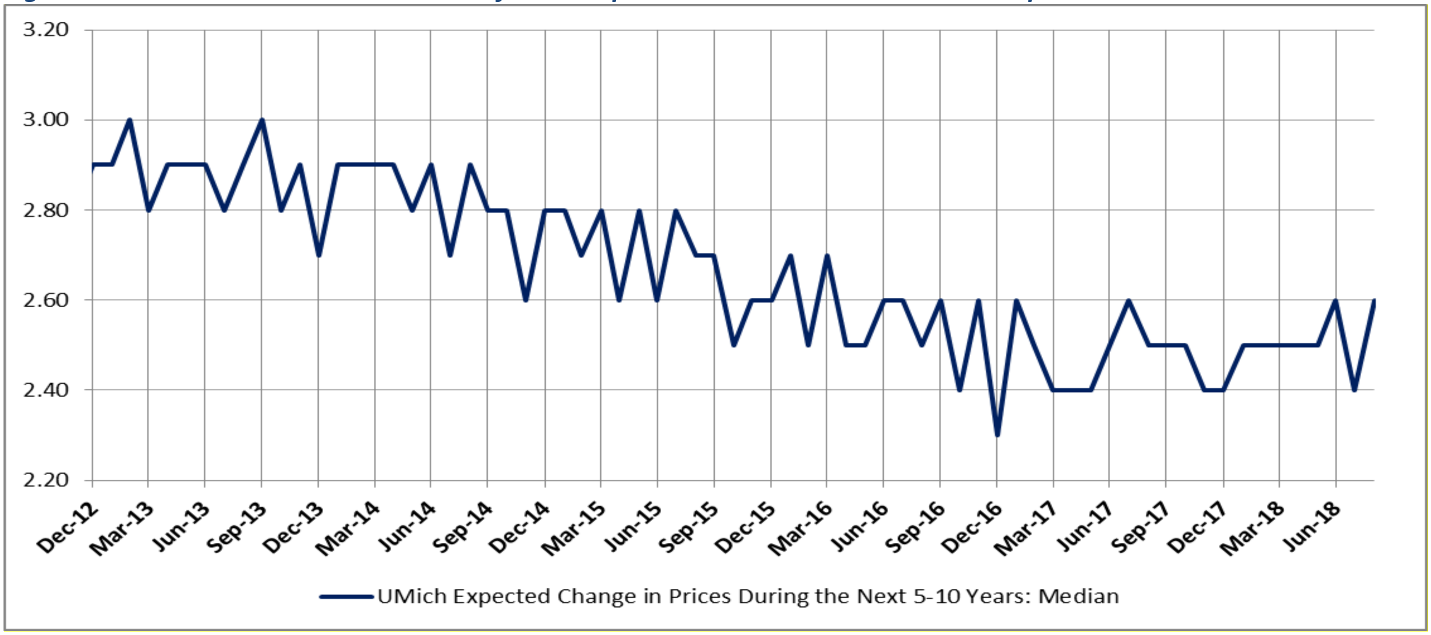
Figure 2. Crude Prices Break Out Strongly in September



Source: Bloomberg

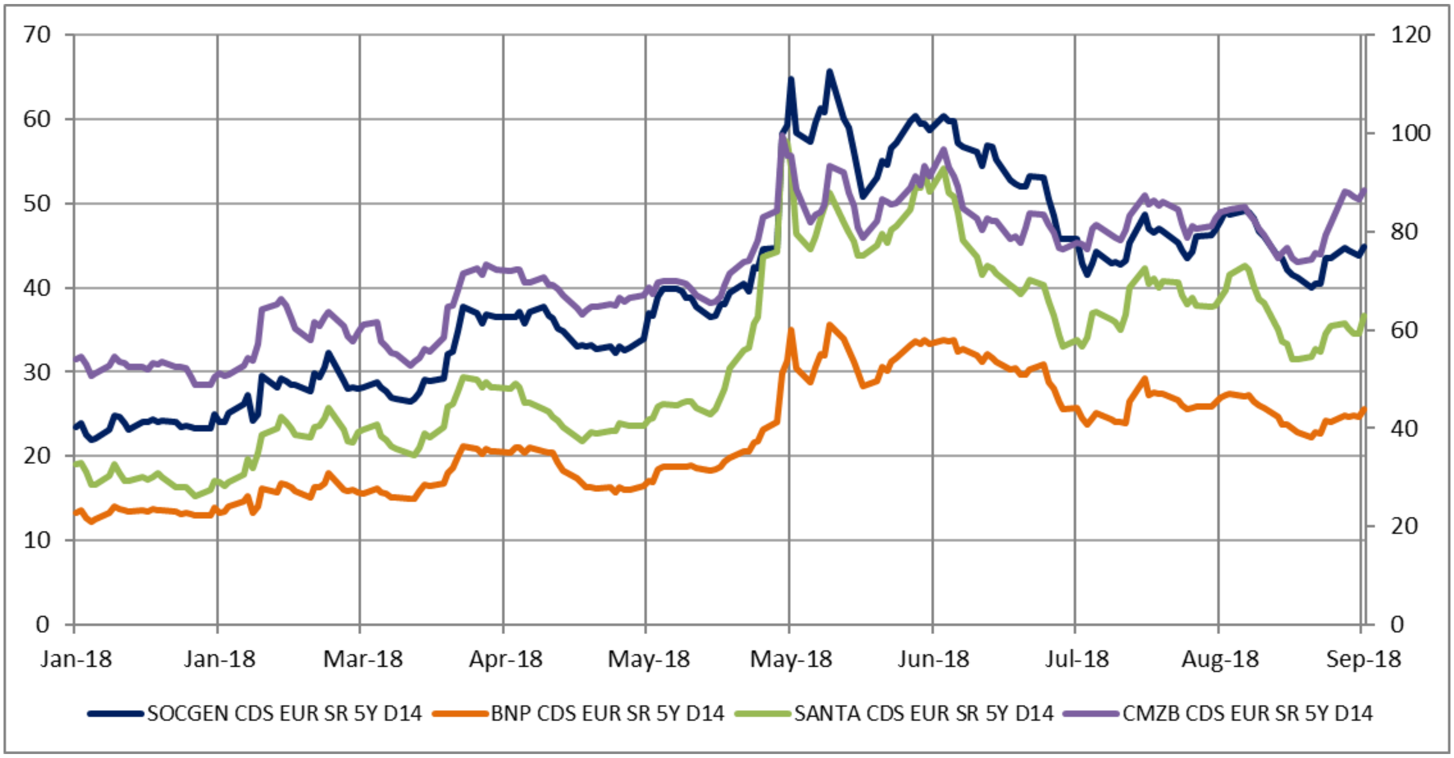
In Europe, Italian domestic public debt market developments – tied to the government's scheduled submission in late September of the country's 2019 fiscal budget for consideration by the European Commission – have exerted modest upward pressure to credit spreads. In the process, the submitted budget exceeded deficit guideline levels set under the Euro fiscal pact; however, the impact of such market unfriendly policy development has barely impacted Eurozone financial sector credit indicators, as captured by approximately unchanged credit default swap spread levels of major Eurozone regional financial institutions (Figure 4).

