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GLOVISTA INVESTMENTS

Glovista Global Perspectives

This Issue:

Global Perspectives P.1

Emerging Markets Perspectives P.8

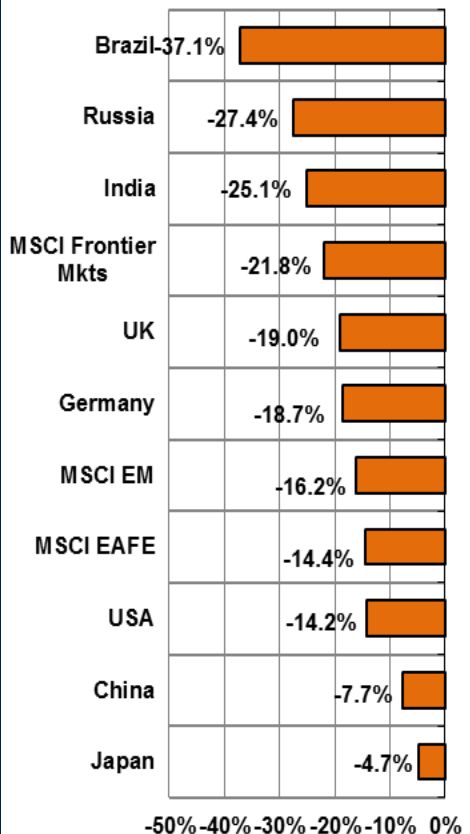
Global Pandemic fuels Deepest, Fastest Activity and Market Downturn since Depression Era; Market Sell-off Exacerbated by Illiquidity and Positioning; Prompt, Outsized Policy Response Lays out Foundation for Sustained Recovery; Glovista Sustains Defensive Portfolio Stance

In March, the coronavirus epidemic sadly transitioned into global pandemic status. As a result, owing to the virus' (a) asymptomatic transmission, (b) non-trivial death rate ranging between 0.7%-2%, and its (c) now pandemic status, governments from around the world (encompassing close to 1 in 6 of the world's population) have chosen to induce a transitory shutdown of much of their local economies in an effort at minimization of loss of life. Figure 1 outlines global markets' response to confirmation of the coronavirus' escalation into pandemic status.

Happily, some countries have already shown the effectiveness of containment efforts - along with a broadening of testing protocols - to such an extent so as to lead to the lifting of their quarantine programs, particularly those in North Asia (including China, HK, Taiwan, Singapore, Japan and South Korea) over the past several weeks. More recently, in the Eurozone, the latest projections of medical specialists concerning the diffusion of the pandemic - in the affected regional countries - predict the middle to end of April (around three weeks from now) as the likely period by when the lifting of quarantine protocols can be expected. The Americas and Africa regions are expected to reach such stage during the first half of May owing to those regions' more recent entry into quarantine periods.

Evidently, the final, confirmed duration of the government-induced disruption to economic activity will dictate the overall costs to the global economy and consequently, corporate earnings, with the accompanying implications on financial asset prices, including equities, credit and others. Moreover, a full normalization of economic activity – particularly across borders – is unlikely to occur before the end of the year.

Country-wise Monthly Performance in USD terms (March 2020)*



Source: MSCI & Bloomberg

**As of March 27th, 2020*

S&P500 Monthly Sector Performance – March MTD 2020*

Sectors	% Change	FY1 PE Ratio
Energy	-36.67%	24.9
Materials	-15.84%	15.6
Industrials	-19.47%	16.1
Cons Disc	-13.71%	20.9
Cons Stap	-7.59%	17.7
Technology	-10.73%	19.5
Healthcare	-7.90%	13.6
Financials	-20.66%	9.7
Utilities	-9.80%	17.2
Telecom	-14.80%	15.1
Real Estate	-14.87%	32.3
S&P500	-13.97%	16.0

**As of March 27th, 2020*

Source: Bloomberg

Nevertheless, by all counts, a sharp sustained economic recovery is most likely to take hold starting in late May, early June at the latest. Moreover, in quantifying the pandemic's global economic effects, it is important to recognize the presence of three important factors that are likely to result in a mitigation of the pandemic's overall economic effects. These include:

