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Monthly Market Newsletter

GLOVISTA INVESTMENTS

Glovista Global Perspectives

This Issue:

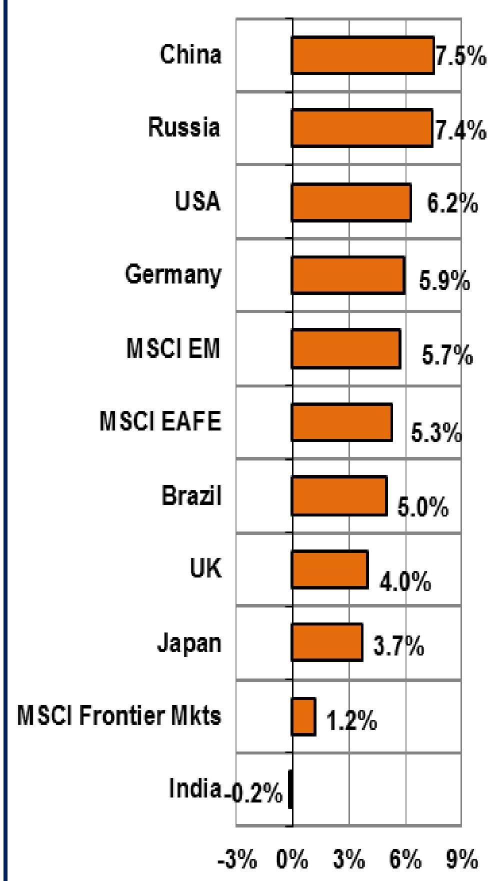
Risk Markets Bounce as FED Confirms Start of Rate Cut Cycle and ECB Signals Further Stimulus Against Soft Macro Calendar; Glovista Sustains Cross-Asset Class Tilts, Raising Non-US Exposure as US$ Cycle Likely to Turn Lower

In June, risk markets have bounced strongly following the generalized market sell-off that unfolded during the month of May. Figure 1 illustrates the June month-to-date return performance across a number of major risk indices, cutting across the equities and fixed income divides. The rally in risk markets has unfolded despite below consensus readings across a number of economic activity indicators, particularly in the goods sector – as illustrated in Figure 2.

We attribute the sharp bounce in risk indices during the month of June to the US Federal Reserve's confirmation of its decision to initiate a rate cut cycle, likely to begin at the July 31st meeting, thus marking the end of the policy rate hike cycle that began in December 2015. Specifically, at its scheduled June 19th meeting, the US Federal Reserve provided the rationale behind an imminent start of a rate cut cycle based on a continued deceleration in economic growth these past several months along with the absence of inflationary pressures. In fact, at the scheduled meeting, FOMC directors updated their economic projections (the so-called "Fed dots") for this year and next, in the direction of moderately higher economic growth and lower inflation pressures. Moreover, almost half of the FOMC directors viewed as justifiable a 50 basis points cut in the reference Federal Funds rate this year. Figure 3 illustrates the shift in the FOMC dot plots (inflation and GDP growth) between the last meeting and the June meeting.

The same week as the US FED meeting also witnessed a momentous European Central Bank meeting at the conclusion of which ECB President Draghi provided a similar rationale for an imminent increase in monetary stimulus. A few days later, the Bank of Japan (the world's third largest) further reinforced its commitment to maintain soft liquidity conditions given the challenging global economic environment, impacted by continued US-China trade frictions.

