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GLOVISTA INVESTMENTS

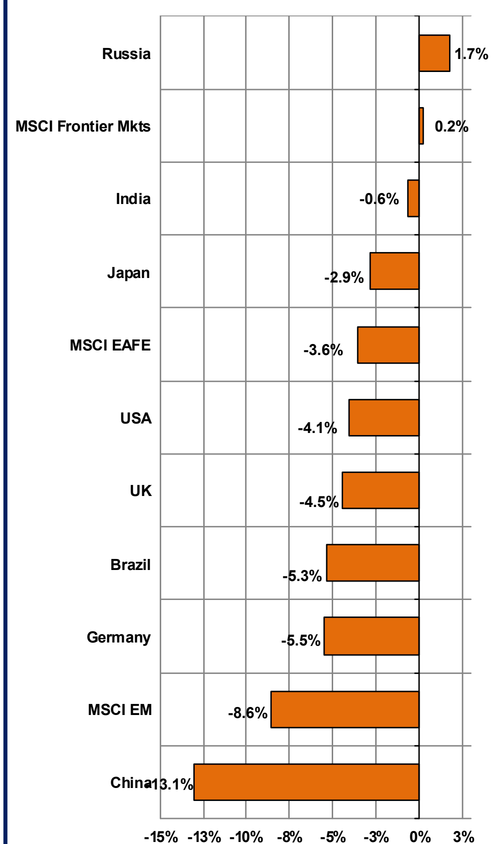
Glovista Global Perspectives

This Issue:

Risk Assets Sell Off on Significant Decline in Global Activity Momentum and Increased Risk Premium on Disrupted US-China Trade Discussions; Glovista Further Tightens High Quality Equities Tilts, Raises Cash Levels and Buys Gold

In May, risk assets have recorded the largest price declines since the sharp December 2018 sell-off. For example, Figure 1 illustrates the close to 4.1 percent May monthly price decline recorded by global equity prices – as represented by the MSCI ACWI index as well as the close to 6 percent monthly decline for the broad US equity index comprised of the Value Line index constituents. In addition, owing to the central role exerted by the aborted US-China trade discussions in the recent global sell-off, emerging market equity prices have been impacted disproportionately during the month, recording a close to 8.5 percent for the month.

Country-wise Monthly Performance in USD terms (May 2019)*



Source: MSCI & Bloomberg

**As of May 24th, 2019*

Aborted US-China Trade Discussions and Weakening of Activity Indicators, including in the USA, Fuel Sharp Sell-off in May

We attribute the May sell-off in global risk markets to two principal factors:

- The US Trump administration's decision to effectively abort US-China trade discussions. Trade discussions came to a halt on May 6th 2019. Such decision has unleashed investor expectations over the growing prospects of a protracted trade war between the world's two largest economies, adversely impacting important sectors of the global economy, including technology. Should no trade agreement be reached later this year, increasingly the baseline case embraced by most investor groups, and the US government proceed with the application of 25 percent import tariffs on an additional US $ 310 billion of Chinese imports, the impact on US core PCE inflation may be in the order of + 50-75 basis points while the impact on US GDP growth may amount to – 50 basis points. Larger order effects are possible, through second order business and consumer confidence effects.

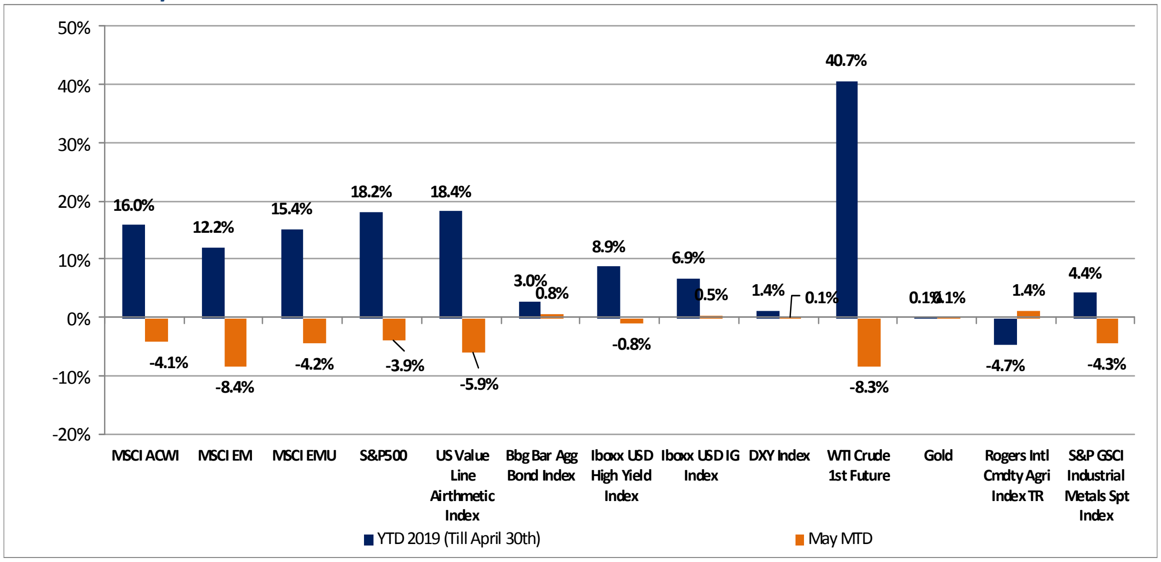
S&P500 Monthly Sector Performance – May MTD 2019*

