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Monthly Market Newsletter

# Glovista Global Perspectives

This Issue:

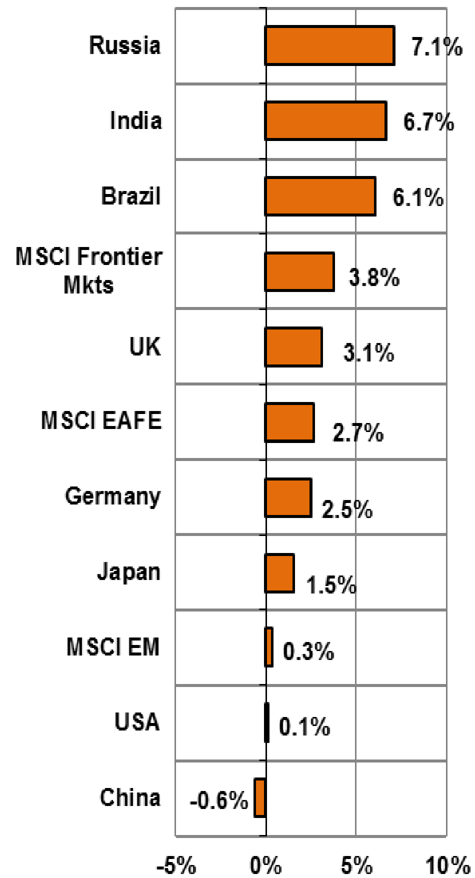


## *Long Duration Assets Sell Off Sharply in May, led by Cryptos and Non-Profitable Tech Stocks; Glovista Sustains Value including Non-US Equities Overweight and Underweight Bond Duration Tilts*

In May, headline risk indices, such as global equities – as represented by the MSCI ACWI index - and corporate bonds – as represented by the Barclays US corporate bond index- have traded within narrow ranges, recording approximately flat return performance for the month. Figure 1 illustrates the May month-to-date return performance for a number of risk indices, including the two referenced above, along with their corresponding 2021 year-to-date performance. Such consolidating price dynamic during the month of May is largely the result of investors' portfolio rebalancing actions in the face of excessive acceleration of inflation and growth expectations around the middle of the month. As we discuss further below, since the middle of the month such dynamics have reversed partially. As we look ahead, we expect continued moderation in market-derived growth and inflation expectations over the ensuing months, lending ongoing support to risk markets, especially non-US equities and value-oriented risk indices.

As illustrated in Figure 1, the consolidation in risk indices' performance during the month of May is rather misleading as it hides a set of unusually momentous market developments, including most notably a crash in crypto asset prices and severe price declines in other similarly long duration asset groups, including non-profitable growth oriented stocks, especially tech. For example, Figure 2 illustrates the intra-month crash in crypto asset prices during the month of May, to the tune of 38.5 % as reflected in the Nasdaq Crypto Index (NCI). Likewise, Figure 3 illustrates the close to 10 % intra-month decline recorded by US small cap growth stocks, as represented by the Russell Small Cap Growth index.