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



Source: MSCI & Bloomberg

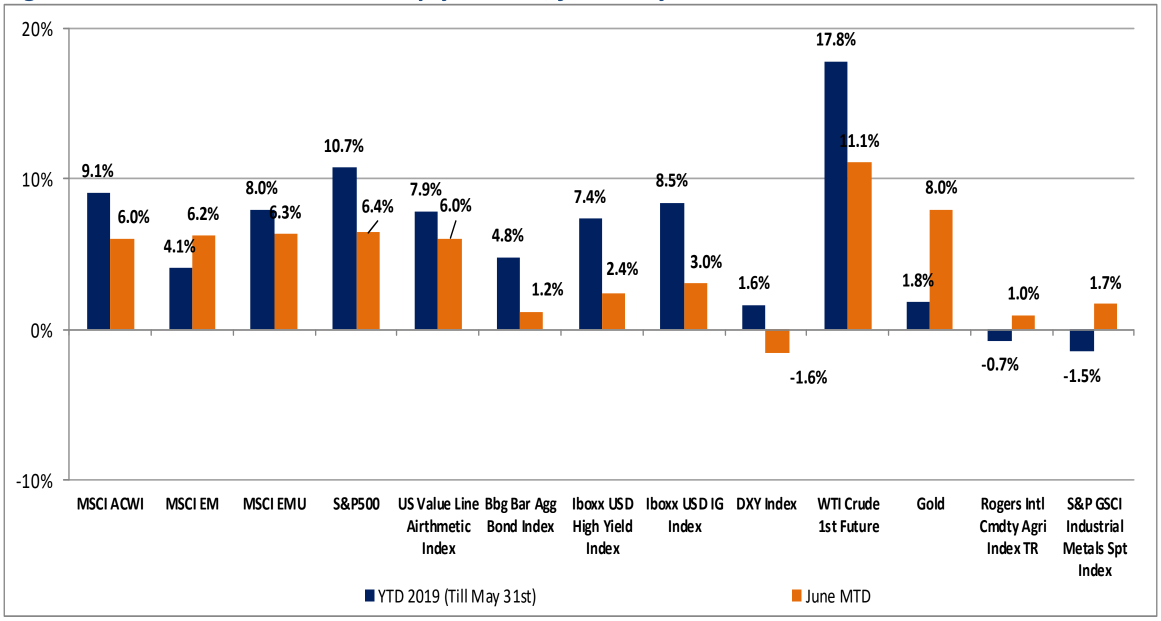
**As of June 27th, 2019*

S&P500 Monthly Sector Performance – June MTD 2019*		
Sectors	% Change	FY1 PE Ratio
Energy	7.78%	17.9
Materials	10.54%	18.3
Industrials	6.71%	16.8
Cons Disc	7.36%	21.6
Cons Stap	4.74%	19.9
Technology	8.90%	20.5
Healthcare	6.11%	16.0
Financials	5.09%	12.2
Utilities	2.56%	19.2
Telecom	3.45%	17.2
Real Estate	0.96%	39.8
S&P500	6.28%	17.6