Sectors	% Change	FY1 PE Ratio
Energy	-7.59%	16.7
Materials	-6.53%	16.2
Industrials	-5.76%	16.1
Cons Disc	-5.56%	20.7
Cons Stap	-0.47%	19.8
Technology	-7.12%	19.2
Healthcare	0.06%	15.5
Financials	-4.42%	11.9
Utilities	1.39%	19.2
Telecom	-3.05%	17.1
Real Estate	1.76%	41.1
S&P500	-4.07%	17.0

**As of May 24th, 2019*

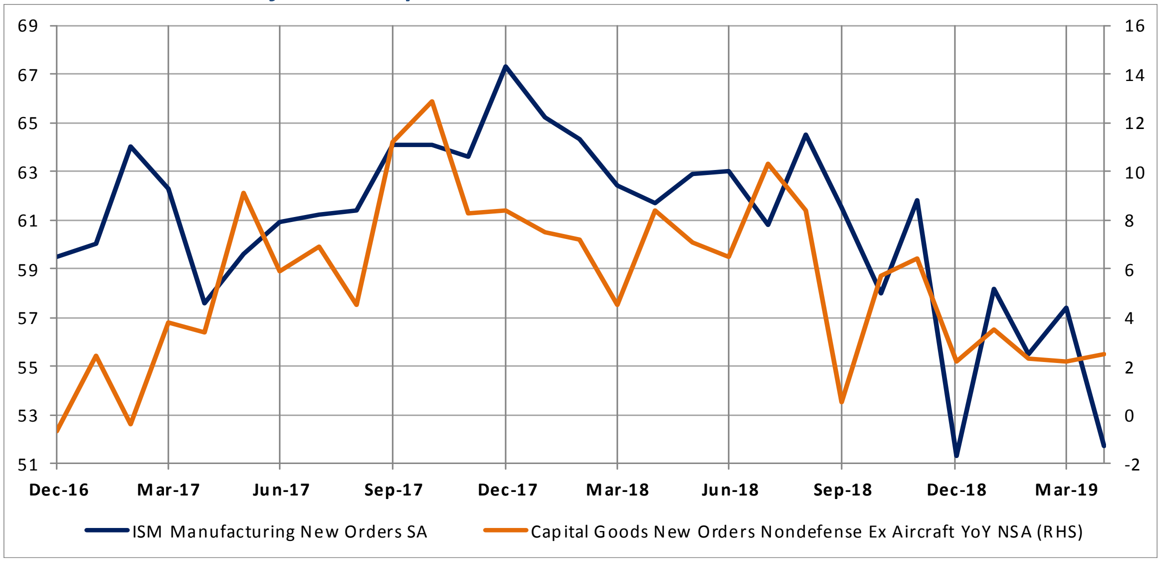
Source: Bloomberg

Figure 1. May Brings About the Largest Risk Asset Price Declines since the December 2018 Market Collapse



Source: Bloomberg

Figure 2. April US Manufacturing New Orders Index Declines to Low Levels; Similar Year-on-Year Growth Declines for Core Capital Goods New Orders