Figure 3. U.S. Consumer Medium-term Inflation Expectations Moderate Further in September



Source: University of Michigan

Figure 4. Investor Unfriendly September Italy Fiscal Developments Exert Minimal Impact on Major Eurozone Regional Financial Sector Credit Indicators



Source: Bloomberg

We credit the Euro currency's modest weakening versus the US Dollar during the month of September to the above mentioned Italian country risk concerns that surfaced. As discussed further below, we expect the recent period of U.S. Dollar strength to reverse over the short-term as the global macro and financial calendars shed a picture of a far more robust global expansion than what has been reflected in the data these past several months, largely on account of European political developments and U.S. led trade war frictions.

	September 28th 2018	September MTD Change
Gold	1192.5	-0.7%
Silver	14.6978	1.1%
Oil	73.25	4.9%
EUR	1.1604	0.0%
JPY	113.7	2.4%
GBP	1.3031	0.5%
CHF	0.9817	1.3%
CAD	1.2908	-1.0%
AUD	0.7224	0.5%
BRL	4.0504	-0.1%
MXN	18.7183	-1.9%

Source: Bloomberg

Rates	September 28th Level
1 Yr CD	1.25%
5 Yr CD	1.89%
30 Yr Jumbo Mortgage	4.76%
5/1 Jumbo Mortgage	4.15%
US Govt. 10 Year	3.0612%
10 Yr Swap Spread	5.94%

Source: Bloomberg

Finally, in China, during the month of September the government announced additional stimulus measures – including lower taxes and reserve requirement ratio cuts – as a means to counter any adverse growth impacts emanating from the Trump Administration's decision to proceed with the application of a second round of tariffs on Chinese imports effective in September, albeit at a lower (10 percent) rate than feared by some in the markets (with some expecting a 25 percent tariff). As such set of policy stimulus measures work their way through the Chinese economy, we expect global financial variables – including the U.S. Dollar – to reflect a more even activity momentum across several of the world's regions, outside the US.

As we look ahead, the Glovista Investment team expects the direction of the U.S. Dollar to materially condition the outlook for asset priced dynamics across major asset categories, both in absolute as well as in relative terms across asset groups.

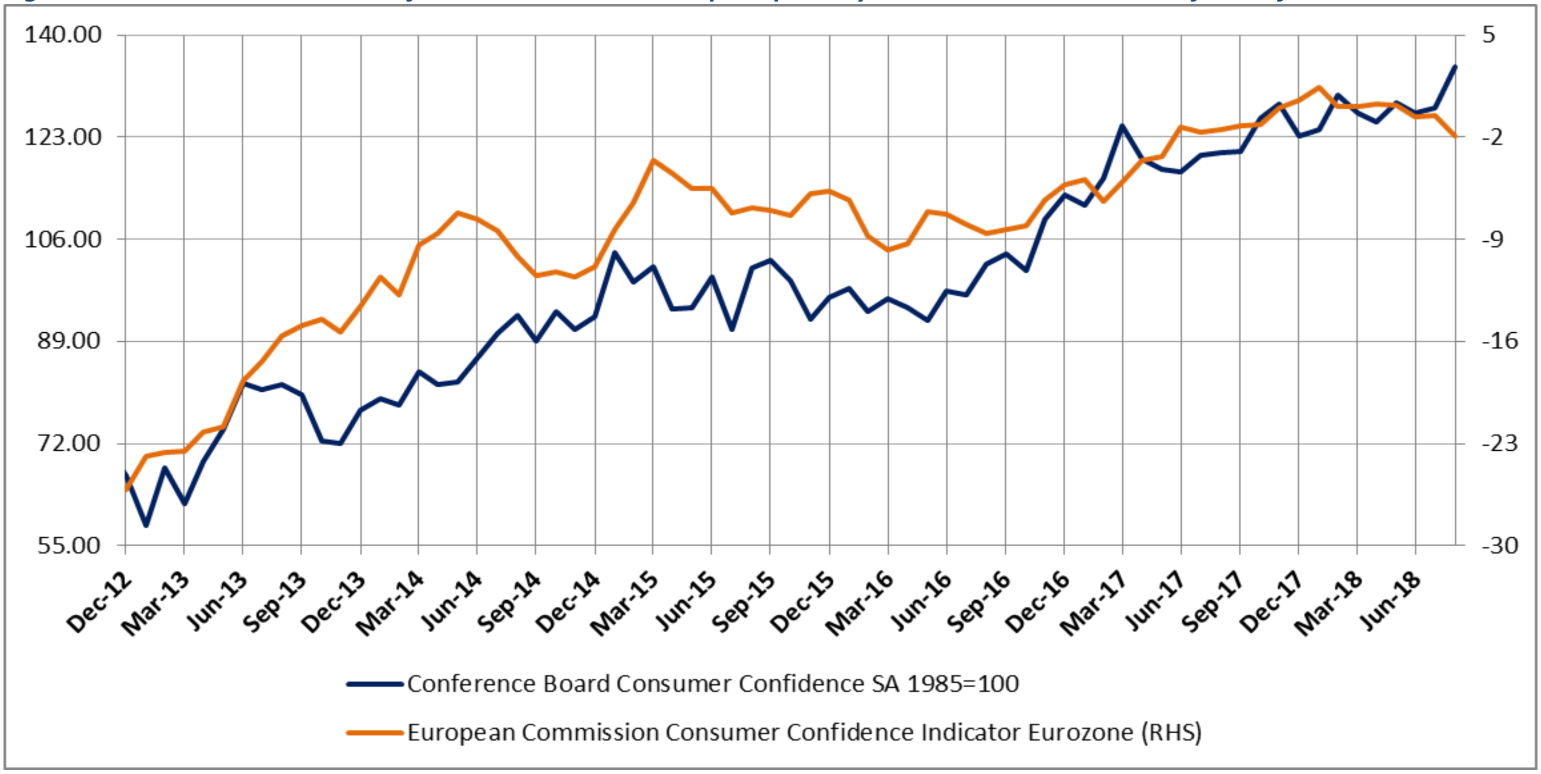
U.S. Dollar Upside Likely to be Limited, Suggestive of an Impending U-turn in Return Performance Leadership between US and International Equities