*As of June 27th, 2019

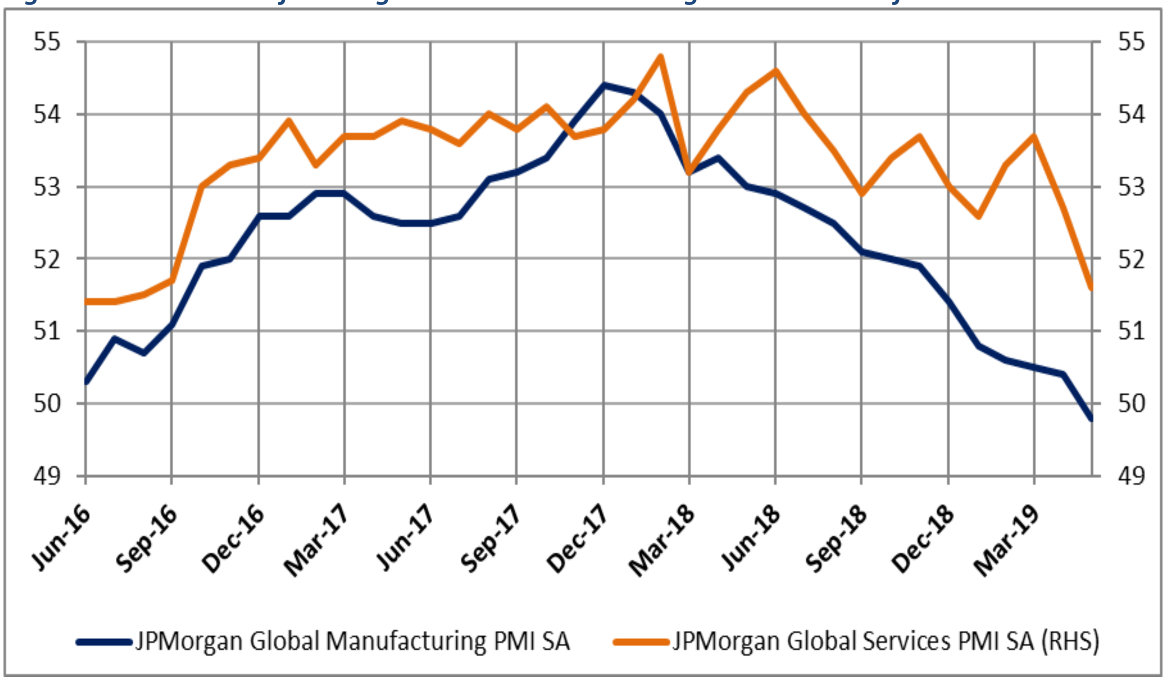
Source: Bloomberg

Figure 1. Risk Indices Bounce Sharply in June, fueled by Dovish G3 Central Bank Guidance



Source: Bloomberg

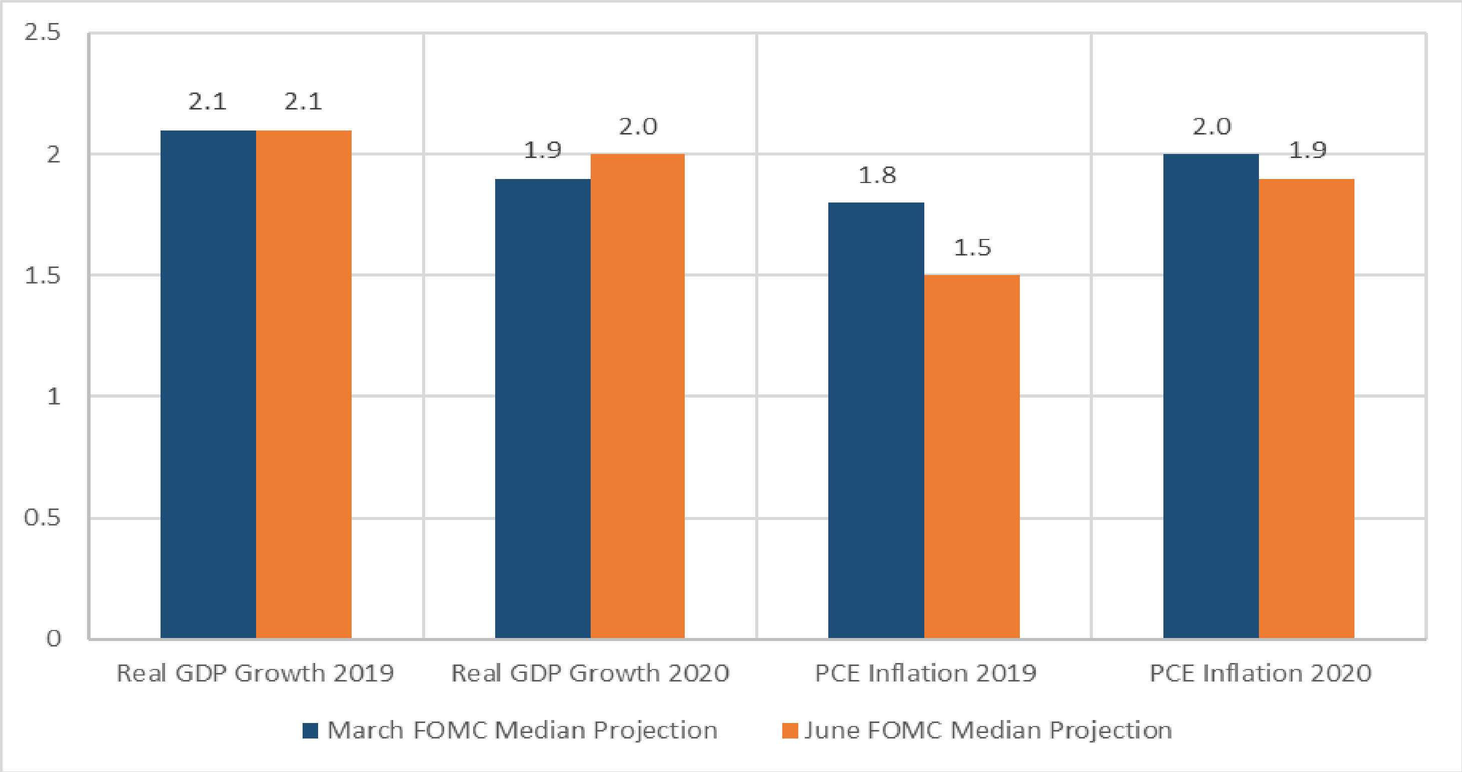
Figure 2. Global Manufacturing and Service PMI Readings Continue to Soften in June