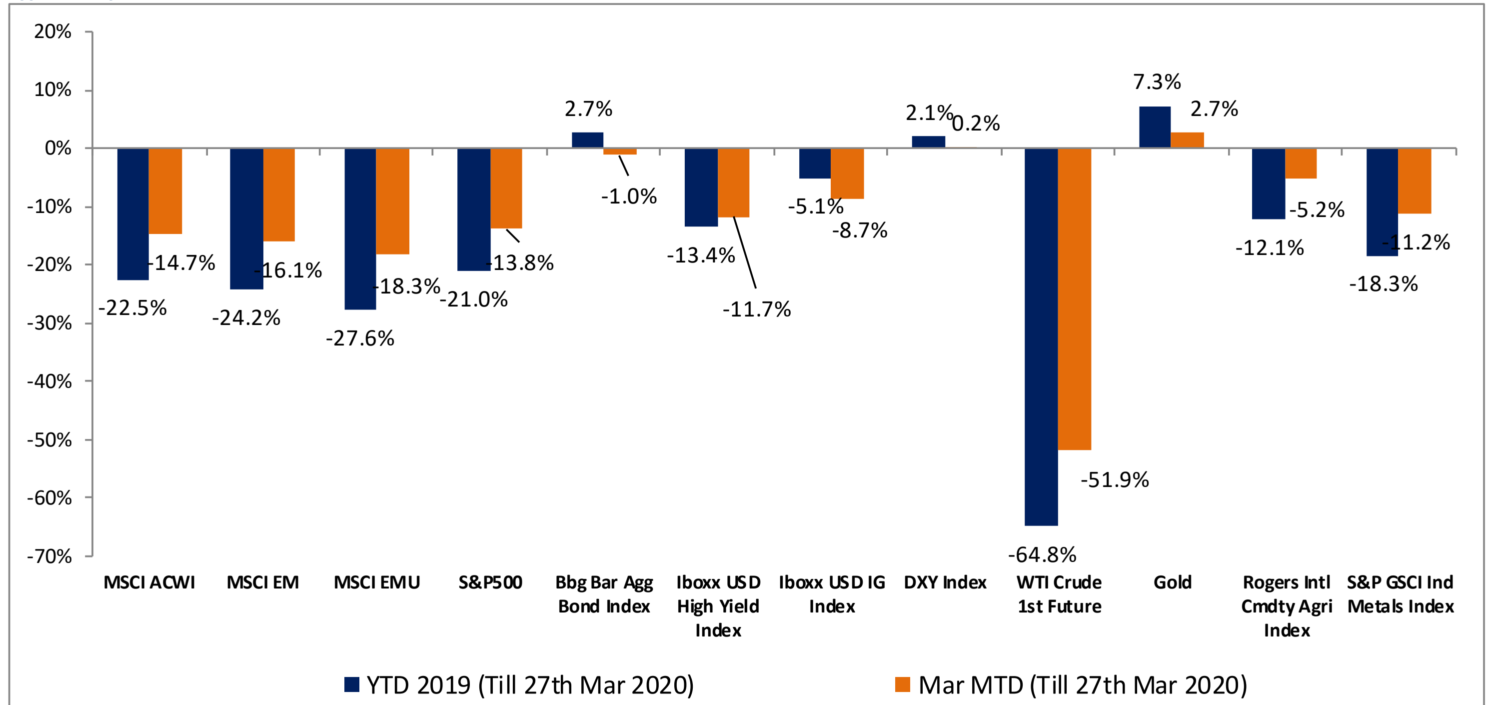
- the unprecedentedly prompt and outsized policy response by the world's largest economies to the pandemic – announced over the past several days - in the form of vast fiscal, credit and monetary policy stimulus measures – amounting, just on the fiscal dimension, to upwards of 10 % of GDP in the case of the United States - along with direct measures aimed at the continued well-functioning of major US Dollar and Euro currency funding markets, with said actions guaranteed to exert powerful supportive effects at a global financial sector level. For example just in the USA, some of the important policy responses include: a $2 trillion CARES Act that provides for direct transfers, extended unemployment insurance, food assistance, incentives for firms to maintain payroll, loans for businesses, funding for hospitals, transfer to state and local governments and deferral of payroll tax. In addition, the Federal Reserve lowered the benchmark interest rates by 150 bps and announced a purchase of treasury and agency securities in the amount as needed to keep the market functioning. The US Federal Reserve also announced funding facilities for commercial paper issuance, primary dealer credit facility, money market liquidity facility, primary and secondary corporate credit facility and TALF for asset backed securities issuance.

- the world goods sector's below trend growth in the period leading to the onset of the pandemic, on account of the negative effects resulting from last year's trade tensions between China and the USA, along with the disruptions associated with the Brexit process in Europe. Such consideration suggests the goods sector's impact from the pandemic is likely to be far less durable than it would have been otherwise, taking into consideration the goods sector's business cycle stage in the developed world. As a result, we should expect the goods sector's recovery around the middle of the year to be especially solid and durable.

- the pandemic's likely short-duration, measured in the narrow sense of the quarantine periods' duration, of around 2 months on average – stands in stark contrast to the much longer duration of ailments responsible for most of the post-WWII recession episodes, whose root causes lied in aggregate demand excesses, arguably absent in the current juncture of the global economic cycle.

As of the writing of this column, with the information we have at present pertaining to the likely duration of the quarantine programs around the world's major economic blocs, we estimate the deceleration of 2020 world GDP growth to be in the order of 4 to 6 percent versus pre-virus period estimate. Such revised projections would place overall world GDP contraction in 2020 to hover in the vicinity of -3%, placing 2020 as the worst performing year for the global economy in decades.