**Country-wise Monthly Performance in USD terms (May 2021)***




***Source: MSCI & Bloomberg***

**As of May 26th, 2021*

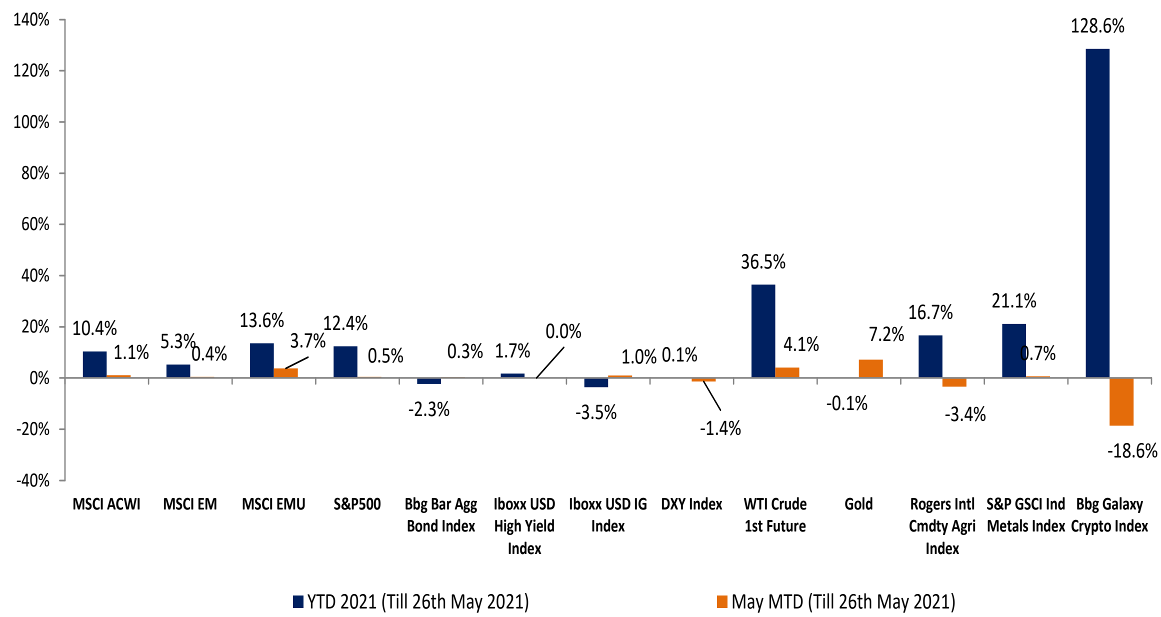
**S&P500 Monthly Sector Performance – May MTD 2021***

| Sectors | % Change | FY1 PE Ratio |
|---|---|---|
| Energy | 4.77% | 19.7 |
| Materials | 4.42% | 19.8 |
| Industrials | 1.61% | 28.3 |
| Cons Disc | -3.86% | 35.1 |
| Cons Stap | 2.25% | 21.9 |
| Technology | -0.83% | 27.0 |
| Healthcare | 1.60% | 17.1 |
| Financials | 3.41% | 14.7 |
| Utilities | -2.58% | 18.8 |
| Telecom | 0.02% | 22.8 |
| Real Estate | 0.61% | 50.5 |
| S&P500 | 0.35% | 22.6 |

