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GLOVISTA INVESTMENTS

Glovista Global Perspectives

This Issue:

2019 Review and 2020 Year-Ahead Outlook: Continued Emphasis on High Quality, Value-Oriented Markets with Dialed Up Non-US Regional Tilts

As we look ahead to the 2020 global macro and market outlook, it is opportune to provide a brief account of the more salient macro and market developments of 2019 as the year draws to a close. We provide such discussion in the section immediately below followed by an outline of the principal considerations anchoring Glovista's 2020 global macro and market outlook. We conclude with a discussion of our market outlook for 2020 along with portfolio strategy views for the beginning of the year.

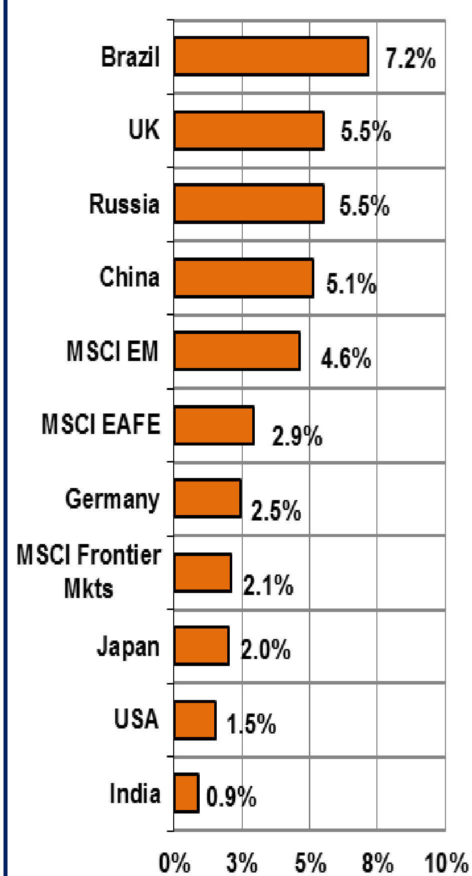
2019 Review: Global Economy Undergoes a "Tale of Two Cities" Syndrome in 2019 as Goods Sector Records Recession-like Slowdown along with Resilient Service Sector. Year Draws to Close with Signs of Goods Sector Rebound

Global markets started off the year with unusually elevated concerns over then prevailing disinflationary, contractionary undercurrents plaguing the global economy during the fourth quarter of 2018. Such concerns were disrupted early in 2019, courtesy of two major policy reversals out of the US:

- the US Federal Reserve's reversal in its policy rate stance from rate hikes to rate cuts, signaled by FED Chair Powell's momentous January 4th, 2019 speech delivered at the annual meetings of the American Economic Association;

- the Trump Administration's investor-friendly shift in stance vis-à-vis China surrounding the disruptive trade tensions that were set off in March 2018 by US President Trump which entailed an initial 25% tariff imposition on all steel imports (with exceptions for some countries) and 10% tariff imposition on all aluminum imports (with exceptions for some countries).

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



Source: MSCI & Bloomberg

**As of December 16th, 2019*

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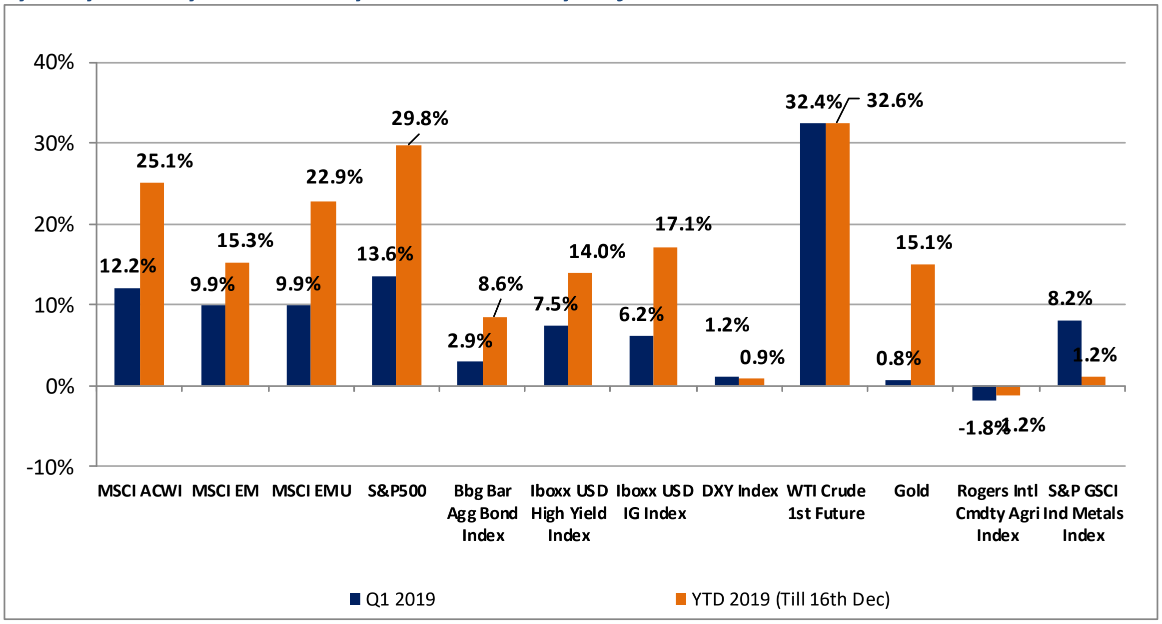
S&P500 Monthly Sector Performance – December MTD 2019*		
Sectors	% Change	FY1 PE Ratio
Energy	3.77%	20.7
Materials	1.09%	20.4
Industrials	-0.39%	19.1
Cons Disc	0.70%	23.2
Cons Stap	1.48%	21.1
Technology	2.43%	22.7
Healthcare	2.40%	17.3
Financials	2.15%	13.9
Utilities	1.68%	20.5
Telecom	1.05%	19.5
Real Estate	-2.08%	35.6
S&P500	1.61%	19.5