Figure 1. Global Markets Sell Off Sharply in March, Discounting the Sharp – though likely Transitory- Contractionary Effects of the Coronavirus' Transition into Pandemic Status



Source: Bloomberg & Glovista Calculations

Figure 2. March Sell-off in Risk Markets: Largest 2 Week Percentage Declines in Modern Times

Source: Bloomberg & Glovista Calculations

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	March 27th 2020	March MTD Change
Gold	1628.16	2.7%
Silver	14.4683	-13.2%
Oil	21.51	-51.9%
EUR	1.1141	1.0%
JPY	107.94	-0.0%
GBP	1.246	-2.8%
CHF	0.9517	1.4%
CAD	1.3985	-4.3%
AUD	0.6168	-5.3%
BRL	5.1002	-14.0 %
MXN	23.3426	-18.8%

Source: Bloomberg

Rates	March 27th Levels
1 Yr CD	0.73%
5 Yr CD	0.91%
30 Yr Jumbo Mortgage	3.89%
5/1 Jumbo Mortgage	3.45%
US Govt. 10 Year	0.6746%
10 Yr Swap Spread	-0.04%

Source: Bloomberg

As we look ahead at the second half of 2020 and 2021, we expect a period of sustained economic acceleration with low inflation, largely absent central bank policy rate hikes along with supportive fiscal policy backdrops. However, the pandemic's sudden and outsized impact on corporates' and sovereigns' balance sheets is likely to lead to global investors' differentiation across the quality factor domain. We take on such considerations in the below sections which address both recent market effects from the pandemic shock along with Glovista's portfolio strategy views over the ensuing short- and medium-term horizons.

March Market Sell-off Exacerbated by Illiquidity and Investor Positioning

Global financial markets' response to the newly learned reality of a global pandemic in early March displays a number of important characteristics worth discussing so as to properly place the percentage declines recorded by asset markets within a fundamental macro context. First, one of the most salient characteristics of global market developments during the month of March is that of unprecedented speed of asset price declines within such a short period. For example, Figure 2 illustrates the case of global equities while Figure 3 does the same for crude prices, resetting the prevailing prices as of February 29, 2020 to a level of 100.

The second important characteristic of the March sell-off is the seizing up evidenced in global markets, particularly with regards to liquidity. Specifically, the extent of illiquidity permeating large swaths of tier 1 global financial sectors – including Treasurys, agency paper, mortgages, municipals, among many others – during the earlier part of March was close to unprecedented with the exception of the most troubling market sessions during the 2007-2009 Great Financial crisis, during which the global financial system almost came to a halt. Examples of the drying-up of liquidity conditions during the month of March include the blow-out in an index calculated by Bank of America measuring the funding stress in the global financial system across rates, credit and currencies (Figure 4), sharp swings into discounts to net asset value for some of the most liquid US fixed income exchange traded funds (ETFs) (Figure 5) along with a sharp blow-out in bid offer spreads for usually liquid financial instruments, such as US high grade bonds.

Figure 3. March Crude Price Sell-off: Largest 2 Week Percentage Declines in Modern Times

Source: Bloomberg & Glovista Calculations

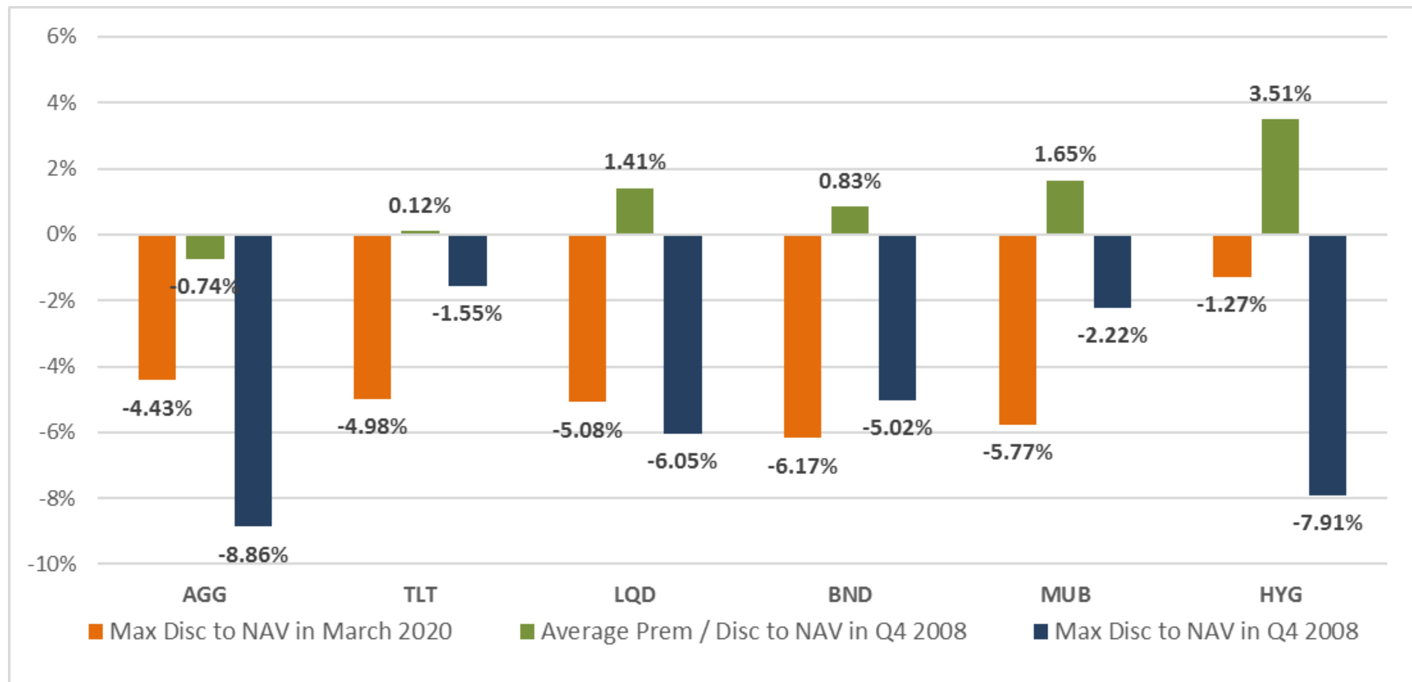
Figure 4. Bank of America Liquidity Risk Indicator measuring funding stress in the global financial system across rates, credit and currency markets