The Glovista Investment team embraces as baseline case a global macro outlook in which the U.S. Dollar should begin to retrace some of the strength recorded this year, reflected largely by the back-up in risk premium (mostly trade war related) levels. We hold this view on the basis of several considerations, including the following:

- Financial history reminds us that the US Dollar cycle – capturing primarily the Euro US Dollar exchange rate cross – responds primarily to changes in the relative growth momentum in domestic absorption (consumption and investment expenditure) between the Eurozone and U.S. economies. On this basis, we believe the past several quarters of economic data point to future US Dollar weakness given the strong resilience exhibited by Eurozone consumer confidence indicators versus the US at a juncture in which the US economy has been subjected to a powerful cocktail of fiscal (tax cuts and government spending increases) policy stimulus, in contrast to the Eurozone which has not been subject to fiscal stimulus measures.

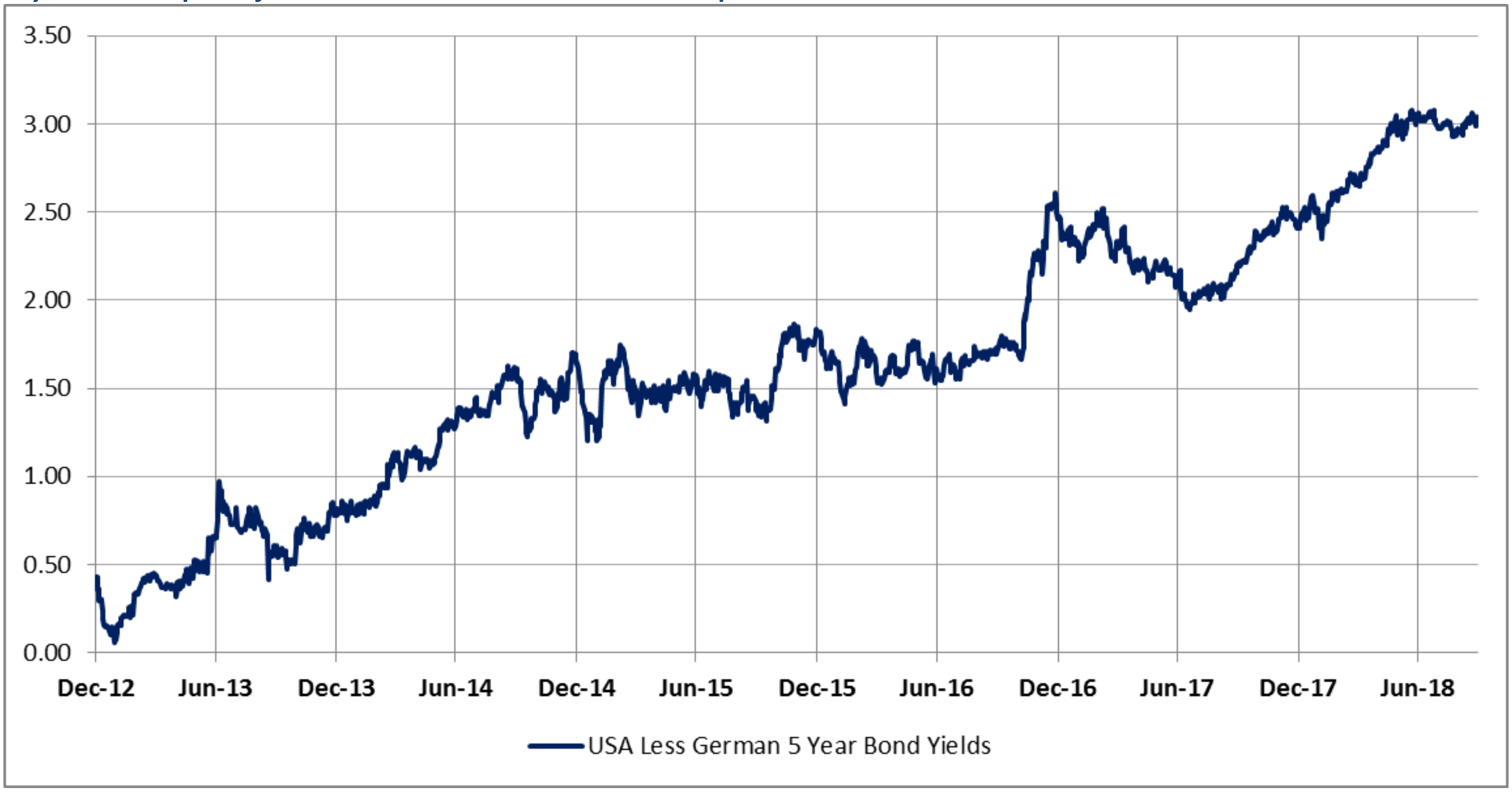
  Our assessment that US interest rate differentials with the Eurozone command limited additional upside looking out to the next 24 months. For example, Figure 6 highlights the unchanged differential between US and German 5 year bond yield differentials these past 5 months despite the asymmetric impact on the economies stemming from the introduction of US fiscal stimulus and the adverse impact exerted on the Eurozone by the US trade policy-led deceleration of Asian economies (a major trading partner for the Eurozone region) as well as recent Italian political developments. We believe such yield differentials will reverse themselves in the coming months, with a bullish implication for the Euro currency versus the US Dollar.