As of December 16th, 2019

Source: Bloomberg

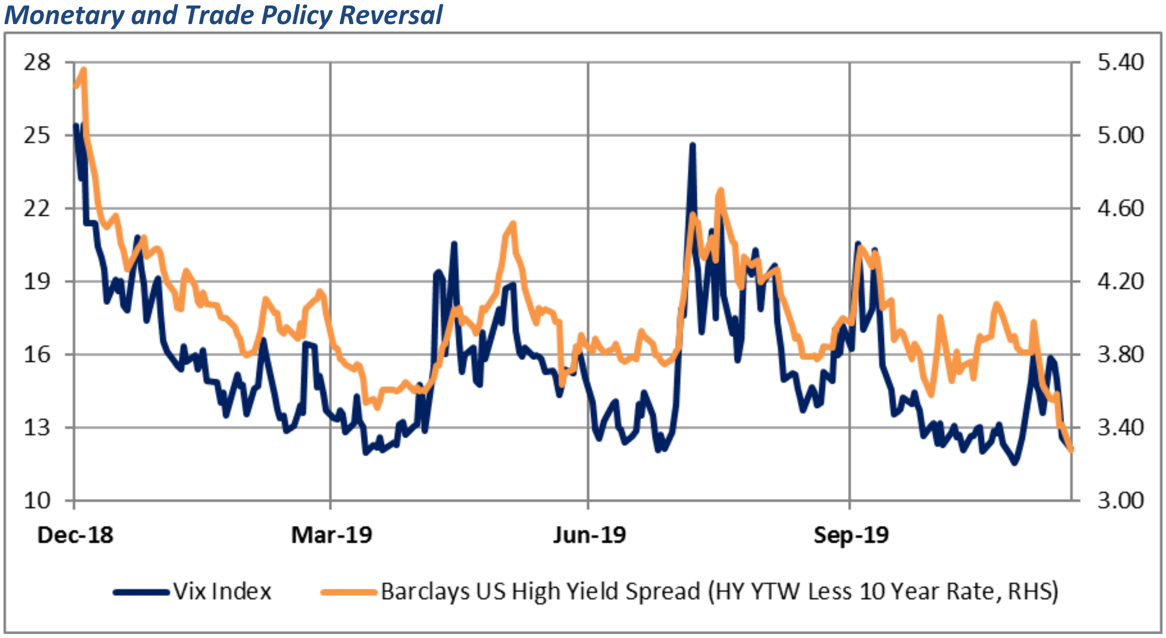
Figure 1. Risk Assets' Sharp Rally in Q1 of 2019, boost factor to Overall 2019 YTD Gains, Set off by Early January US Monetary and Trade Policy Shifts



Source: Bloomberg & Glovista Calculations

The duo of US policy shifts listed above, announced in early January, set off a sharp reversal across the world's principal risk markets, cutting across the equities, credit and commodities divides. For example, Figure 1 illustrates the sharp rally in global equities, high yield and crude prices during the first quarter of the year, alongside overall 2019 year-to-date (as of December 16) gains. In our view, the large percentage gains that unfolded during the year's first quarter set off a virtuous cycle leading to a sharp sustained decline in risk premium levels. For example, Figure 2 illustrates the sharp, sustained decline recorded in US equity volatility and credit spreads throughout 2019 – particularly during the first quarter of the year.

Figure 2. Equity Volatility and Credit Premia Compressed Sharply following January US Monetary and Trade Policy Reversal



Source: Bloomberg

While risk markets' backdrop strengthened measurably early in the year, particularly on the back of the US FED's policy reversal, the global economy's performance around the second quarter of the year began to reflect the damaging effects exerted by the global trade disruptions emanating from the trade measures imposed by the US government, not only on China but also on the future of NAFTA, in 2018. In addition, the rekindling of the BREXIT process also contributed to the disruption in the global manufacturing sector economy. We believe that much of the traumatic effects exerted by the disruptive trade protectionist measures announced in the middle of 2018 sprang not from direct but indirect mechanisms, particularly tied to the private sector's capital expenditure behavior in the developed world. One has to bear in mind that much of the world economy's growth since 1990 has resulted from growth in global trade. Figure 3 highlights the sharp deceleration recorded by the world economy's manufacturing sector sentiment levels throughout the year, stabilizing only in October and recording an incipient recovery in November.

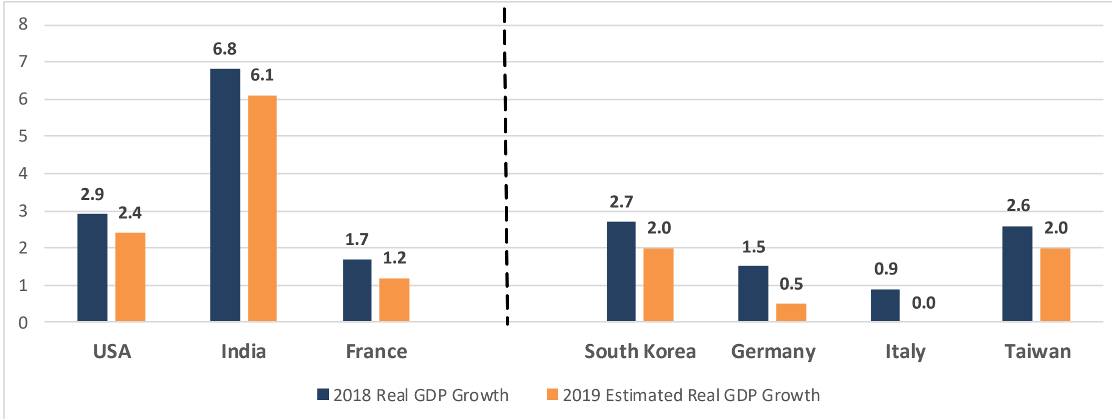
Figure 3. World Economy's Manufacturing Sector Sentiment Weakened Steadily Throughout 2019, Flashing a Recovery Starting only in November

Source: Markit

Besides the adverse growth effects stemming from US-China trade tensions and BREXIT, a comprehensive account of the main drivers underpinning the global goods sector's annus horribilis in 2019 must also include the effects resulting from trade tensions between Japan and South Korea as well as the effects of General Motors' labor strike, Boeing's problems facing its 737 MAX jetliner and the effects on the global auto production (especially Germany's and China's) from the implementation of new environmental standards.

The above mentioned dynamics underlie the "Tale of Two Cities" pattern in the global economy's 2019 performance so that predominantly domestic, service-sector oriented economies, such as the USA, India and France significantly outperformed peers whose economic fortunes are tied predominantly to global trade in the goods sector, such as Germany, Italy and South Korea. Figure 4 illustrates the difference in 2019 versus 2018 GDP growth performance for that pool of national economies.