Source: Bank of America

A third important characteristic of the March sell-off entailed the blow-out in credit premium levels in a rather non-discriminating manner so that within a number of large sectors, higher quality-credits sold off as much or more than lower quality peers. One such example entailed the US high grade debt market vis-à-vis a sub-set of US high yield debt peers. Similar dynamics were evident between the US municipal debt markets and the US high yield sector as well as within the loan market across varying creditworthiness categories.

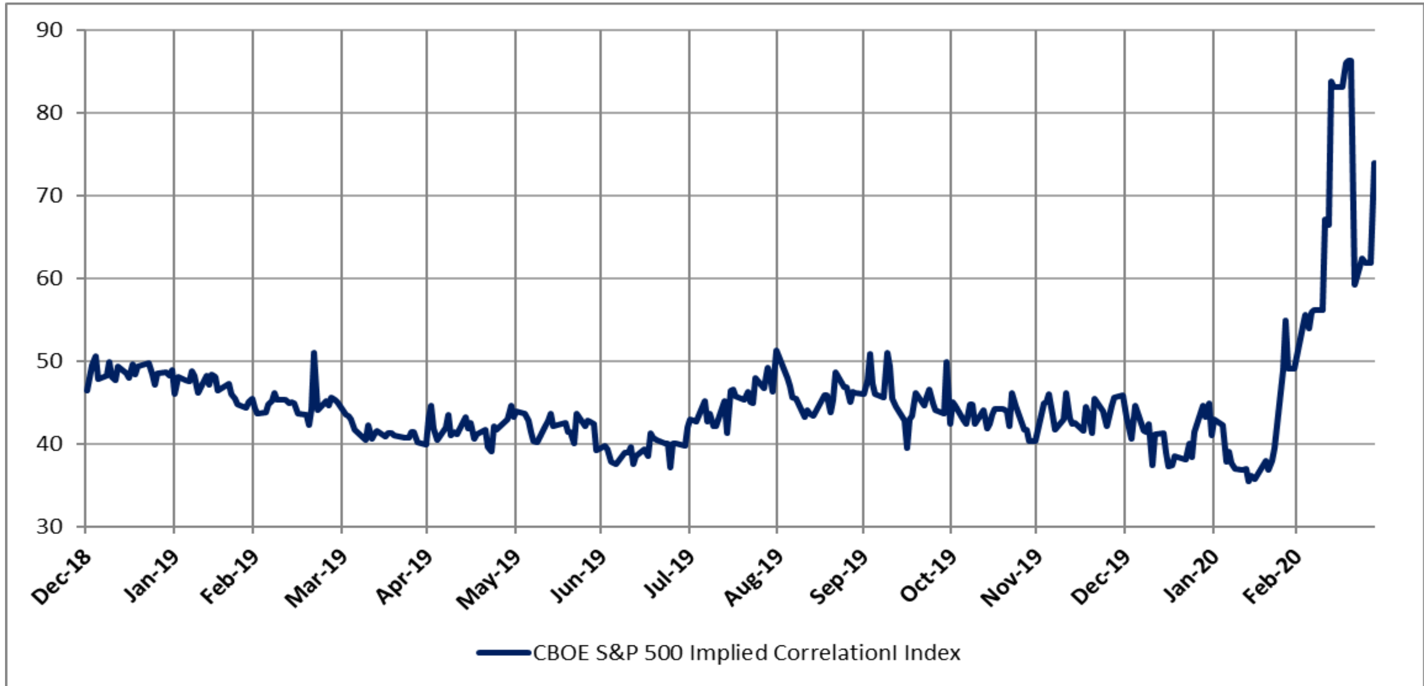
Such non-discriminating price dynamics were also evidenced in the massive blow-up in pairwise return correlations within some of the largest equity indices in the world (Figure 6).