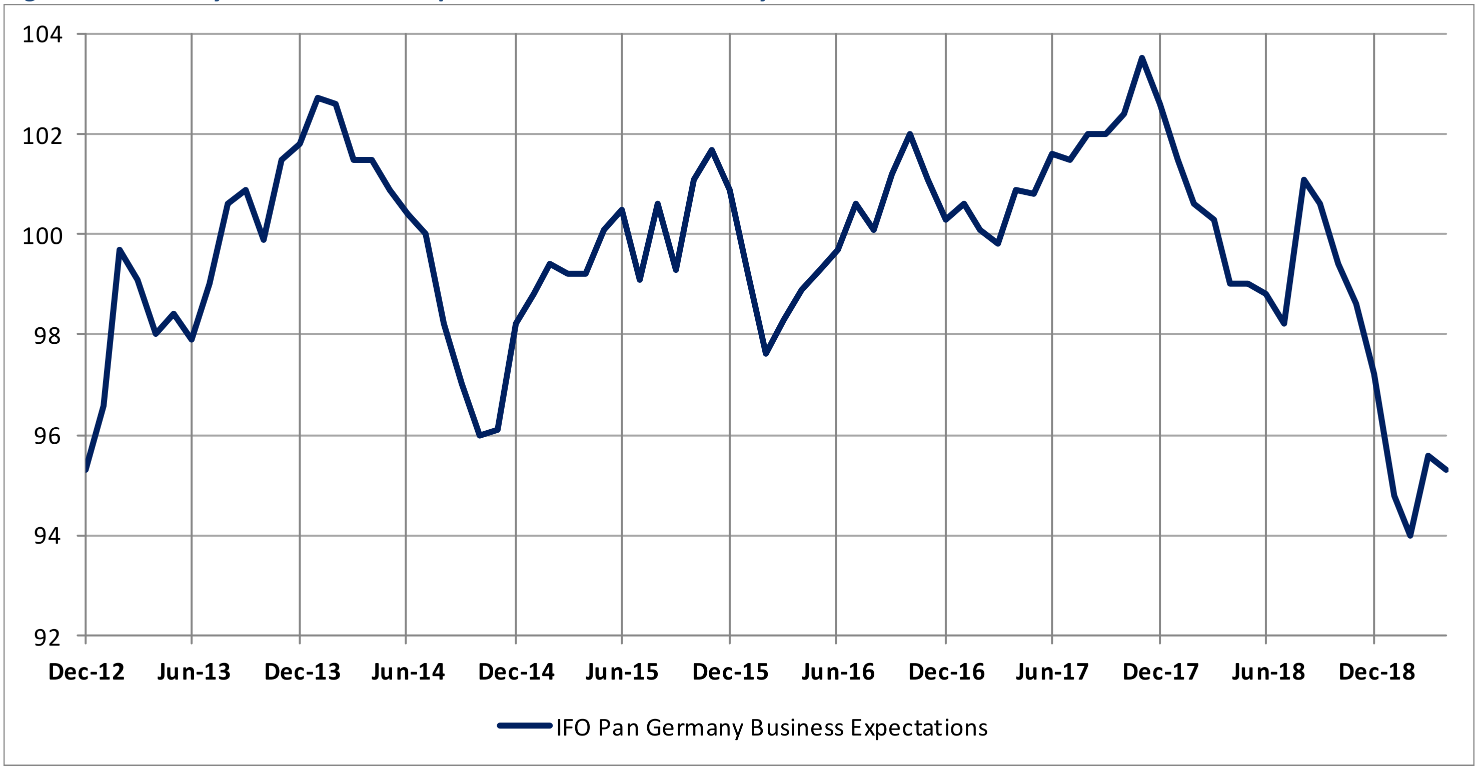


Source: Institute of Supply Management & US Census Bureau

- Broad deceleration in economic activity momentum across some of the world's largest national economies, including the US and Germany. For example, Figure 2 illustrates the sizable decline recorded in US manufacturing Markit PMI new orders and core capital goods orders (on a year-on-year basis) while Figure 3 illustrates the sustained decline in Germany's IFO business expectations index. The deceleration in activity momentum at a global level is also evidenced across the service and manufacturing sector domains, as illustrated in Figure 4.