Source: Markit

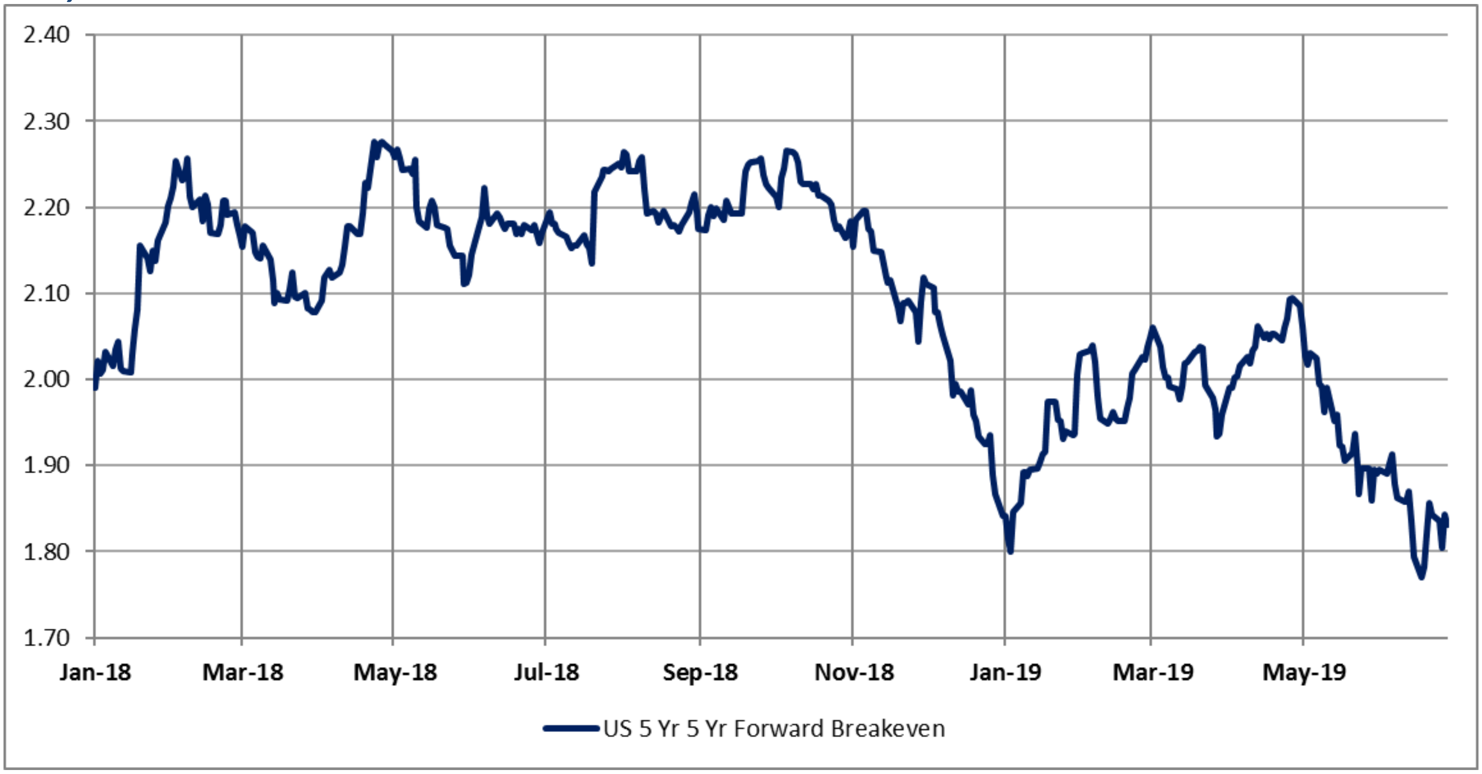
A common factor impacting the Federal Reserve's and ECB's decision to reverse policy rate direction and further cut policy rate levels emanates from the absence of inflationary pressures, as illustrated by the considerable deceleration in inflation expectations levels these past several months (Figure 4).