Figure 5. Eurozone Consumer Confidence Indicators Hold up despite Asymmetric Fiscal Stimulus in favor of US



Source: Conference Board and European Commission

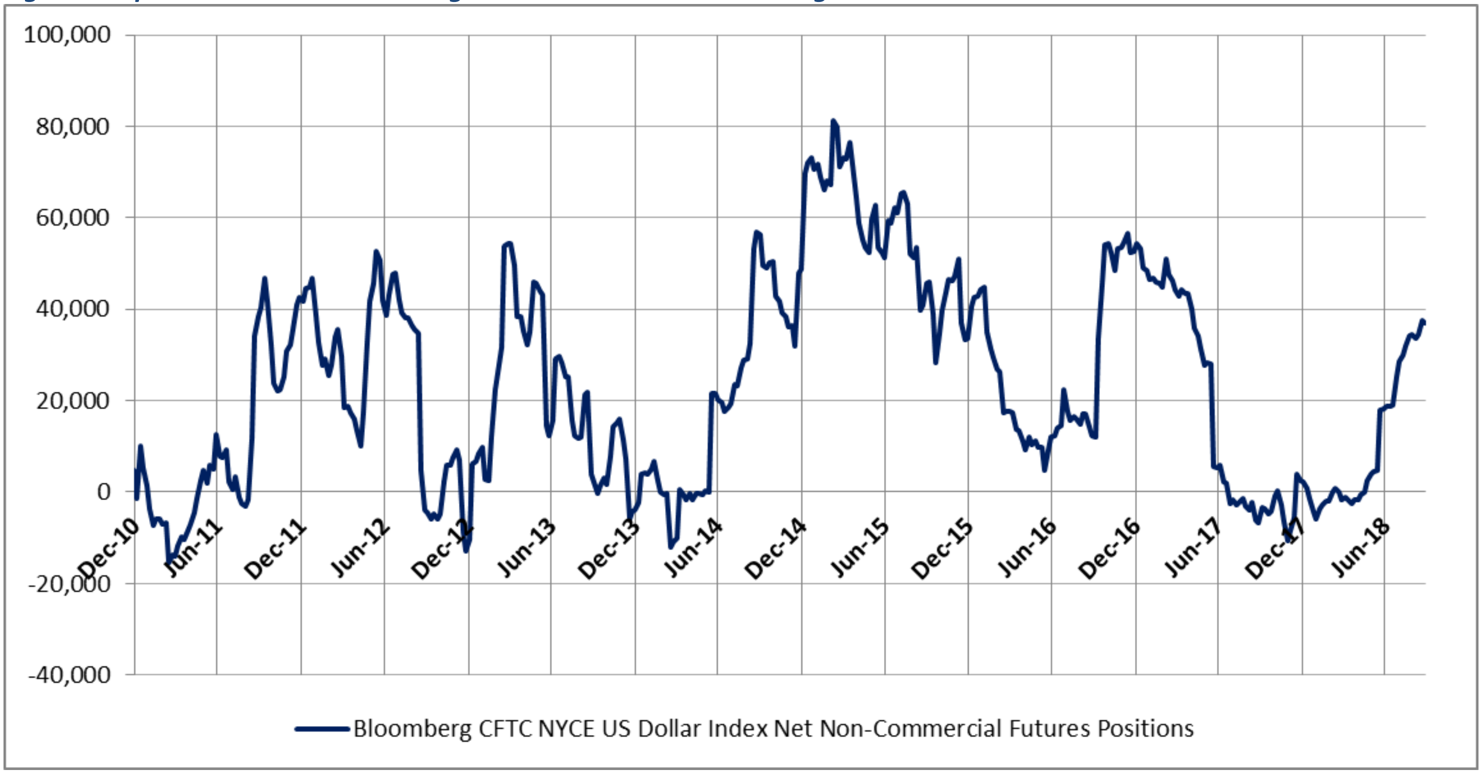
Figure 6. US-German 5 Year Government Bond Yield Differentials Hover at Unchanged Levels since May 2018 despite Asymmetric Impact of Year-to-Date Fiscal and Trade Developments across the Two Countries



Source: Bloomberg and Glovista Calculations

▪ U.S. Dollar's over-owned status on the part of the international speculator investor community (Figure 7)