*As of May 26th, 2021*

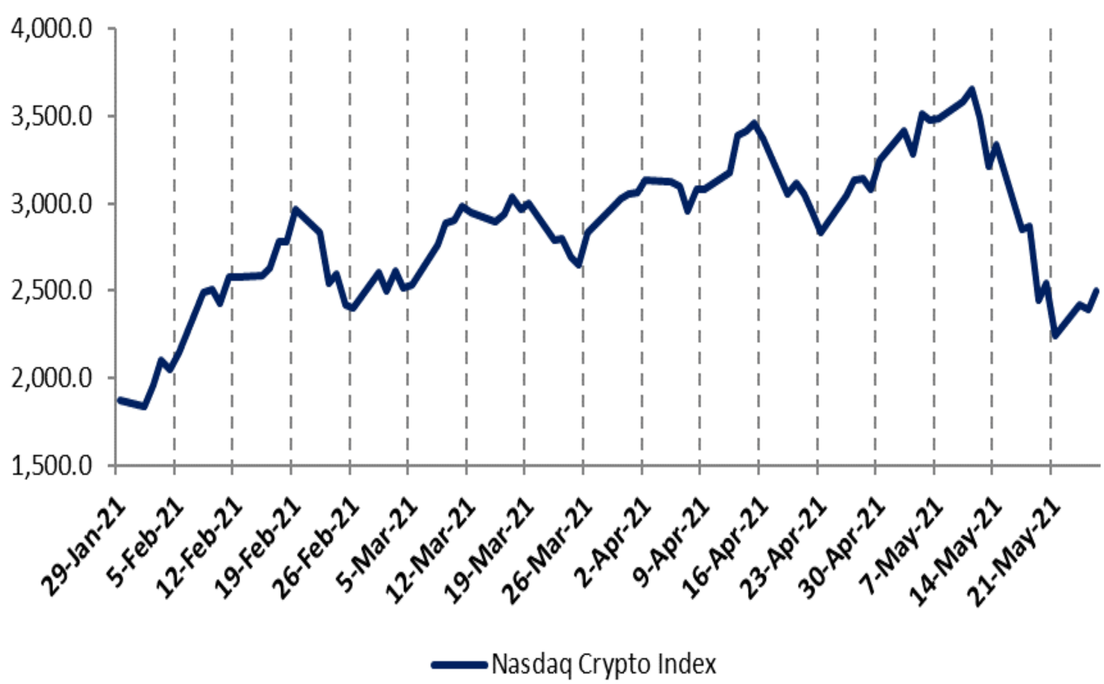
***Source: Bloomberg***

***Figure 1. Composite Risk Indices' Approximately Unchanged May Performance Hides Extraordinarily Large Cross-Sector Dynamics during the Period***




***Source: Bloomberg and Glovista Calculations***

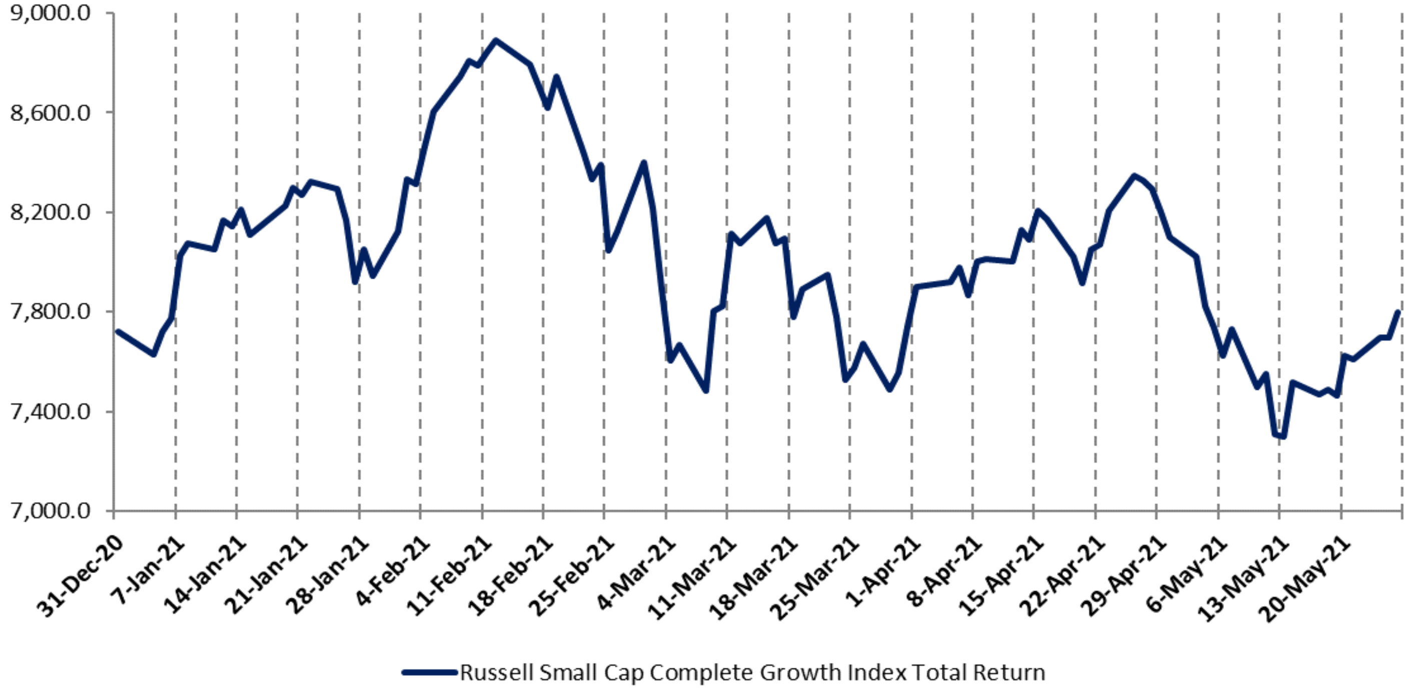
***Figure 2. Crypto Asset Prices Crash close to 40%, Intra-month, in May Fueled by Spike in Inflation Expectations and Excessive Use of Leverage***