Figure 3. June FOMC Meeting Encompassed a Dovish Tilt in FED (Growth and Inflation) Growth-Inflation Dots



Source: FOMC

Figure 4. US Inflation Expectations Weaken Markedly since late April Period, Impacting FED's Disposition to Initiate Rate Cut Cycle



Source: Bloomberg

Recent Expenditure Indicators Point to Resilience in Global Demand Conditions thru the Recent Period of Steady Declines in Economic Sentiment Readings

	June 27th 2019	June MTD Change
Gold	1409.79	8.0%
Silver	15.2605	4.7%
Oil	59.43	11.1%
EUR	1.1369	1.8%
JPY	107.79	-0.5%
GBP	1.2674	0.4%
CHF	0.9766	-2.4%
CAD	1.3095	-3.1%
AUD	0.7009	1.0%
BRL	3.8202	-2.6%
MXN	19.1785	-2.2%

Source: Bloomberg

Rates	June 27th Level
1 Yr CD	1.58%
5 Yr CD	1.95%
30 Yr Jumbo Mortgage	4.17%
5/1 Jumbo Mortgage	3.69%
US Govt. 10 Year	2.014%
10 Yr Swap Spread	-6.00%

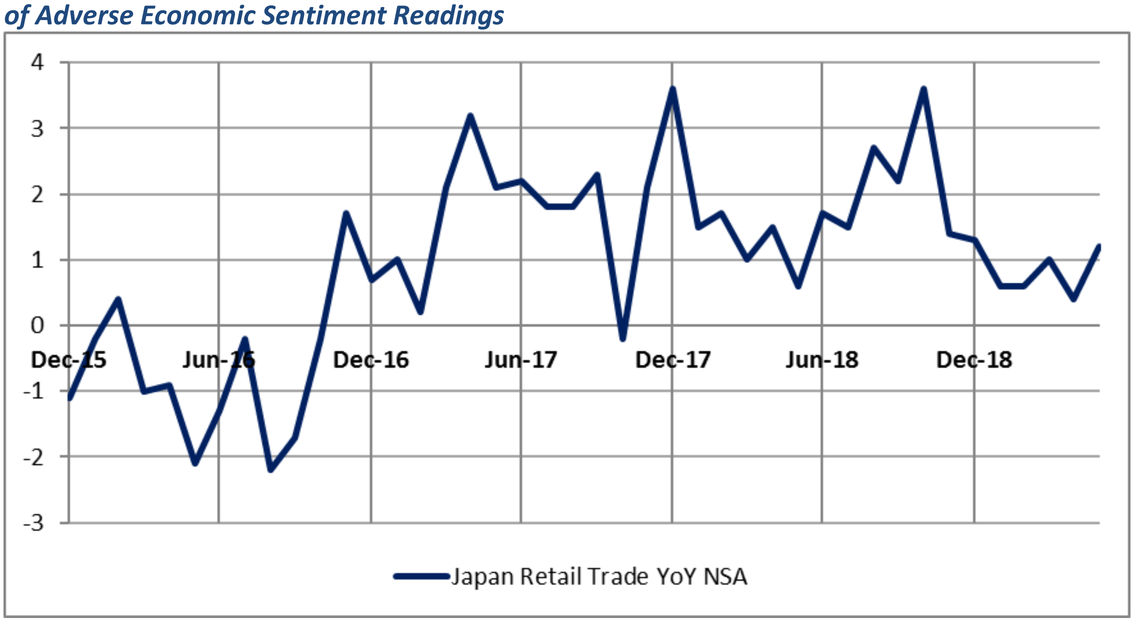
Source: Bloomberg

As we review the global economic calendar over the past several weeks, we find an interesting contrast between so-called soft indicators (that include primarily sentiment diffusion indices, capturing consumer and service as well as manufacturing sector firms) and so-called hard economic releases that include consumer and business expenditure readings (not sentiment). Specifically, the calendar shows continued resilience in aggregate demand conditions across a number of the world's major economic blocs (including the USA, Japan, China and Germany) thru a period in which sentiment conditions have deteriorated. Figure 5, 6, 7 and 8 offer an example of such demand sector dynamics.