Figure 4. Global Economy's 2019's "Tale of Two Cities" Performance: Contrast between Pool of Goods versus Sector Oriented National Economies (2018 & 2019 GDP Growth Estimates from the IMF)



Source: IMF

	December 16th 2019	December MTD Change
Gold	1476.18	0.8%
Silver	17.0395	0.1%
Oil	60.21	9.1%
EUR	1.1144	1.1%
JPY	109.55	-0.1%
GBP	1.3332	3.1%
CHF	0.9824	1.8%
CAD	1.3155	1.0%
AUD	0.6885	1.8%
BRL	4.0577	4.2%
MXN	18.9323	3.1%

Source: Bloomberg

Rates	December 16th Levels
1 Yr CD	1.16%
5 Yr CD	1.41%
30 Yr Jumbo Mortgage	4.04%
5/1 Jumbo Mortgage	3.87%
US Govt. 10 Year	1.8713%
10 Yr Swap Spread	-0.0538%

Source: Bloomberg

The year's sharp deceleration in goods sector activity momentum coincided with the rekindling of China-US trade tensions as well as the escalation of Brexit uncertainty concerns. Specifically, in May both of those dynamics escalated via:

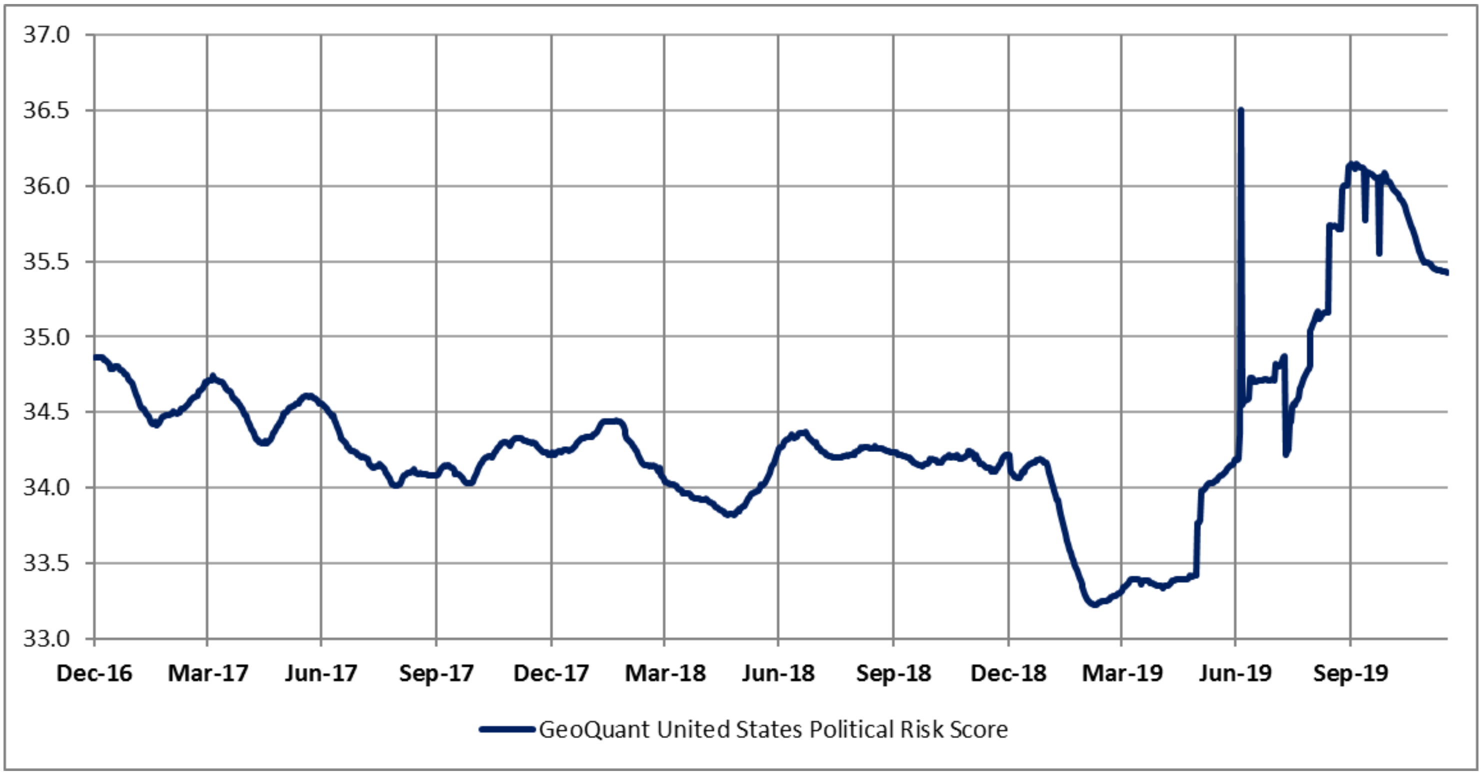
- US President Trump's decision to raise tariffs on US$200 billion worth of Chinese imports from 10% to 25%, effective May 10th. In addition, Mr. Trump also indicated that at a future date he would impose new 25% tariffs on additional $325 billion worth of Chinese goods, which covered essentially all of the remaining Chinese products imported to the USA.

- Prime Minister Theresa May stepped down as leader of the Conservative Party as well as Prime Minister after proving unable to pass the Withdrawal Agreement in the House of Commons.

The rekindling of such geopolitical concerns is captured in the sharp rise in geopolitical risk starting around the end of the year's first quarter (Figure 5). As noted above, such geopolitical risk concerns were further aggravated by the escalation of bilateral trade tensions between Japan and South Korea around the month of July 2019.