Figure 5. Some of the Largest, Most Liquid US Bond ETFs Swing into Large Discounts to Net Asset Value, as Reflection of Extraordinary Illiquidity Pervading Underlying Fixed Income Instruments



Source: Bloomberg & Glovista Calculations

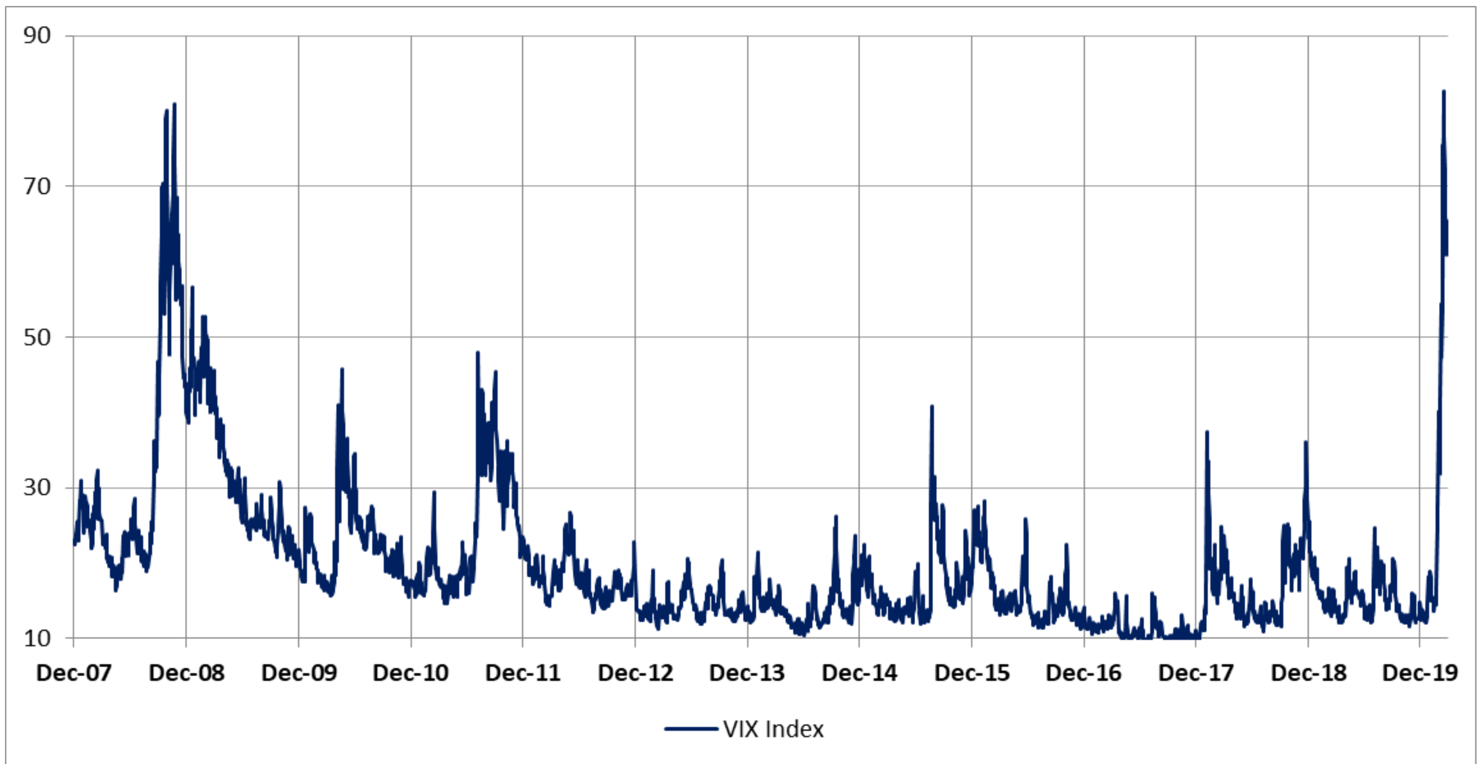
Figure 6. March Sell-off's Non-discriminating Feature Entailed Fundamentally Unjustified Increase in Paiwise Correlations Across Stocks Within S&P500