Figure 7. Speculators' Net Positioning Levels in US Dollar: Overbought



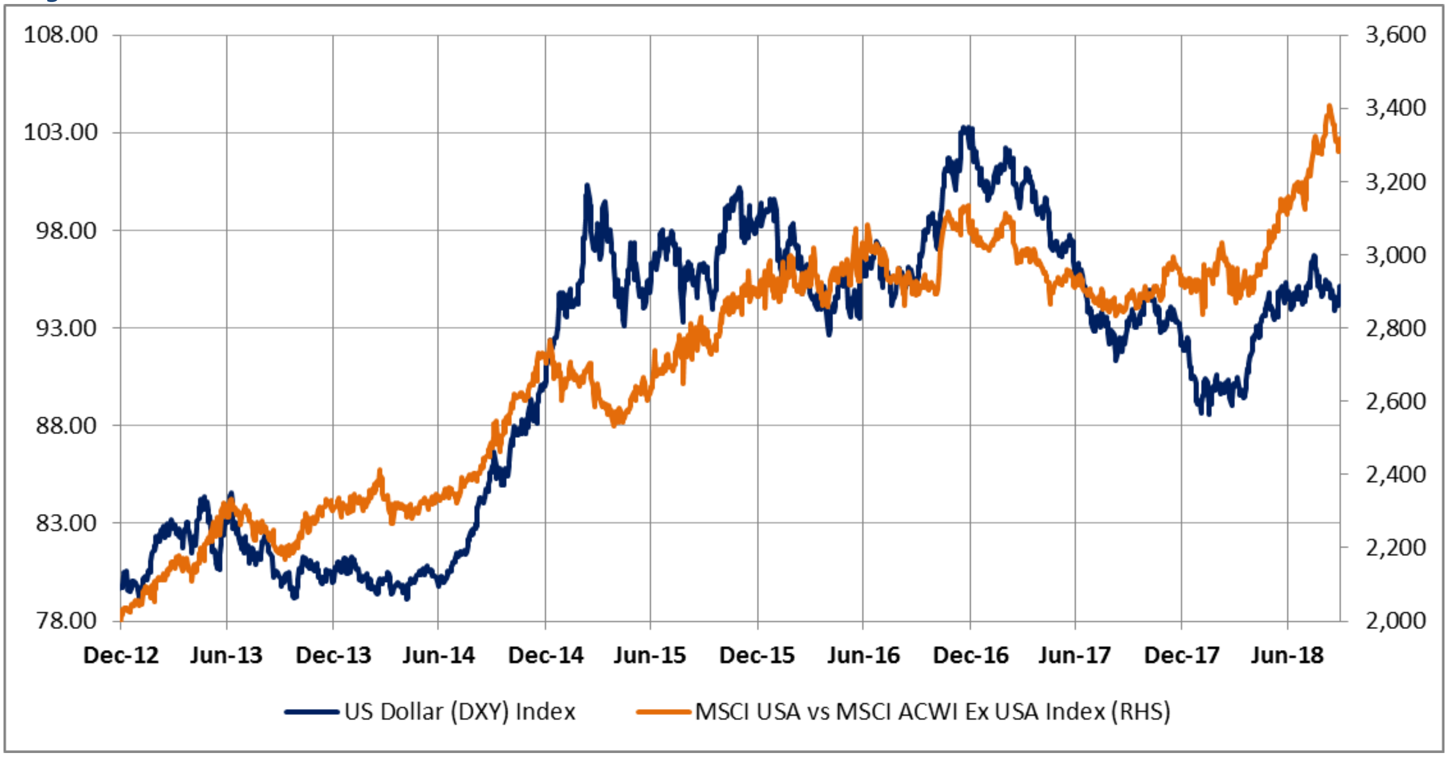
Source: Bloomberg

▪ Rising likelihood of a moderation in the Trump Administration's pitch level with regard to additional protectionist trade policies to adopt vis-à-vis China as the US November mid-term elections come to pass. As is well known, a majority of Republican congressional members do not share President Trump's position on the use of trade tariffs. It is clear that this year's trade war rhetoric sponsored the strengthening of the U.S. Dollar as the US economy is largely closed with comparison to the Eurozone region, by a factor of 3 as measured by traditional trade openness ratio indicators.

From a macro factor perspective, the U.S. Dollar exerts considerable importance on the relative return performance between U.S. and International equities. For example, Figure 8 illustrates the close positive and contemporaneous nexus between U.S. equities' relative return performance versus non-US equities and the U.S. Dollar index so that U.S equities underperform non-US equities during periods of U.S. Dollar declines (such as the period between 2000 and 2010) with the converse for the period ranging between 2010 and the present. That is, the post 2010 US equities' outperformance of international equities has obtained along a strengthening US Dollar.