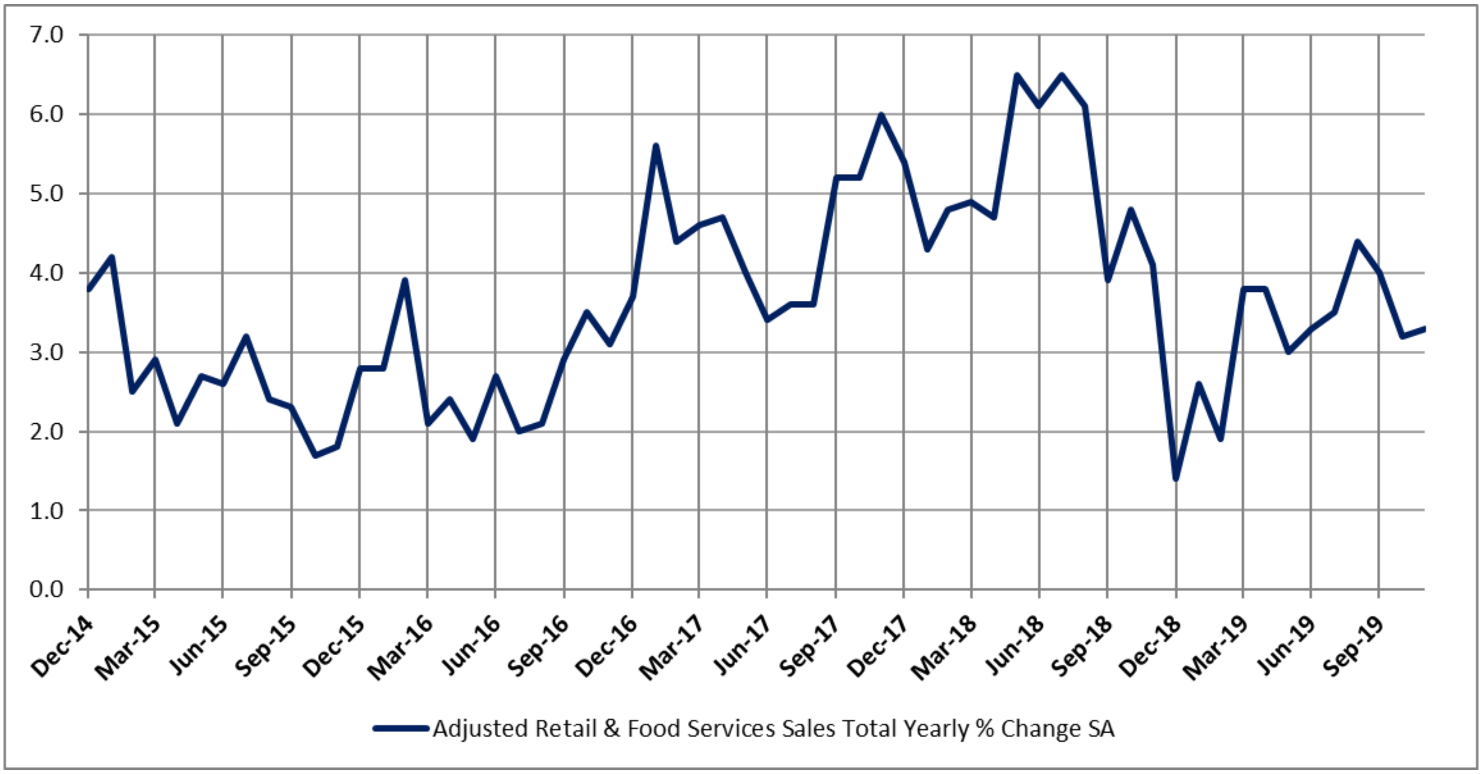
Fortunately for the global economy's medium-term outlook, the sustained erosion in business confidence (particularly goods sector related) – along with the disruption unleashed on the world's goods sector production chain from the escalation of US-China trade tensions throughout the year's second and third quarters – was not met by a meaningful deceleration in household spending or confidence levels, as attested by the resilience of retail sales growth momentum (Figure 6). We credit such resilience to (a) the service sector's fast higher share of US overall economic activity as well as (b) US households' healthy savings rate levels (Figure 7) and wage growth, along with the solid strengthening in financial conditions sponsored by the US Fed's decision to reverse its policy rate stance earlier in the year (Figure 8).

Figure 5. 2019Q2 Spike in Geopolitical Risk Coincides with Deceleration in Goods Sector Momentum



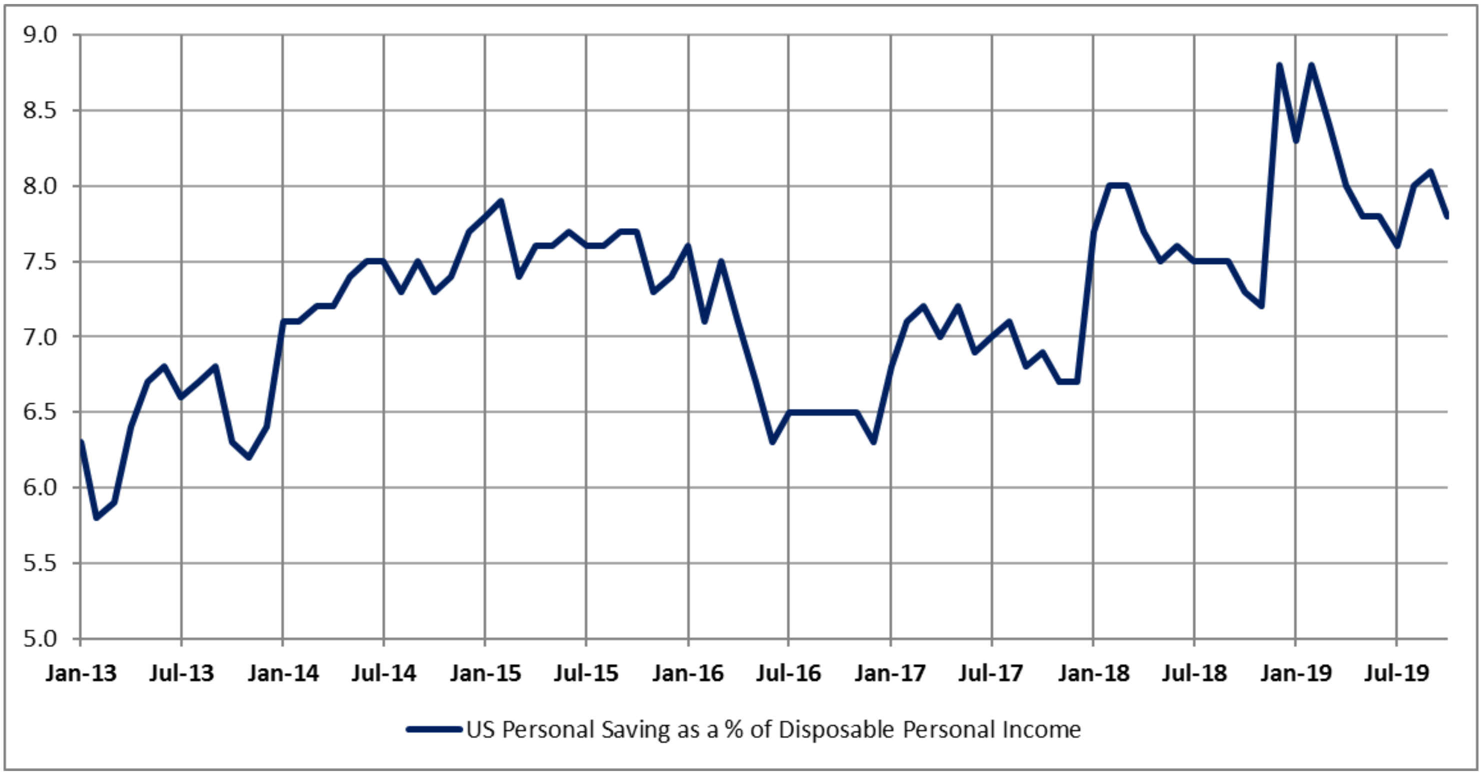
Source: GeoQuant

Figure 6. US Retail Sales Growth Resilience Meets Erosion of Goods Sector Business Confidence