***Source: Bloomberg***

From a broad market risk perspective, it is worth noting the absence of any contagion-like effect from the May crypto market crash on the broader markets, either equities or credit. We view the latter as indicative of the absence of systemic risks associated with the crypto market, a most welcome development from investors' perspective.

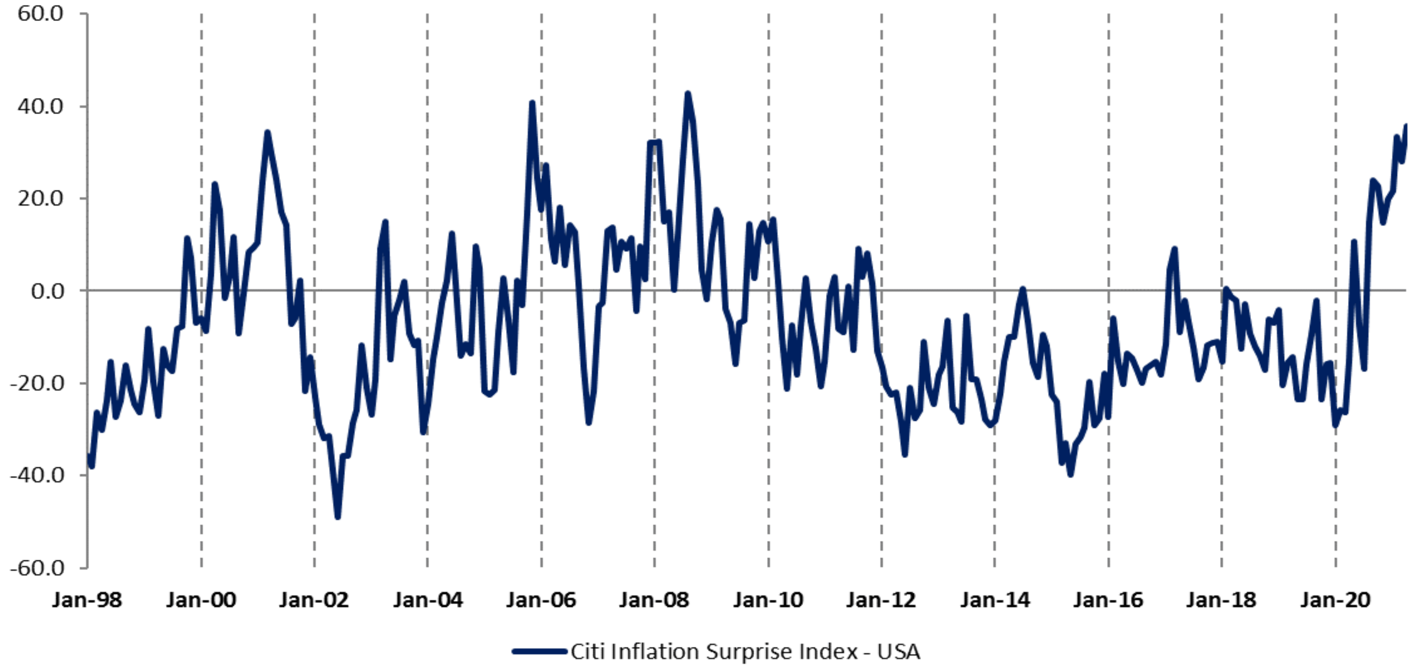
*Figure 3. US Small Cap Growth Stocks Decline Close to 10%, Intra-month, in May Fueled by Spike in Inflation Expectations and Excessive Use of Leverage*