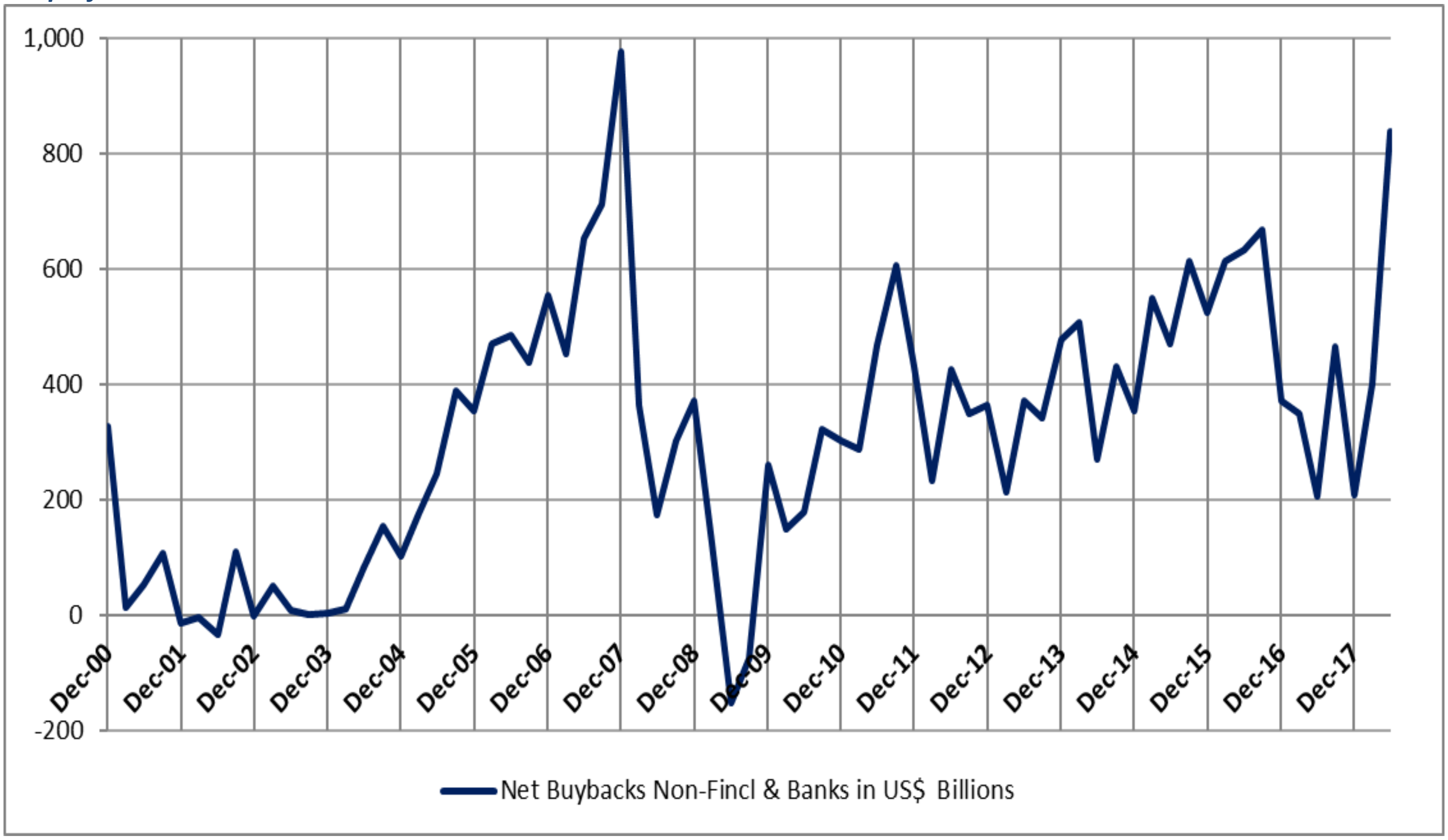
Besides the impact of a strengthening US Dollar these past several years, our investment team attributes the past several years' US equities' outperformance versus international peers to another factor: the massive amount of share buybacks conducted by US equities, funded largely via debt issuance –of close to 500 billion USD per year (Figure 9). That the practice of massive share buybacks represents mainly a US only affair, not present in Europe or Japan at US comparable levels, further raises the potential for US equities to underperform international equity peers over the coming years given (a) the considerably more indebted US corporate balance sheets that have resulted from the issuance of US debt to fund buybacks as well as (b) the rise in the cost of US debt capital.

Figure 8. Nexus between U.S. Dollar Index and Relative Performance between U.S. Equities and Non-US Peers over the Long Term



Source: Bloomberg and Glovista Calculations

Figure 9. Corporate Share Buybacks, Largely a U.S. Only Affair, as Major Supportive Factor to US Equities Outperformance Vs. Non-US Peers since 2010



Source: Bloomberg

Glovista Sustains Solid Equities Exposure on Economic Momentum, Relative Valuations versus Bonds, and Seasonality

We maintain a constructive stance towards global equities, with a heightened emphasis on international value stocks. Our stance reflects a number of considerations outlined below:

- Our expectation of minimal recession risk facing the global economy prior to 2020, in the absence of geopolitically driven dislocations to the global production chain – e.g. Middle East war, China conflict with the US or major terrorist attack.

- Equities' cheap relative valuations versus bonds. Global equity valuations are approximately in line with multi-decade average levels while bond yields hover close to 300 basis points below long-term average levels. Figure 10 illustrates equities' attractive yield levels versus bonds even without accounting for the significant low levels of realized equity volatility versus bonds'.

Figure 10. Equities' Relative Valuations versus Bonds, Attractive: Earnings Yield versus Bond Yield Differentials

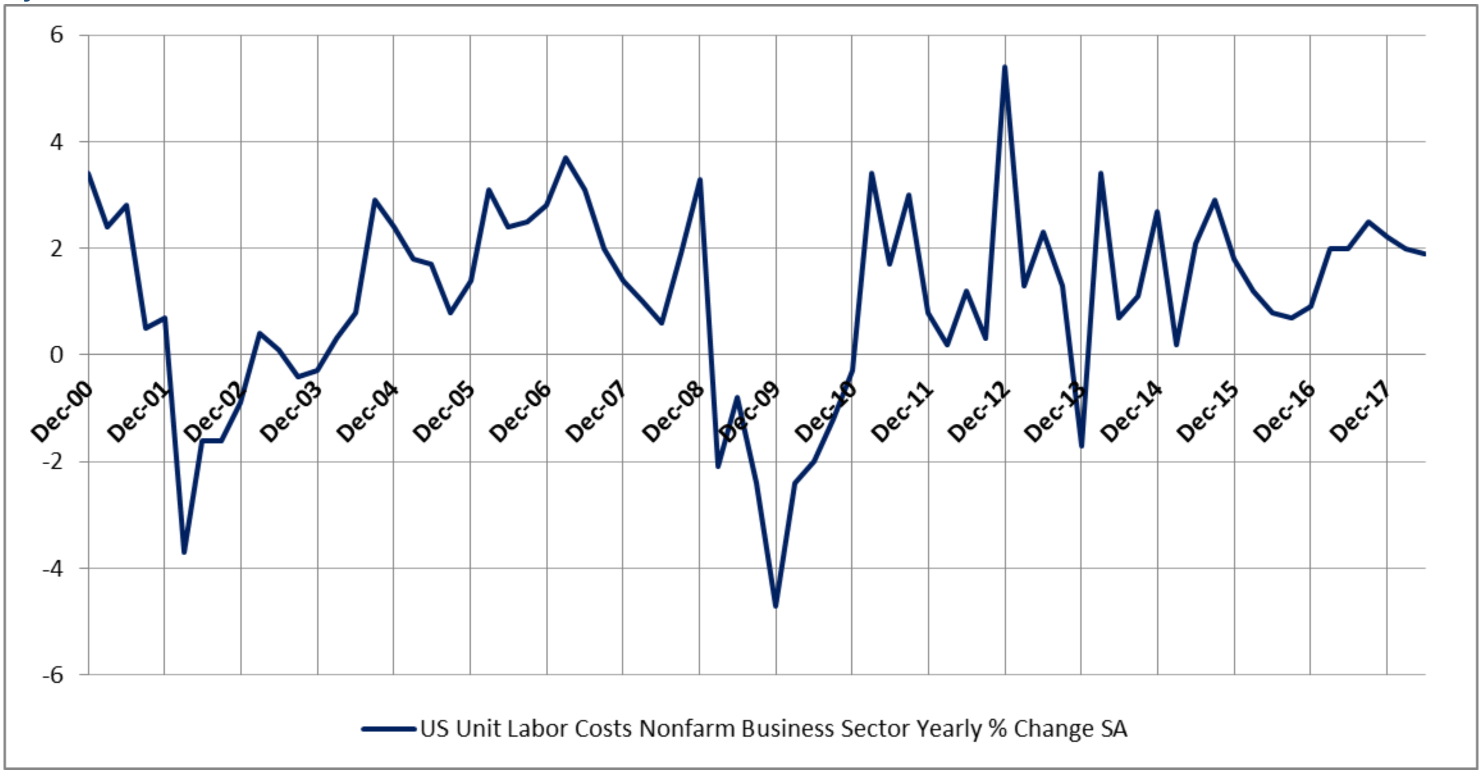
Source: Bloomberg and Glovista Calculations