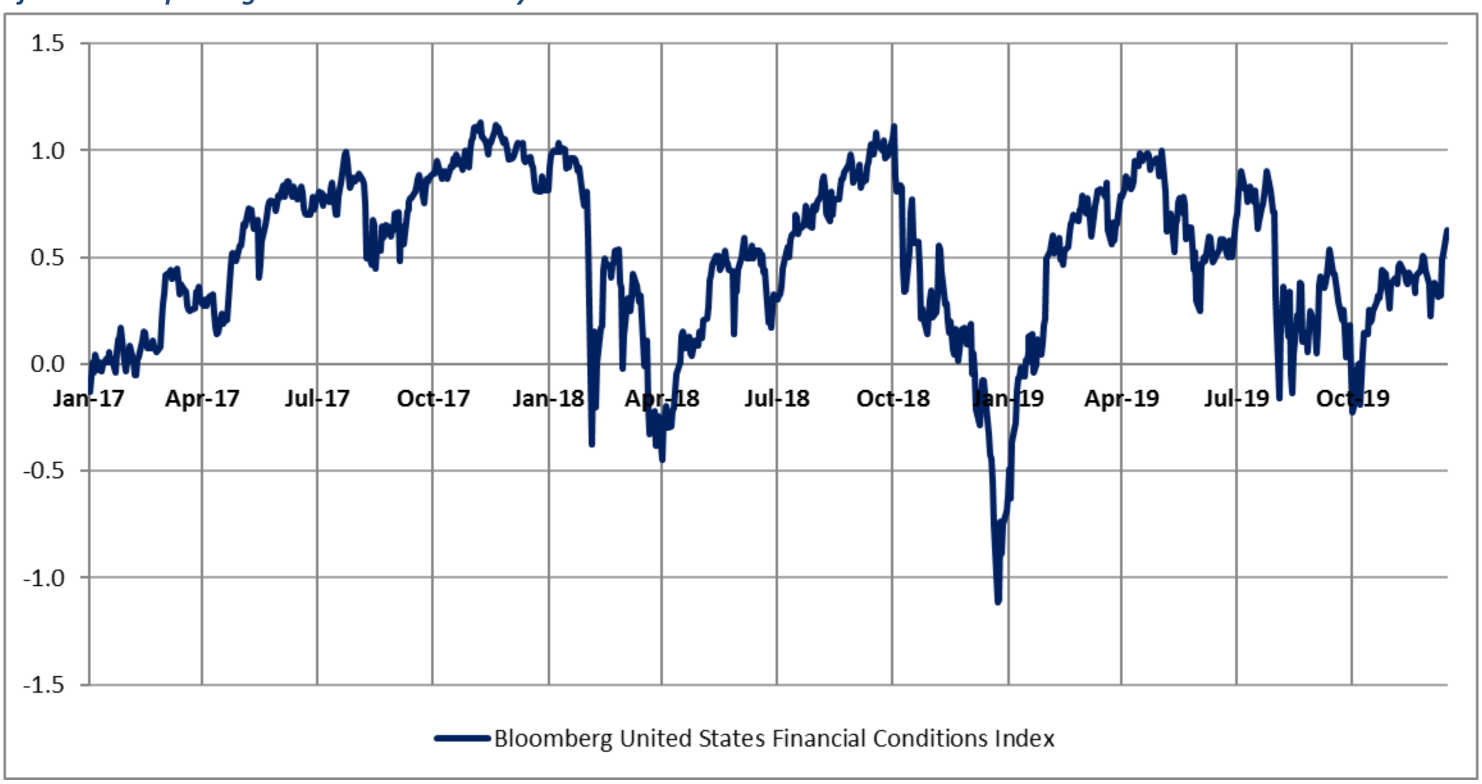
Source: US Census Bureau

Figure 7. Domestic Expenditure Resilience Supported by High Personal Savings Rate early in 2019



Source: Bureau of Economic Analysis

Figure 8. Sustained Bounce in Financial Conditions Supportive of Asset Prices and Consumer Confidence throughout Period of Turmoil impacting Goods Sector Globally