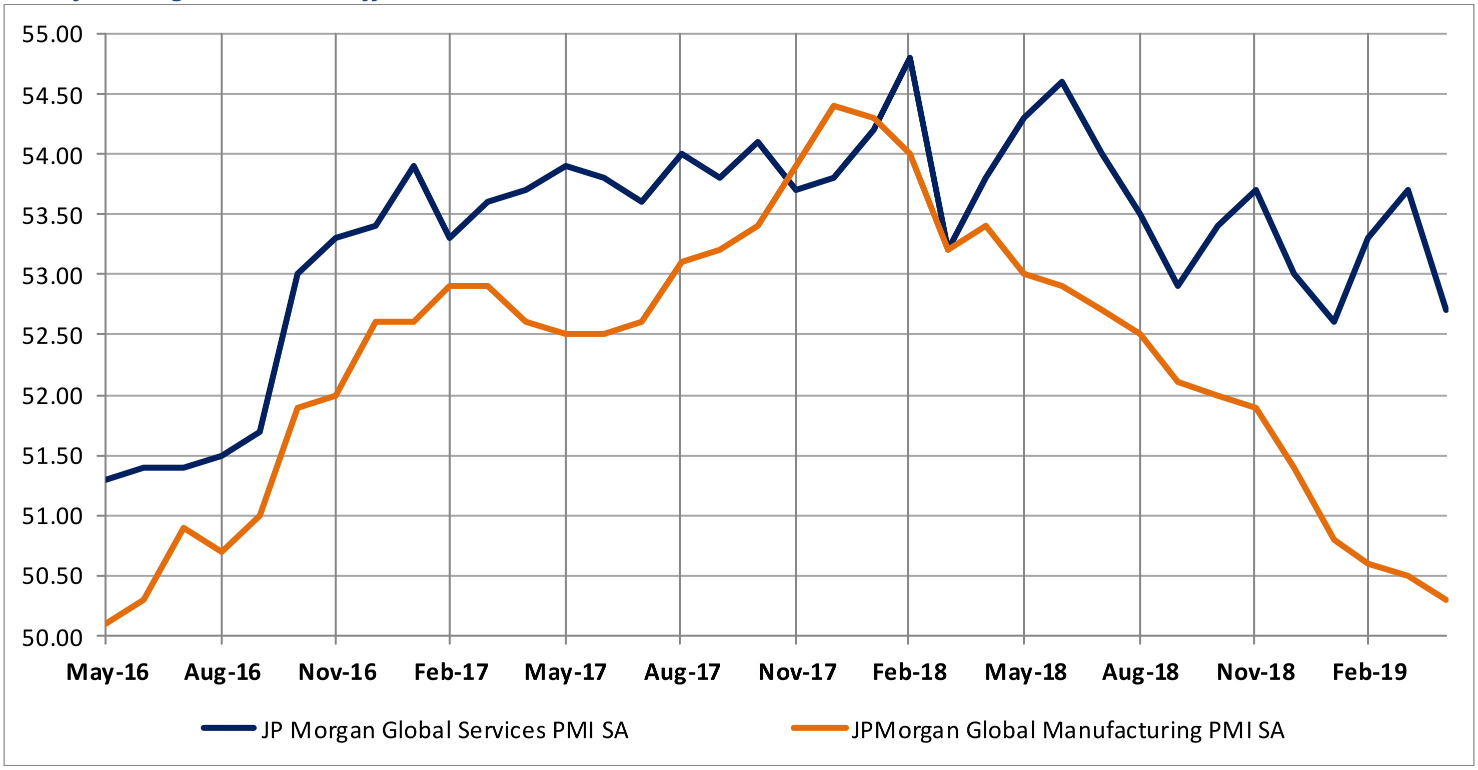
The deceleration of global economic growth momentum at the same juncture in which risk premium levels have spiked – courtesy of the aborted China-US trade discussions as well as the US Trump administration's decision to raise military alertness levels with Iran – carry unambiguously adverse implications on risk asset prices through two different channels: downward revisions to economic (and earnings) expectations, and lower valuation multiples on risk assets.

Figure 3. Germany's IFO Business Expectations Hover at Multi-year Low Levels



Source: IFO Institute

Figure 4. Slowing Global Activity – across Goods and Service Sectors – Evident in Recent Declines in JPMorgan Global Manufacturing and Service Diffusion Indices



Source: Markit

	May 24th 2019	May MTD Change
Gold	1284.75	0.1%
Silver	14.5675	-2.6%
Oil	58.63	-8.3%
EUR	1.1203	-0.1%
JPY	109.31	-1.9%
GBP	1.2714	-2.4%
CHF	1.0022	-1.7%
CAD	1.3437	0.4%
AUD	0.6927	-1.7%
BRL	4.0299	2.7%
MXN	19.0517	0.6%

Source: Bloomberg

Rates	May 24th Level
1 Yr CD	1.53%
5 Yr CD	1.96%
30 Yr Jumbo Mortgage	4.16%
5/1 Jumbo Mortgage	3.65%
US Govt. 10 Year	2.3202%
10 Yr Swap Spread	-5.31%

Source: Bloomberg

Figure 5. US Inflation Expectations Decline to December 2018 Levels following Underwhelming Global Economic Calendar and Spike in Risk Premium Levels

Source: Bloomberg

An additional development further reinforcing the month of May's decline in risk asset prices stems from the fall recorded in inflation expectations despite the support on crude prices normally resulting from a spike in geopolitical risk levels (in light of the recent escalation of US military alertness levels with Iran). Figure 5 illustrates the significant decline in US inflation expectations these past several weeks, approaching December 2018 levels while Figure 6 highlights the decline recorded in crude prices these past two weeks despite the support normally expected to result from growing tensions between the West and Iran.