***Source: Bloomberg***

In our assessment, the sharp price declines recorded in May by long duration assets, whose valuations are either extended (e.g. small cap growth) or ambiguous (e.g. cryptos), conforms to well established vulnerabilities confronted by such securities in periods associated with accelerating inflation and economic growth levels and momentum. In that light, the month of May's global macro calendar offered a number of significant upside surprises on both the inflation and economic activity fronts. For example, Figure 4 illustrates the extent of upside inflation surprises for the US while Figure 5 highlights decade high levels for the US service sector sentiment diffusion index.

*Figure 4. US Inflation Surprise Index Reaches Highest Level in Decades*




***Source: Citigroup***

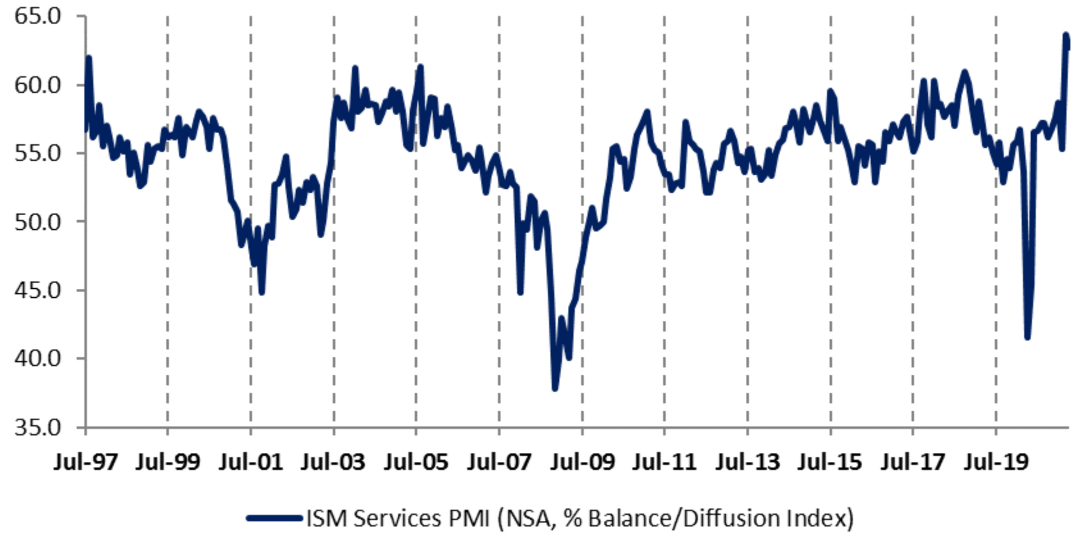
| | May26th 2021 | May MTD Change |
|---|---|---|
| Gold | 1896.67 | 7.2% |
| Silver | 27.6825 | 6.8% |
| Oil | 66.21 | 4.1% |
| EUR | 1.2192 | 1.4% |
| JPY | 109.15 | 0.1% |
| GBP | 1.4119 | 2.1% |
| CHF | 0.8982 | 1.6% |
| CAD | 1.2123 | 1.3% |
| AUD | 0.7743 | 0.3% |
| BRL | 5.312 | 2.3% |
| MXN | 19.881 | 1.8% |

*Source: Bloomberg*

| Rates | May 26th Levels |
|---|---|
| 1 Yr CD | 0.32% |
| 5 Yr CD | 0.45% |
| 30 Yr Jumbo Mortgage | 3.1% |
| 5/1 Jumbo Mortgage | 3.19% |
| US Govt. 10 Year | 1.58% |
| 10 Yr Swap Spread | -0.04% |

*Source: Bloomberg*

***Figure 5. US Service Sector Sentiment Index Hovers at Highest Level in Decades***




***Source: Institute for Suppy Management***

The set of underlying macro dynamics anchoring the upward acceleration in inflation and growth momentum have been discussed in prior columns, entailing the following:

- cost-push inflation tied to supply side bottlenecks, a legacy of the long shutdown period across the global economy;

- the binary- or digital-like nature of demand acceleration stemming from the ongoing reopening of some of the world's largest consumer economies, especially the USA. Such unprecedent growth dynamic is further exacerbated by the synchronous nature of the reopening of national economies across Europe and North America;

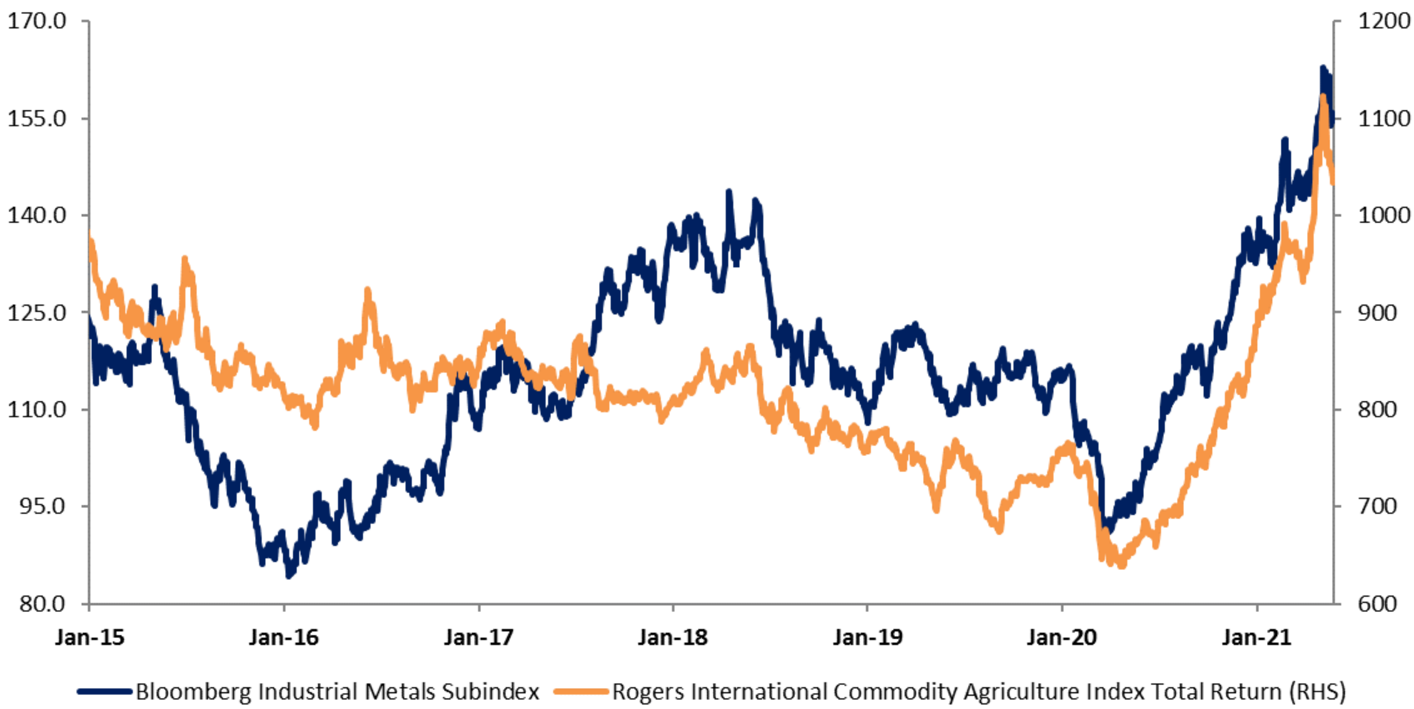
- the unusually strong cash flow position in which US consumers find themselves at the time of reopening lends additional force to the expenditure acceleration. Such unusual strength in cash position is largely the result of a succession of massive transfer payments extended by the federal government throughout 2020 and 2021. Similar developments are also present in Europe and elsewhere in the developed world, most notably the European Recovery Fund that will be implemented over the course of several years, benefiting predominantly periphery countries;

- US Dollar weakness, unfolding throughout much of the past twelve months, has further exacerbated the spike in world commodity prices, across the soft, industrial, energy and precious metals domains, and;

- Central banks' continued commitment in sustaining exceedingly loose liquidity and credit conditions.