Figure 5. US Capital Goods New (Core) Orders Hover Close to Recent High Levels thru the Recent Period of Adverse Economic Sentiment Readings

Source: US Census Bureau

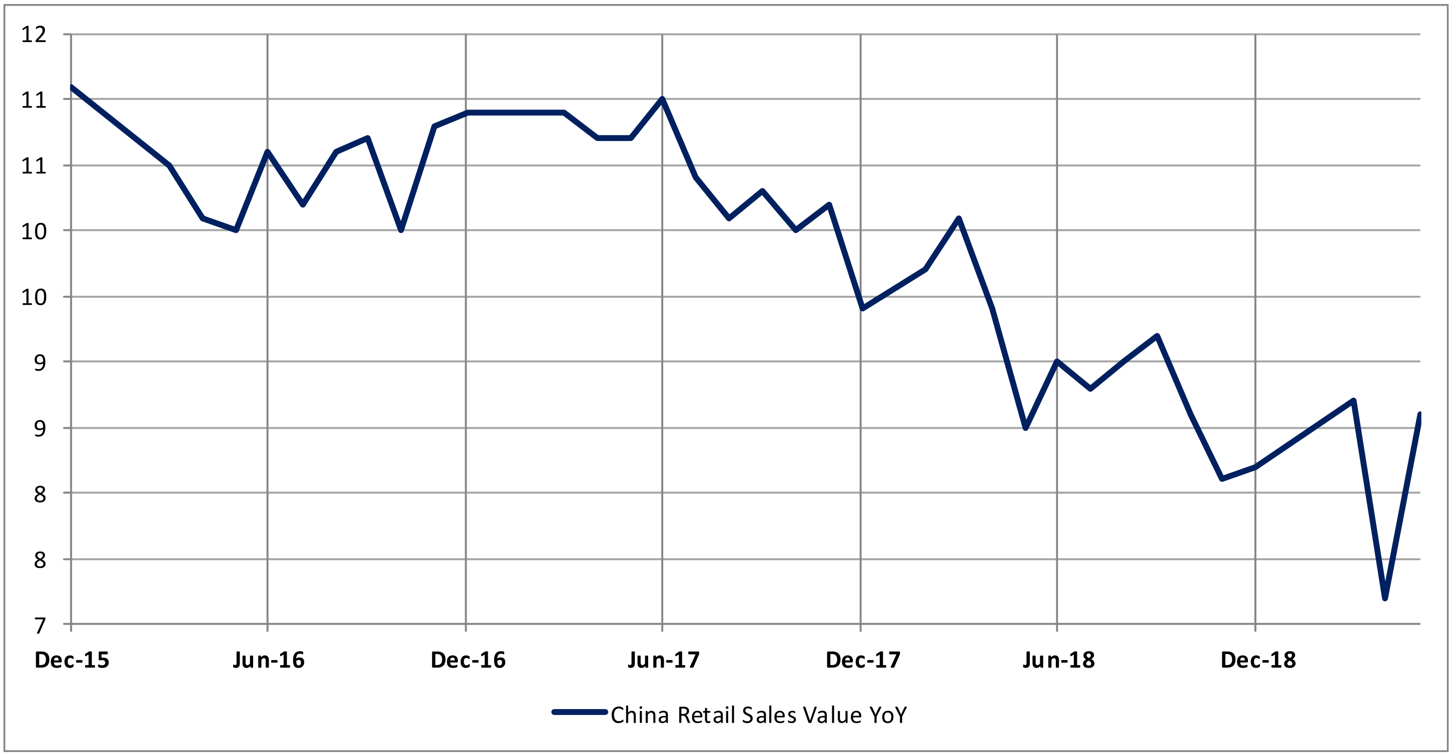
Figure 6. Japan Retail Expenditures Annual Growth Rate Remains Stable thru Recent Period of Adverse Economic Sentiment Readings