Source: Bloomberg

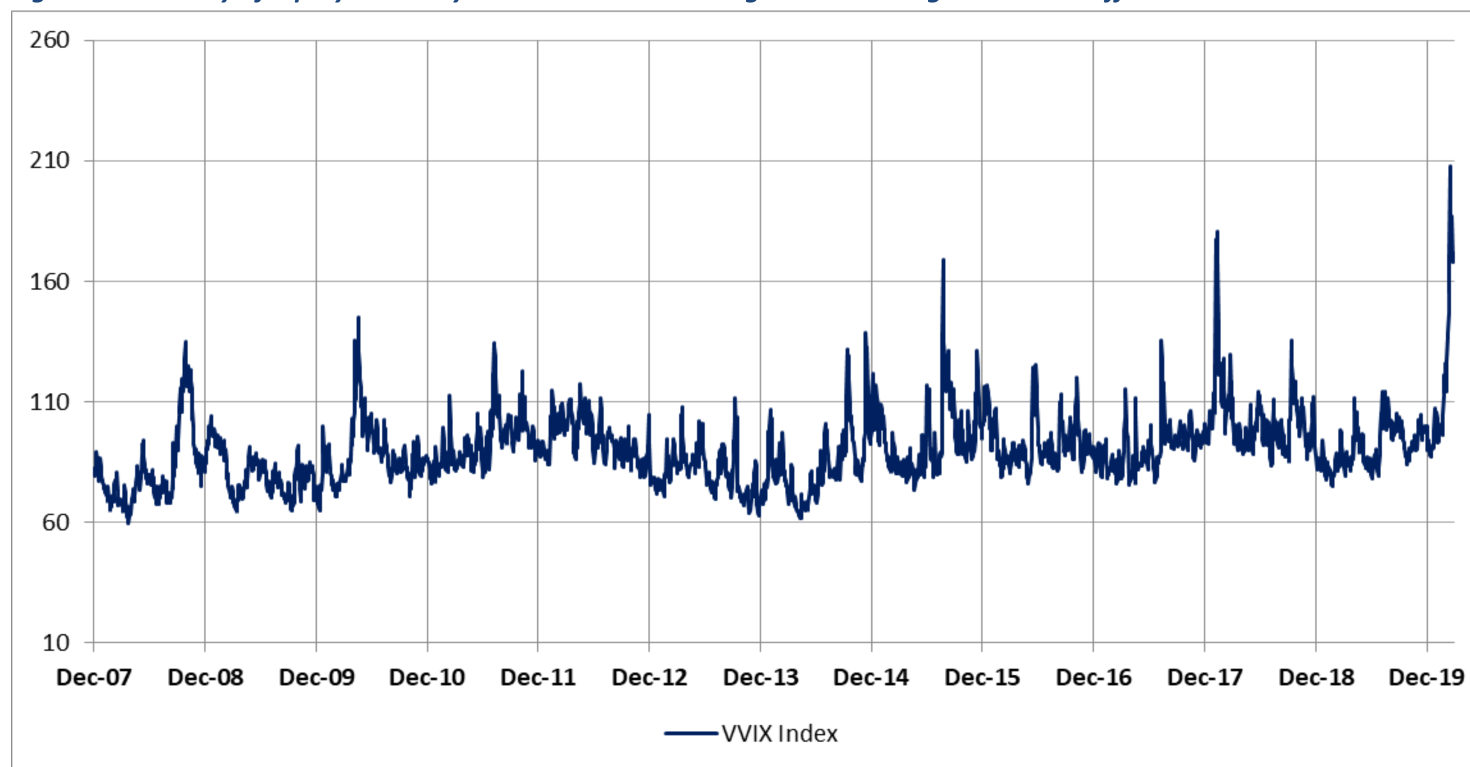
Fourth, the blow-up in implied volatility levels – both in equity and fixed income markets – and volatility of volatility reached and exceeded historically high levels, as illustrated in Figure 7 and Figure 8, respectively.

Figure 7. Implied Equity Volatility Levels (VIX Index) Reach Highest Levels since 2007-2009 Crisis



Source: Bloomberg

Figure 8. Volatility of Equity Volatility Reach New All-time High Levels during March Sell-Off



Source: Bloomberg

Finally, the late stages of the sharp March sell-off in risk markets witnessed a massive reversal in return correlations between risk assets (equities) and risk-free/safe haven assets (e.g. US Treasurys and gold), as illustrated in Figure 9.

The Glovista investment team views the above-mentioned characteristics of the historic March market sell-off as the manifestation of both fundamental as well as important technical market considerations. First, from a fundamental perspective, the epidemic's escalation into a pandemic entailing the traumatic economic dislocations discussed above justifiably led to a reevaluation of asset risk premium levels (at least til further details of the pandemic's likely evolution becomes known) as well as economic growth and corporate earnings growth estimates for 2020, in particular. We view such fundamental developments accounting for close to 60 percent of the asset price declines unfolding during the month of March. We believe the balance of the March asset price declines reflects a number of market technical considerations, including:

- global equities' sizable overbought condition during the late February period – as illustrated in hedge funds', risk parity funds' and CTAs' outsized net long equities exposures as well as retail investors' and global balanced funds' large net equities exposures.

- excess levels of leverage in the financial system, including via structured products such as 2x, 3x levered ETFs and fund products as well as leverage in private markets, the quantification of which is difficult to gauge given those markets' private status. Anecdotally, the March sell-off's damage to the levered space was considerable as witnessed by the broad forced shut-down of levered ETFs tied to the US municipal, BDC, commodities, fixed income and equities space.

- the generalized levels of illiquidity permeating large swaths of the public markets – including US fixed income – is partly the result of new regulations imposed in the aftermath of the Great Financial Crisis period (e.g. Volker Rule, Dodd-Frank).

Glovista Sustains Defensive Portfolio Stance, Favoring High Quality US and Emerging Market Stocks along with US High Grade Debt Securities and Tactical Exposure to Gold Commodity

Against the above discussed backdrop, and taking advantage of the sharp dislocations and lower prices across asset markets during the month of March, the Glovista investment team has raised its equities exposure from previous low levels. We have continued to maintain defensive portfolio exposures via high quality stocks and bonds. Moreover, we have continued to trade gold exposure from the long side.