Source: Bloomberg

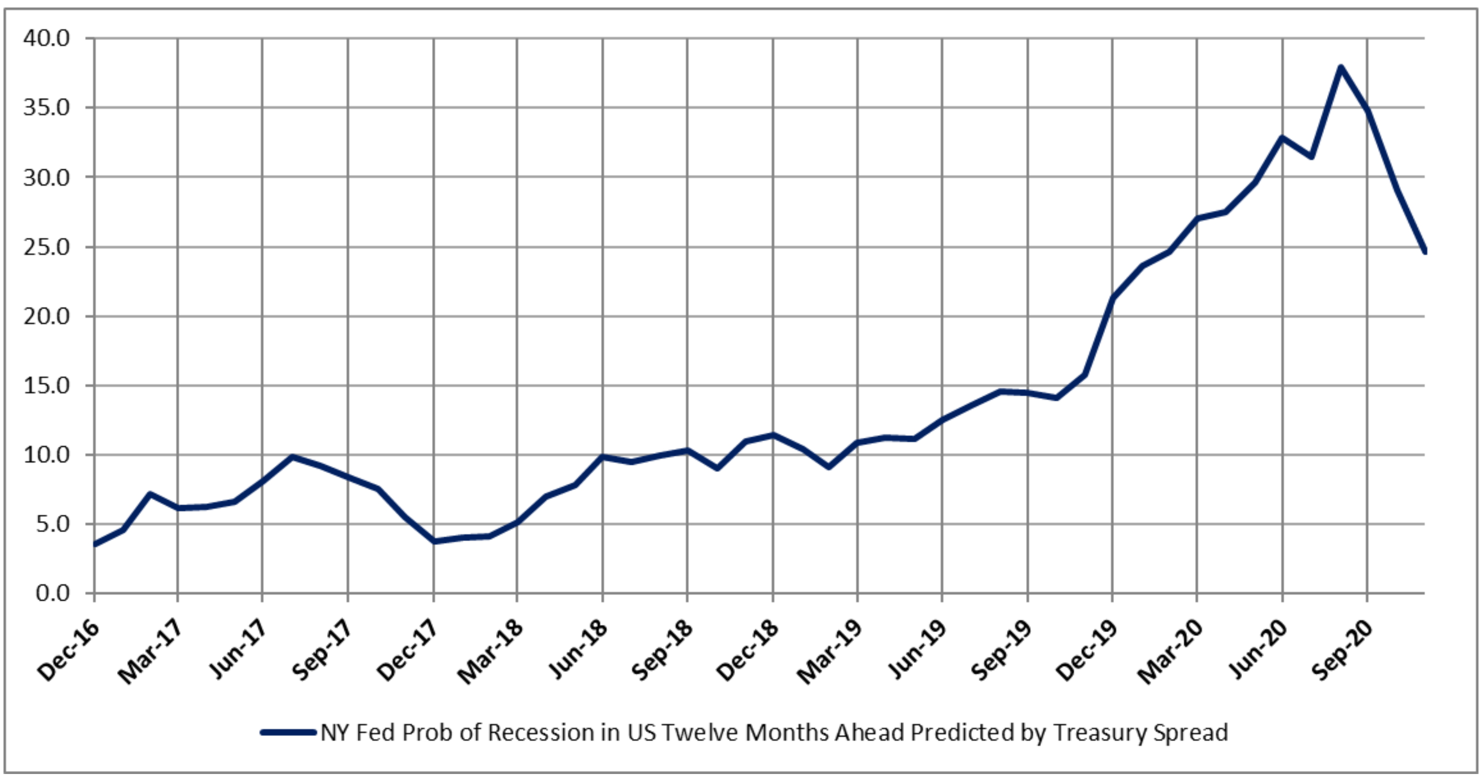
As 2019 is drawing to a close, the two principal confidence and activity drag factors impacting the global economy and financial markets have been significantly mitigated as a result of recent developments, listed immediately below, thus injecting much visibility of global manufacturing sector activity momentum early in 2020:

- On 13th December (2 days before the deadline) the US and China reached a phase one agreement whereby the US agreed (a) not to proceed with 15% tariffs on US $160 billion worth of consumer goods, and (b) to the reduction of tariffs imposed on September 15th on US$120 billion of Chinese goods from 15% to 7.5%. China, on its part, agreed to increase the purchase of US goods and services by at least $200 billion over the next two years, suspend retaliatory tariffs and implement intellectual property safeguards.

- Prime Minster Boris Johnson and his Conservative party secured a landslide victory (365 seats out of 650) in the British general elections held on 12th of December on the platform of "get BREXIT done". This majority provides Mr. Johnson the power to press on with his domestic agenda and more space to negotiate a withdrawal agreement with the European Union without the need to solely rely on the hawkish wing of the Tory party.

As a result of the two above mentioned considerations, the world economy's goods sector is likely to post a meaningful recovery in the first half of 2020, thus leading market-based measures of recession risks to decline over the past several weeks (Figure 9).

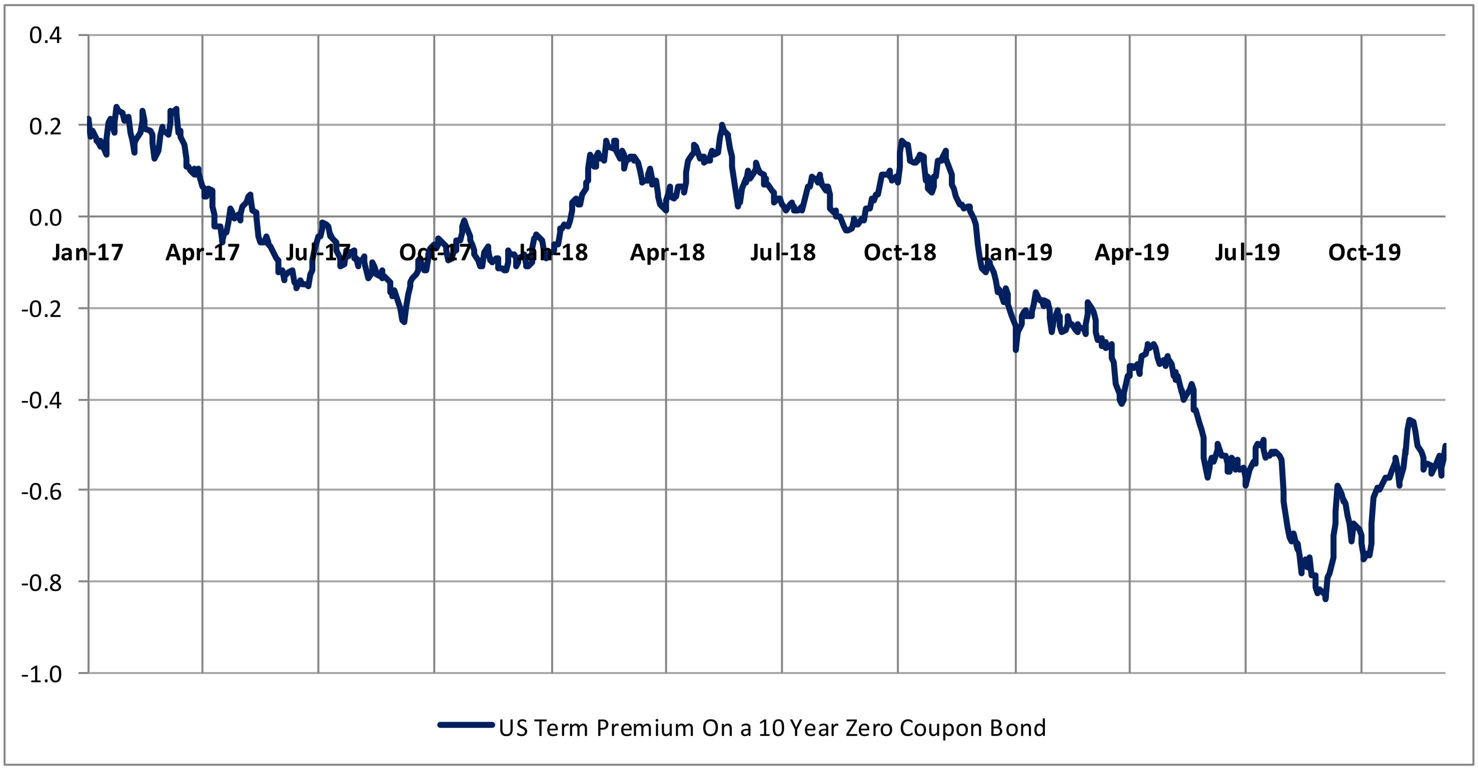
Figure 9. US Recession Probability Declines Meaningfully over the Past Several Weeks on the Back of Resilient Expenditure Dynamics and Market-friendly Resolution of Brexit and US-China Trade Tensions