Source: Ministry of Economy Trade and Industry Japan

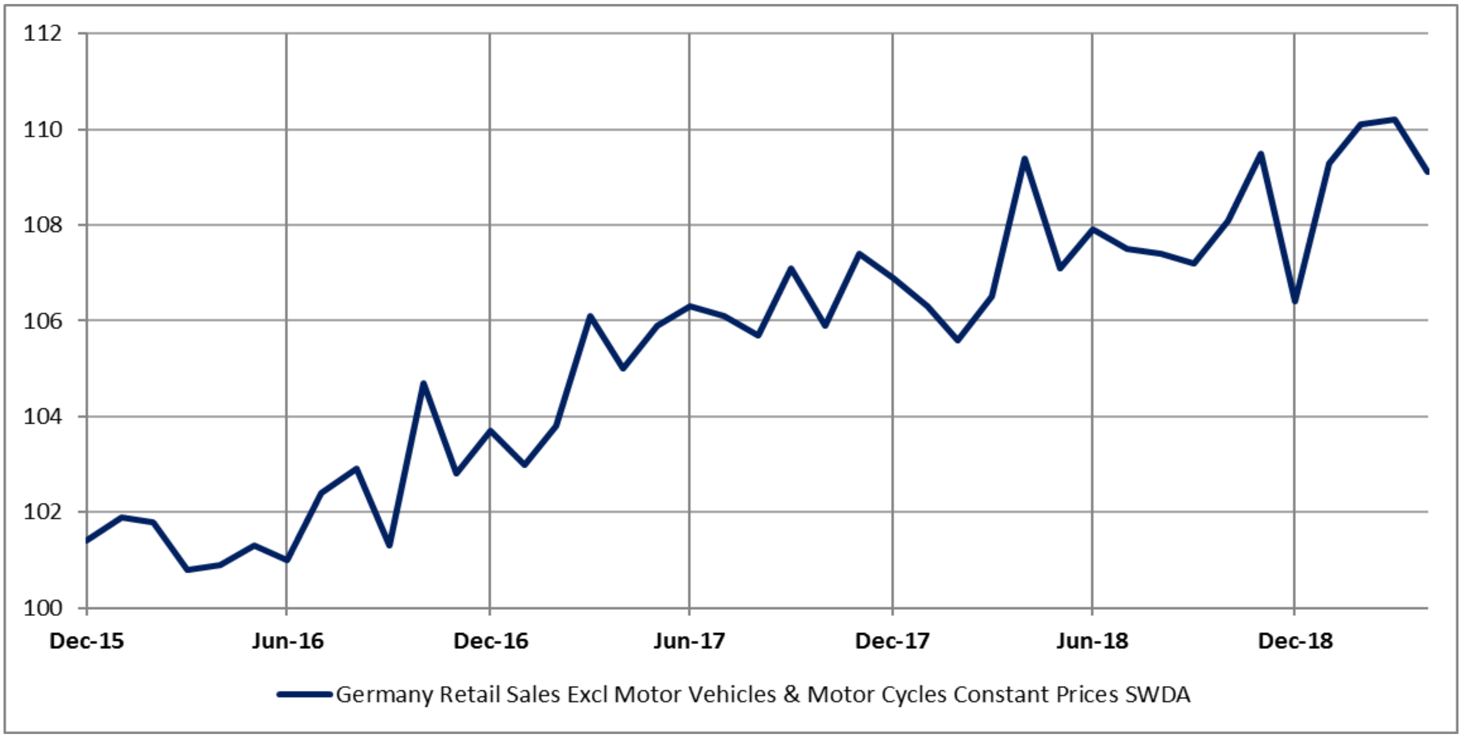
As we look ahead at the next several months, we believe the impending loosening of liquidity conditions (primarily in the US Dollar bloc, following the US FED's turn in the dovish direction) will reinforce the resilience of aggregate demand conditions globally.