As we look ahead, we hold a constructive outlook towards high quality equities given our expectation of a resumption in global economic and earnings growth starting around the month of June. Moreover, we view the speedy introduction of massive monetary and fiscal policy stimulus from the world's major economic blocs (US, Europe, China and Japan) as instrumental in curtailing adverse tail risk scenarios surrounding the second half of 2020 and 2021 world economic outlooks. In addition, we expect central bank policy to remain supportive of risk markets well into 2022 given the virtually assured benign inflation stance globally as the resumption of trend growth takes at least 24 months to be attained. Evidently, as of the present juncture, the presence of important downside risks (both tied to the possible recurrence of the coronavirus epidemic during the Fall season in the northern hemisphere as well as the potential adverse interaction between labor market, sales turnover and credit conditions as the cycle turns) remains a conditioning factor to the investment outlook.

Owing to the risks noted above, we believe it is judicious to maintain a high-quality factor tilt to our portfolio positioning well through the end of this year. Within the equities domain, such quality factor exposure takes the form of overweight exposure to high quality US defensive sector stocks and emerging market equities – particularly in the Asia region. Within the fixed income space, we favor exposure to US high grade debt securities as well as selective exposure to high quality emerging market corporate debt. In the commodities space, we continue to favor gold exposure and avoid exposure to energy and industrial metal commodities.

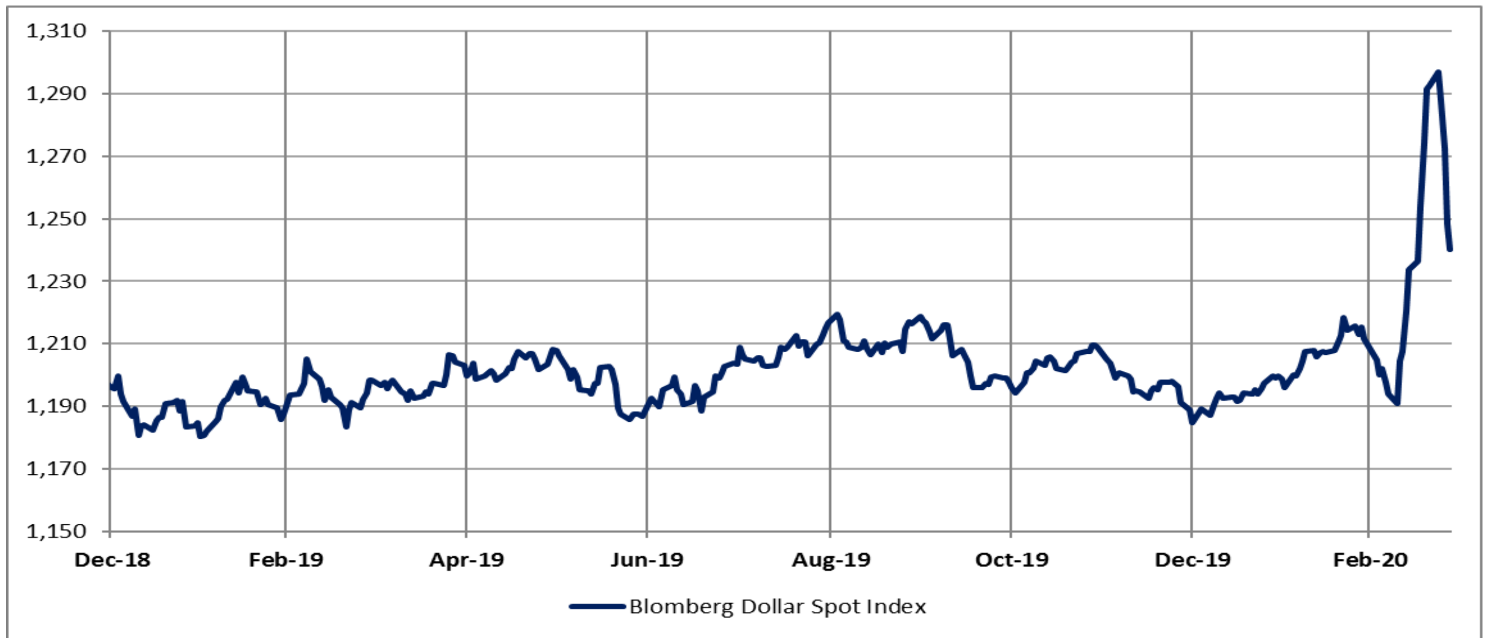
Emerging Markets Perspectives

EM Equities Participate Solidly in March Global Sell-off, Fueled by Outsized World Recession Concerns, Strengthening US$ and Falling Commodity Prices; Glovista Sustains Asia Overweight Tilts

In March, emerging market equities have participated materially in the outsized risk market sell-off impacting global markets, triggered by the onset of the pandemic early in the month and discussed at length in the adjoining *Global Perspectives* column. The sell-off in emerging market equity prices has been reinforced by the presence of several short-lived technical market factors outlined in the accompanying *Glovista Global Perspectives* column. Such technical market factors include the excessive levels of broad market illiquidity unfolding during the most vicious stages of the March sell-off. Such illiquidity dynamics manifested themselves, among others, via the outsized US$ strength and weakness in medium-term inflation expectations, both of which have reversed themselves considerably over the past two weeks (Figure 10 and Figure 11, respectively).