Figure 6. Crude Prices Record Sharp Declines in May Despite Spike in Geopolitical Risk (Iran tensions)

Source: Bloomberg

As we look ahead at the economic outlook, we continue to embrace a baseline scenario in which economic recession will be averted this year. However, it is clear that the magnitude of downside risks to the outlook have risen markedly owing to the aborted US-China trade discussions and the ensuing likelihood of a protracted trade war period between the world's two largest economies. Such increased downside risks underpin the rationale behind our managed portfolios' positioning, discussed immediately below.

Against Heightened Downside Risks to the World Economic Outlook, Glovista Further Reaffirms Overweight Tilts to High Quality Equities, Short-term US High Grade Paper and Gold

Against the macro backdrop delineated above, one in which risks of further disinflation coexist with lower rates of economic activity momentum, the Glovista investment team has further tightened our managed portfolios' overweight tilts to quality equities, including US consumer staples and healthcare, as well as short-dated US high grade debt paper and gold commodity.

As we look at the upcoming weeks, the calendar is bereft of potentially positive catalysts, other than a likely meeting between US President Trump and China President Xi at the upcoming June G20 Summit meeting in Japan. The US corporate earnings season looms further behind in the calendar while the direction of FED and ECB monetary policy is unlikely to change, absent material weakness in risk markets.

Emerging Markets Perspectives

Aborted US-China Trade Talks in Early May Jolts Global Markets, Especially North Asia EM Bourses; Glovista Further Raises Value-Oriented Country Overweight Allocations

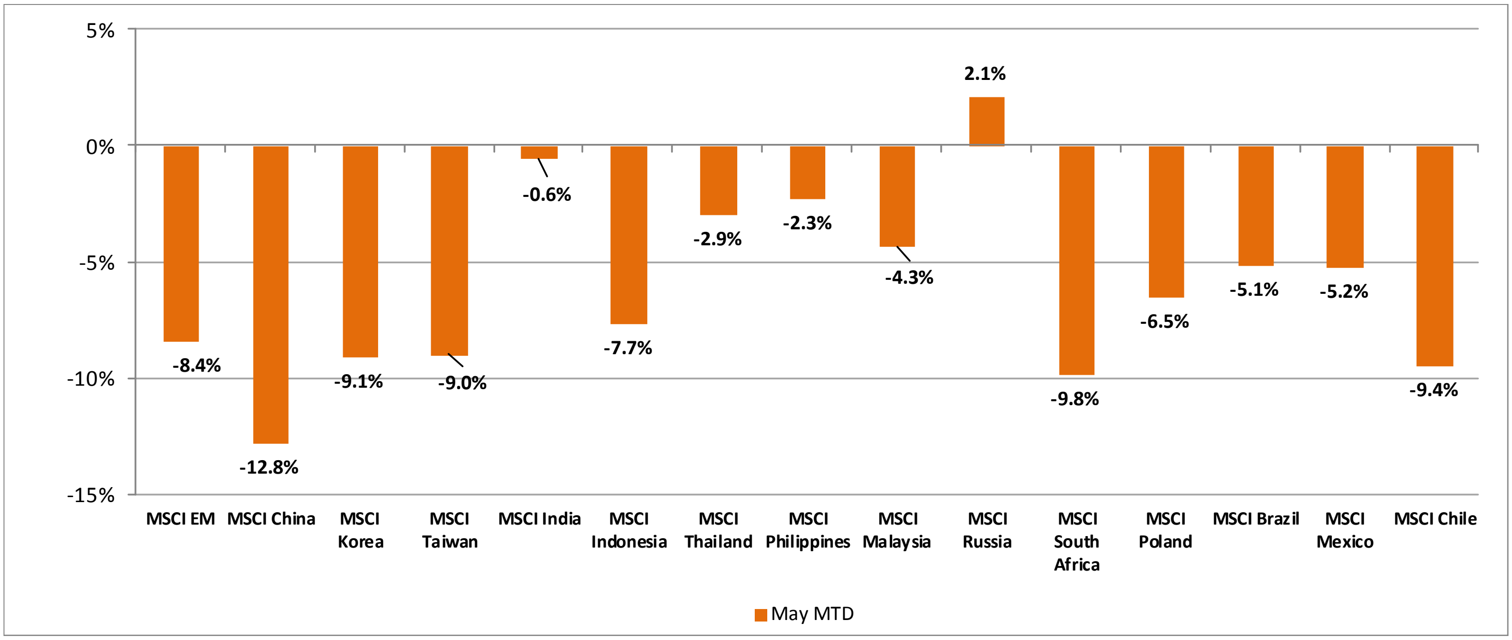
It should come as little surprise that Emerging Market equities has been the most adversely impacted asset class by the disruption in US-China trade discussions given that China, Korea and Taiwan (the latter two as key elements of the China manufacturing supply chain) comprise close to 55 percent of the Emerging Markets equities universe, as represented by the MSCI EM benchmark. Figure 7 illustrates the May 2019 month-to-date return performance for each of the largest 15 national market index constituents of the MSCI EM universe.