Figure 7. China Retail Expenditures Annual Growth Rate Bounces to Q4 2018 Levels thru Recent Period of Adverse Economic Sentiment Readings



Source: National Bureau of Statistics of China

Figure 8. German (Core) Retail Sales Hover at Recent High Levels thru Recent Period of Adverse Economic Sentiment Readings



Source: German Federal Statistical Office

Figure 9. US Cyclical Stocks Look Poised to Outperform Defensive Sector Peers in the Coming Months as Investors Reassess Pessimistic Expectations on the Cycle

Source: Bloomberg and Glovista Calculations

Of course, the economic outlook is not without risks. US President Trump and China President Xi are scheduled to meet on June 28 at the G20 Summit being held in Japan. It is widely expected that no final agreement will be reached but rather an agreement to continue discussions. Arguably, the US election calendar supports a scenario in which an agreement is not reached till the end of this year or beginning of next year when such timing would be most favorable to the President's campaign. However, it remains possible for continued frictions to escalate further in the coming months. Likewise, over the past two weeks Middle East tensions have escalated, resulting in the increased potential for military conflict between the US and Iran. Any of those dynamics, should they unfold, would prove adverse to risk indices via the corresponding spike in risk premium levels.

Glovista Raises Non-US Equities Exposure on Potential for Weaker US$ and Bounce in Bond Yields; At the Sector Level, Glovista Raises Value Sector Exposure

Against the global macro developments discussed above, the Glovista investment team sustains overweight equities exposure while conducting two sets of rebalancing actions. At the geographic level, we have trimmed our US equities overweight tilt as recent US Federal Reserve actions are likely to bring about a sustained weakening in the US Dollar. Likewise, the recent massive rally in sovereign bond yields has been especially beneficial to US equities owing to the heavy growth sector component in US benchmark. In that light, at the sector level, over the past several days we have rebalanced our portfolios' equities sleeve away from growth in favor of value, including US financials which enjoy the additional supports coming from the successful passage of stress tests conducted by government regulators as well as the reduced likelihood of further yield curve flattening.

Within the value sector domain, we continue to favor emerging market equities. In fixed income, on fundamental macro and valuation grounds, we continue to favor exposure to intermediate / short duration in the corporate (high yield and high grade) markets. In commodities, we recently took profits in our gold and gold mining equities exposure, on tactical grounds.

Emerging Markets Perspectives

EM Stocks Bounce Strongly in June, Fueled by Declining US$, Reduced G3 Central Bank Policy Risk Premium and Firmer Activity Momentum versus Developed Peers

In June, Emerging Market equities have outperformed developed market peers following a challenging month of May. In our view, three key factors account for EM equities' strong performance during the month of June:

- The sharp June month-to-date decline recorded by the US Dollar index as global fixed income markets discount a lower US interest rate environment. Historically, Emerging Market equity returns benefit from periods of US Dollar weakness (Figure 10).

Figure 10. US Dollar Index Records Sharp Decline in June, Boosting EM Equity Returns

Source: Bloomberg

- In June, emerging market economies' activity calendar strengthened markedly versus developed peers, thus fueling EM equity excess returns versus developed peers (Figure 11).

- Re-engagement of US-China trade discussions via Presidents' meeting at the G20 Summit in Japan (June 28) along with peaceful de-escalation of Hong Kong street protests during the month. These developments have served to compress China equity risk premium during the period.

Against the global macro and policy backdrop unfolding during the month of June, global markets have increasingly discounted a macro outlook characterized by lower rate of global economic growth and lower interest rates. Such macro developments which tend to favor value oriented markets such as Brazil, Russia and Indonesia were accompanied by policy developments that resulted in a compression of China equity risk premium (favoring north Asia markets, including China, Korea and Taiwan). As a result, the June period has proven to be a challenging one for active managers to generate alpha. Glovista's strategy has been able to navigate such period with success and closes the month approximately in line with the benchmark. As we look ahead to the coming months we are positioning the portfolio towards value-oriented country tilts.

Figure 11. EM Economies' Activity Calendar Strengthens versus Developed Peers in June, Boosting EM Equity Excess Returns versus Developed Peers

Source: Citigroup & Glovista Calculations

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