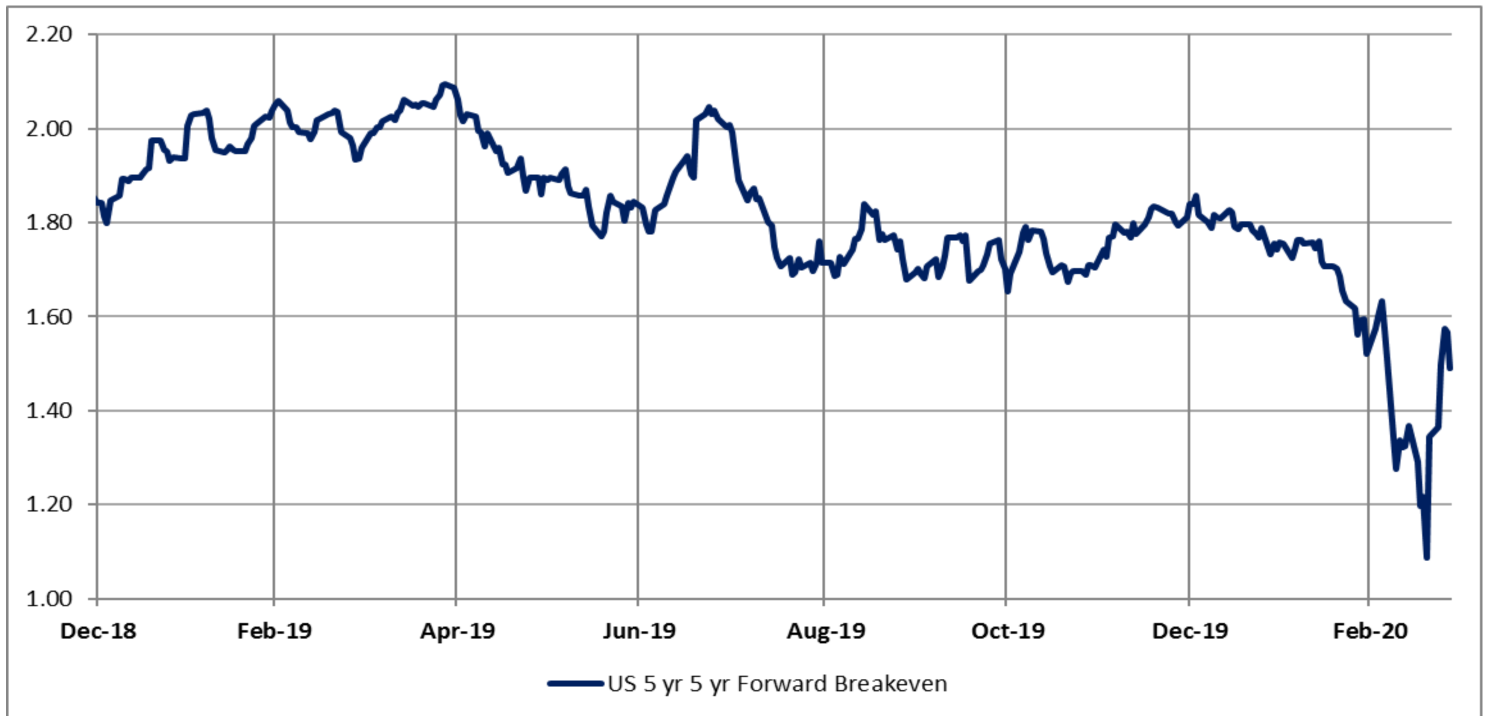
We credit the recovery in macro factors of importance to emerging market equity prices to be ongoing and sustained, not only on account of (a) the technical factors' transitory nature – addressed largely by the ongoing shift in investor positioning and, more importantly, by the monumental G20 governments' policy responses announced over the past week – but also to (b) emerging market economies' (particularly those in the emerging Asia region) improving cyclical momentum along with their advanced stage in overcoming the onset of the coronavirus pandemic – particularly, those countries in the North Asia region (China, South Korea and Taiwan – coincidentally the three largest constituents of the MSCI EM benchmark).

Figure 9. US$ Index Corrects Sharply Down during the Second Half of March on the Back of G20 Governments' Speedy and Large Policy Responses



Source: Bloomberg

Figure 10. Long-term Inflation Expectations have Bounced Strongly on the Back of G20 Government's Speedy and Large Policy Responses



Source: Bloomberg

As we look ahead, we expect emerging market equities to resume their multi-year period of relative US$ return outperformance of international developed (EAFE) market peers on account of their attractive valuations, under-owned status and strengthening (even more so, following the coronavirus' transition into global pandemic status) cyclical momentum, both on account of their local economies' (particularly service sector stocks) growing representation in the MSCI EM benchmark but also the North Asia region's heavy representation (approximately 78 percent) in the EM benchmark.

The Glovista investment team continues to favor overweight allocations to North Asia markets both on relative valuation and relative earnings growth momentum considerations. We recently cut India country allocations to underweight on concerns over that country's vulnerability to the coronavirus pandemic. In Latin America and EMEA, we recently took profits in our underweight allocations to Brazil and South Africa both on currency as well as relative valuation considerations. Finally, we have further trimmed our already underweight exposure to the Gulf regional markets both on cyclical considerations, relative valuations and continued macro financial vulnerabilities stemming from continued energy price weakness.

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