- Growing signs the rhetoric surrounding the year-to-date trade war dynamic is likely to abate as we approach the US November elections.

- Continued well-behaved inflation momentum in the USA and other major economies – see e.g. Figure 11 for the unchanged momentum in US unit labor cost growth.

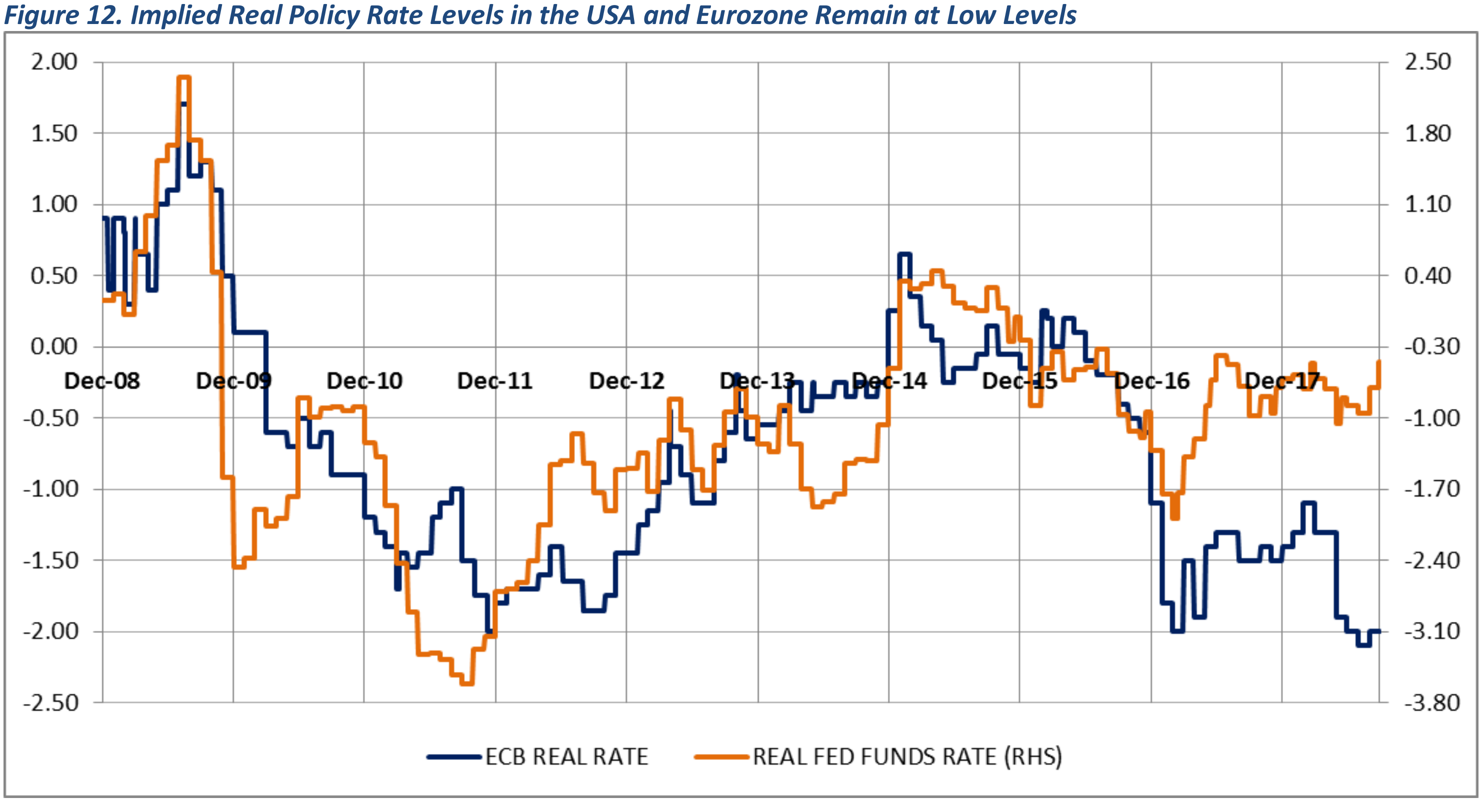
- Continued low implied real yield levels on government debt paper in the Developed economies, an equity market friendly backdrop – see e.g. Figure 12.