Source: Federal Reserve Bank of New York

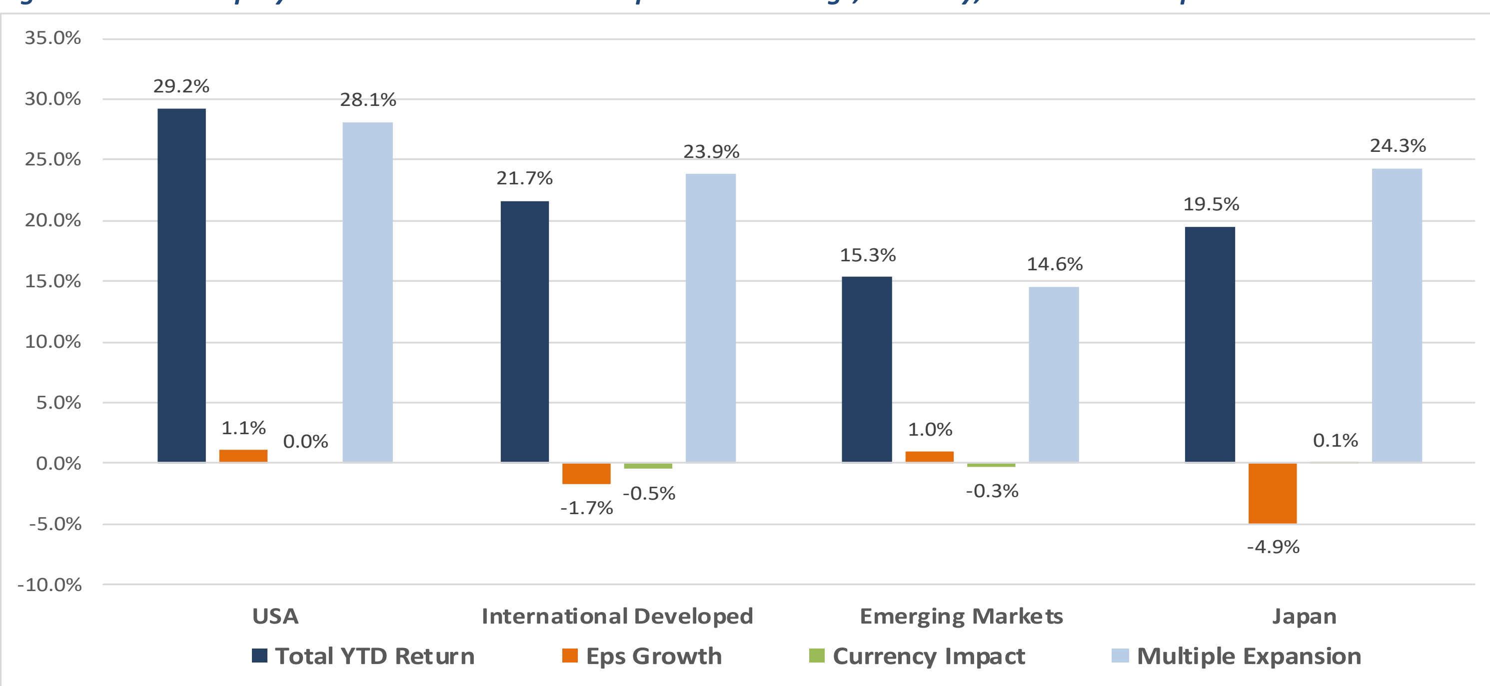
From a global financial market perspective, the year's "Tale of Two Cities" syndrome at the global economic level was reflected in a sharp decline in interest rates across most of the world's largest economic blocs along with a considerable rally in equity prices, partly reflecting the decline in bond yield (debt cost of capital) and resilient consumption expenditure dynamics discussed above. Figure 11 breaks down the make-up of US Dollar returns in global equities while Figure 10 captures the considerable importance exerted by the US Federal Reserve and the European Central Bank in 'talking down' interest rates, as evidenced by the sharp fall in bond term premium levels.

Figure 10. Escalation of Dovish Narrative by US Fed and ECB Underpin Sharp Decline in G10 Bond Yields via the Large Decline in Bond Term Premium Levels



Source: Federal Reserve

Figure 11. Global Equity Indices' Total Return Decomposition: Earnings, Currency, Valuation Multiple



Source: Bloomberg, Yardeni Research and Glovista Calculations

Figure 11 illustrates global equities' total return decomposition for 2019 across earnings, valuation multiple and currency factors and for the world's principal equity index groups. US equities' outperformance reflects primarily the spike in US equity valuation multiples versus the rest of the world, clearly fueled by US assets' 'safe haven' status at a time in which US-China trade tensions led to a rise in global economic uncertainty levels and geopolitical risk.

It is also important to note the US-only beneficiary effects exerted by lower corporate bond yields (unambiguously supported by the unprecedently supportive ECB and FED in 2019) on earnings per share performance. Specifically, debt-funded share buybacks are largely a US-only phenomenon. In 2019, the quantum of US share-buybacks for S&P500 companies are estimated to be $480 billion by Goldman Sachs, a number reflecting the fact that S&P500 companies have paid out more than 100% of free cashflow in the form of dividends and buybacks in 2019. Such dynamics have helped conceal the multi-year long absence of US pre-tax corporate earnings growth, as defined by the US NIPA (US National Accounts, as compiled by the Bureau of Economic Analysis), in contrast to US S&P500 index EPS growth, affected by share buyback dynamics as well as favorable tax cut effects and market concentration dynamics in industries dominated by US multinationals for which tax shifting to overseas domiciles has been substantial these past several years.

As discussed in the outlook section immediately below, we expect such tailwind factors (of a political nature) supportive of US equities' return outperformance of international peers during 2019 to abate considerably, paving the way for non-US equities' return outperformance next year.