The timing of the aborted US-China trade talks comes at a juncture in which earnings revision momentum across most of the largest EM country bourses has been edging higher during the 2019 year-to-date period along with the tailwind afforded by the US Federal Reserve's announcement earlier in the year of no additional rate hikes over the intermediate horizon.

Against such backdrop, at a macro level, an assessment of the EM and China economic implications stemming from (a) the disrupted trade talks between the US-China, along with (b) the escalation of US import tariffs levied on Chinese exports, must recognize the role exerted by direct and indirect effects as well as a handicapping of the odds of a trade agreement later this year. As for the latter, we defer on the conclusions reached by seasoned political analysts who currently handicap the odds of a meaningful trade agreement later this year at less than 30 percent probability. As for the former mentioned dynamic, we estimate the impact from a 25 percent US import tariff levied on the totality of imports from China (around 500 billion US$) to be at most 0.5 percent detraction from Chinese annual real GDP growth this year and another 0.5 percent next year. Such detraction amounts to less than 10 percent detraction from running annualized real GDP growth.

Of course, the role of investor sentiment, including corporate spending levels globally, stemming from the escalation of trade frictions could further exacerbate the global and also China economic growth deceleration resulting from the current state of affairs. Notwithstanding such potential dynamics, we remain constructive towards the outlook, in terms of ultimate GDP growth detraction amounts not deviating materially from first order, direct effects. We hold such view because, at this juncture, global credit conditions remain exceedingly loose – partly courtesy of recently reinforced dovish orientation embraced by the US Federal Reserve this past month of January – and also out of China, anchored by a succession of cuts in reserve requirement ratios along with the introduction of meaningful fiscal policy stimulus measures (tax cuts, government infrastructure expenditure increases). Moreover, this past Sunday's parliamentary election results in Europe should help allay investor fears following clear victory by pro-European groups, with minimal gains made by nationalist groups.

Figure 7. China, Korea and Taiwan Equities Disproportionately Impacted by the Disruption in US-China Trade Discussions since Early May



Source: Bloomberg & MSCI

Against the consequential developments unfolding during the month of May, the Glovista investment team has reinforced its portfolios' overweight tilts towards value-oriented markets – including Indonesia, Philippines, India, Poland and Brazil – funded by further cuts in our exposure to north Asia markets including Taiwan and Korea. Moreover, our China market exposure has been cut to a modest underweight with the most significant rebalancing taking the form of a rotation into domestic sector stocks (A share market) given that sector's higher insularity vis-à-vis the imposition of US import tariffs. Our decision to raise India country exposure also reflects the heightened visibility of market-oriented reforms to be sponsored by a new Modi government over the medium-term following his strong mandate won at the May elections.

Of course, the outlook is subject to a number of important risk factors, including: the potential for geopolitical conflict (e.g. Iran-US, US-Venezuela); a scenario in which the US Federal Reserve finds the need to reinstate a hawkish stance later this year should the inflation pass-through resulting from the imposition of additional China import tariffs is higher than expected; heightened Eurozone sovereign risk levels should tensions escalate between Brussels and Rome surrounding the upcoming 2020 Italy budget deliberations. As stated above, such risk factors are considerably diminished by the overly loose credit conditions globally, reflected in the exceedingly low real (inflation adjusted) interest rates across most developed markets.

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