Figure 11. U.S. Unit Labor Costs Year-on-Year Growth Rate Remains Unchanged versus Multi-year Average Levels: Absence of Inflation Pressures



Source: Bureau of Labor Statistics

Figure 12. Implied Real Policy Rate Levels in the USA and Eurozone Remain at Low Levels



Source: Bloomberg

Glovista Raises International Value Stocks Exposure; Bond Allocations Remain Underweight; US November Elections and International Trade Environment Remain Risk Factors to the Outlook

We remain constructive towards the equities asset class on account of the various considerations laid out in the above section. Our exposure to fixed income markets remains centered on short duration plays given the lack of value at the long end as well as the US FED's continued rate hike stance.

In equities, from a style perspective, over the past several weeks we have trimmed exposure to growth stocks (especially US IT sector) and raised exposure to international value stocks. We have implemented such rebalancing actions on the back of several considerations, including the following:

- Our expectation of US Dollar topping process;
- Our expectation of a narrowing in GDP growth differentials between the US and the rest of the global economy as a result of the fading of US growth momentum – following the introduction of the large Trump fiscal stimulus measures earlier this year;
- Investor positioning, with strong underweight positioning to value, including Emerging Markets and EAFE;
- Expectation of further normalization in long-term real government bond yield levels, a supportive backdrop for value stocks;
- Incipient signs of a shift in investor sentiment, including iconic stocks such as Tesla and Netflix.

Of course, equities' constructive outlook is subject to a number of risk factors, including the potential for:

- Central bank policy mistakes in the form of additional rate hikes beyond what interest rate sensitive sectors are able to withstand before entering into contraction;
- Further deterioration in the international trade environment, owing to protectionist policies;
- Supply shock impacting the energy markets, of importance to the production sector of the global economy – perhaps triggered by geopolitical events.

Glovista Emerging Markets Perspectives

EM Value Trumps Growth as Phase 2 of US China Import Tariffs Take Effect and Crude Prices Edge Higher; Glovista Further Raises Value Tilt at Country and Sector Levels

In September, Emerging Market equity prices marginally underperformed Developed Market peers as two of the largest benchmark constituents – China and India – were adversely impacted by specific developments. Specifically, Chinese equity prices came under selling pressure during the month as the US Trump administration implemented phase 2 of its import tariff measures against China, consisting of a 10 percent tariff (that may rise to 25 percent in January 2019) introduced in late September on US $ 200 billion of Chinese imports. There remains the potential for a phase 3 to be implemented at a future undefined date, consisting of a 25 percent tariff to be applied on another US $ 267 billion of imports.

As for Indian equities' sharp price sell-off during the month, the adverse market performance was fueled by Indian Rupee currency weakness – partly impacted by the breakout in world energy prices – as well as an unexpected credit event – ILFS' (an infrastructure financing arm owned by state owned enterprises) default on short-term debt obligations. Outside these two major EM country index price developments during the month of September, a number of Emerging Market country indices recorded solid outperformance versus Developed peers. We view said price divergence as a bullish sign for the EM asset class on a prospective basis.

As we look ahead, we hold a bullish outlook towards the EM asset class notwithstanding the potential for continued volatility stemming from ongoing trade tensions between the US and China. Our bullish asset class outlook reflects a number of considerations, including the following:

- Incipient signs of a firming in China's economic momentum following the recent soft patch period fueled by the imposition of import tariffs by the US. Specifically, over the past several weeks the People's Bank of China has introduced a number of cuts in reserve requirement ratio levels while fiscal authorities have announced over the past several days a round of tax cuts to be introduced in short order. Moreover, the year-to-date Chinese Renminbi currency weakness is expected to result in an acceleration of economic momentum during the fourth quarter. In fact, a number of monetary aggregates – particularly the relative growth momentum between M1 and M2 - is statistically suggestive of an upcoming cyclical acceleration;

- Historically, Chinese (and also Emerging Market) equities' relative return performance versus US equities is tied to the relative economic growth momentum between the two. In our view, the US economy's year-to-date growth dominance versus the rest of the world has been the result of two non-recurrent factors – (a) the introduction of the massive tax cuts and government expenditure increases by the Trump administration earlier this year and (b) the economic growth deceleration exerted on a number of Emerging Market countries following the sharp - and statistically difficult to recur in short order – currency depreciations that obtained earlier this year following the introduction of US import tariffs and FED policy rate hikes (with a number of additional rate hikes in 2019 already priced into the Eurodollar curve). As these non-recurrent factors fade, over the coming months US economic growth momentum versus China and the rest of the Emerging Markets is likely to weaken, in our view.

- EM equity valuations are trading at exceedingly cheap levels both in absolute and relative terms versus Developed peers; for example, EM equities P/BV multiples are trading close to a 55 percent discount to US equities, a considerably larger discount than historical average levels in the vicinity of 30 percent.

- Investor positioning towards Emerging Market equities is exceedingly light on a historical basis, a contrarian bullish condition.

Within the Emerging Market universe, in September we have further raised exposure to value-oriented markets owing to the following considerations:

- Our expectation for a reversal of the strength recorded by the US Dollar during the year-to-date period. Under such scenario, value oriented markets – particularly, commodity exporting – are likely to record return outperformance versus the EM benchmark;

- North Asian markets' vulnerability to technology sector slowdown in the face of growing concerns over the sustainability of the memory market strength of the past several years;

- The rally in energy prices, supported by improving demand-supply fundamentals along with energy stocks' cheap relative valuations versus crude prices on a historical basis;

- Under-owned investor status with regard to a number of long-term attractive value oriented markets, such as Brazil – a market that has witnessed large investor outflows these past several months on the back of concerns surrounding the outcome of the upcoming October presidential elections. We believe that current Brazil equity valuations discount such event risks rather materially.

As per the above considerations, we currently favor overweight country allocations to Brazil, Russia, Chile, Mexico and Malaysia. We also hold a modest overweight allocation towards China equities, on a tactical basis. Much of our underweight allocations are centered in Taiwan, Korea and India and South Africa.

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