2020 Outlook: Continued Emphasis on High Quality, Value-Oriented Markets with Dialed Up Non-US Regional Tilts

As we look ahead at 2020, we expect the global economy to avert recession while undergoing benign inflation dynamics. Specifically, we expect the global economy to record strengthening momentum especially during the new year's first half, propelled by:

- the visible upturn in the global goods sector following the close to recession-like slowdown throughout much of 2019, discussed above;
- favorable lagged effects of the liquidity easing that has unfolded throughout much of 2019;
- the unfolding of fiscal stimulus measures across a number of major economic blocs, including the Eurozone, South Korea, Japan and the United Kingdom;
- supportive financial conditions on the global economy, resulting from the ECB's and US Federal Reserve's clear guidance of limited policy rate changes in 2020;
- Normalization of European economic growth momentum as the trio of adverse effects of 2019 begin to fade – Brexit, disruption in Germany's industrial sector (especially autos) and knock-on adverse effects from the US-China trade war of 2019;
- Pick-up in Emerging Market economies' growth momentum on the back of an upturn in the global manufacturing sector, lagged effects from easing of financial conditions and rate cuts implemented across many EM countries in 2019 and continued loose financial conditions globally.

On the price dynamics front, we expect 2020 to record an upturn in inflation momentum yet of small orders of magnitude as large economic regions – especially Europe – still exhibit high rates of slack in factor utilization.

Against such baseline case of modest growth and inflation acceleration in 2020, with US profit margins increasingly under pressure owing to the US economy's late cycle status, we expect global equities to post modest total return performance, in line with EPS growth. Within the global equities domain, we favor overweight allocations to high quality companies – in recognition of the US economy's late cycle status and extended valuations in the credit space. Moreover, we favor overweight allocations to value-oriented sector stocks on valuation considerations and our thesis of growth acceleration, especially in the year's first half – especially, financials, energy and industrials. At the geographic level, we favor overweight allocations to emerging market equities, high quality US stocks and high quality Eurozone stocks (including German, Dutch and French) as well as Japanese equities.

Our constructive outlook towards the equities space reflects equities' attractive valuations relative to fixed income – Figure 12 – particularly under our 2020 no recession baseline scenario. Moreover, from a positioning perspective, we expect the acceleration of world GDP growth momentum early in 2020 along with continued low financial volatility (partly courtesy of accommodating ECB and FED, as per recent guidance) may result in a reversal of the large net outflows from equities recorded throughout 2019 as corporates were the only net buyers of US equities while international equity funds experienced considerable redemptions.

On the fixed income side, we continue to favor short duration exposure especially as the short-end of the curve is well anchored on ECB and Fed policy guidance while our baseline scenario of a cyclical upturn early in 2020 is likely to reset higher bond term premium levels which currently hover at exceedingly low levels. Our expectation for a modest steepening of government yield curves in 2020 should help anchor sustained relative outperformance by value stocks next year. In the currency space, we expect the US Dollar to decline modestly next year on the back of the expected relative strengthening of non-US economic regions as well as increased US risk premium associated with prospects of a left-of-center Democratic Party presidential candidate (e.g. Sanders or Warren).

Figure 12. Equities' Valuations Remain Compelling versus Bonds, particularly given 2020 No Recession Baseline Scenario

Source: Bloomberg and Glovista Calculations

Of course, the global market outlook is not bereft of risks. We believe the most significant risk factor conditioning the 2020 market outlook centers on the US election campaign. From a timing perspective, we believe investor sentiment is likely to be tested in the Spring, around the time of US Democratic Party primaries, as well as in the Fall, around the November general elections. Other risk factors include a derailment of US-China trade discussions on phase two and a surprise inflation acceleration.

Emerging Markets Perspectives

2019 Review and 2020 Outlook: EM Equities' Outlook Brightens Markedly Early in 2020 as 2019 Geopolitical Risk Premium and Cyclical Downturn Headwinds Diminish Considerably at the Close of 2019

The 2019 year-to-date period has been marked with unusually sharp gyrations in emerging market equity indices along with return underperformance versus developed peers. As discussed above, two principal dynamics defining the year include factor developments of exceedingly high importance to emerging market equity prices' historical return performance drivers:

- Unusually large spike in geopolitical risk premium levels, involving the emerging market equities universe's largest country constituent (China), via the sharp intra-year gyrations between Beijing and Washington concerning trade relations between the world's two largest economies;

- Recession-like conditions in the global manufacturing sector, as the world's production base digested the uncertainty and disruptions in the global production chain, stemming from the US government's imposition of import tariffs from China – as well as disruptions tied to trade spat between Japan and South Korea, as well as effects from General Motors labor strike and production problems facing Boeing.

A quick review of emerging market equities' historical absolute and relative return performance versus developed peers shows rather clearly EM stocks' disproportionate sensitivity to material spikes in risk premium levels (especially those originating in a large EM country, such as China this year) as well as momentum changes in the world's manufacturing sector (as illustrated in Figure 3). Against such 2019 backdrop, it is no surprise that emerging market equities recorded an approximately 6.35% percentage and 13.90% percentage return underperformance versus EAFE and US (as represented by the MSCI composite) index peers, respectively. Statistically, the unfolding of such toxic factors - adverse to EM equities' absolute and relative return performance - is manifested most significantly in this year's relative valuation cheapening versus developed peers (Figure11).

As we look ahead to 2020, we expect EM equities to solidly outperform Developed peers – particularly during the year's first half - on account of several considerations, including:

- Strengthening relative economic momentum versus developed peers, with some notable exceptions especially China. A number of large emerging market countries will be implementing a combination of interest rate and tax cuts throughout 2020, including South Korea and India, which will lend additional visibility to those economies' accelerating momentum next year. Even in Latin America, a laggard region in terms of economic growth during 2019, the Mexican and Brazilian economies are widely expected to record accelerating growth rates;

- EM currencies' beneficiary status from a potential decline in the US Dollar, as risk premium levels stabilize at lower levels and the world's industrial cycle turns up;

- EM equities' under-owned status, especially on the part of US based investors;

- EM equities' attractive relative valuations versus developed peers, with forward P/E multiples currently hovering at close to a 30 percent discount versus US peers (Figure 13).

Figure 13. EM Equities' FY1 P/E Valuations versus Developed Peers Hover at 30 Percent Discount

Source: Bloomberg, MSCI & Glovista Calculations

At the regional level, we are positioning our EM portfolios in the direction of raising exposure to North Asian markets during the year's first half – both on account of the region's cheapened relative valuations versus the EM peer group, stemming from the derating resulting this year from China-US trade tension related risk premium considerations – as well as Indonesia (favorable policy backdrop, materials sector exposure and domestic economic momentum), Brazil (particularly the materials sector stocks), and Russia (cheap relative valuations and visible economic momentum). At the sector level, we expect the following sectors to outperform during the year's first half: IT (especially semis), materials, industrials and consumer discretionary.

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