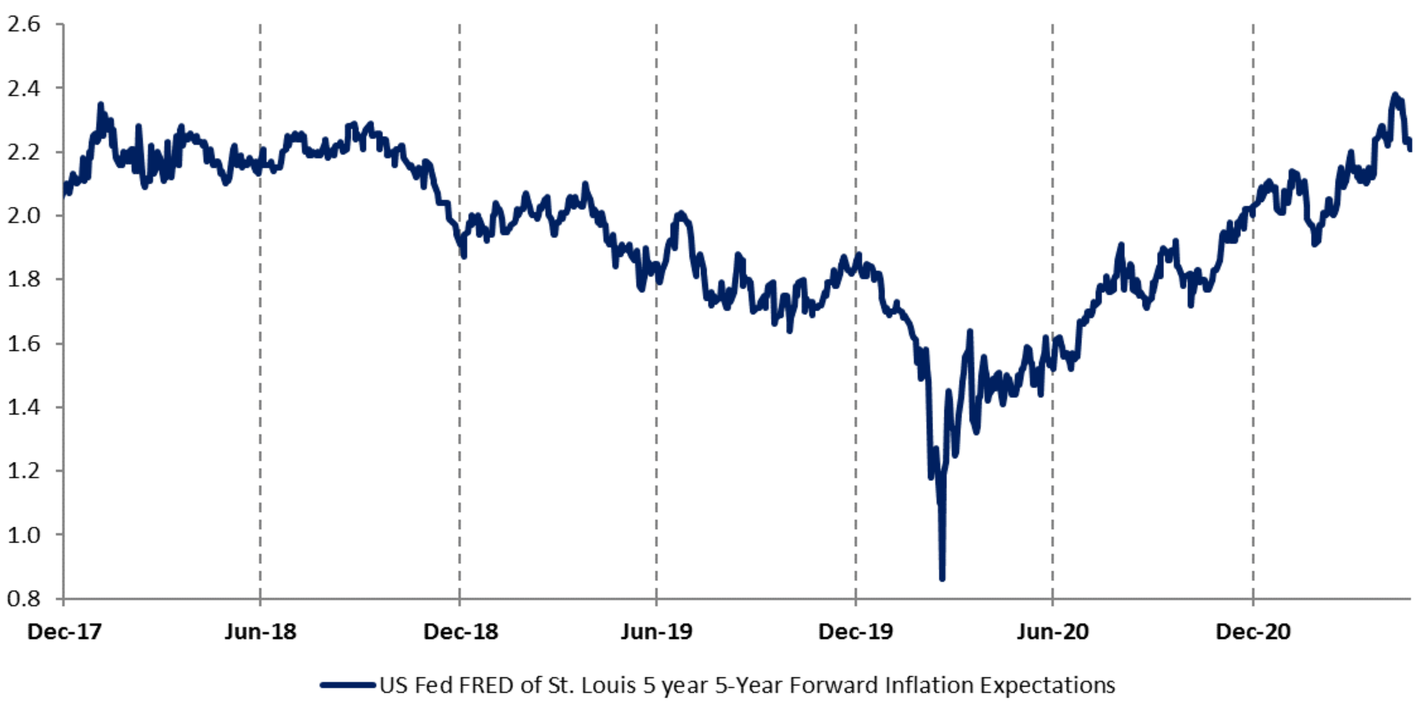
As we review the May inflation and economic growth surprises, we believe US inflation momentum is likely to have peaked in the current quarter as year-ago base comparisons (and other pandemic era-specific factors resulting in unusual spikes in used car prices and imputed rent prices) fade. In addition, the pace of imported inflation momentum is also likely to decelerate owing to the fading of supply bottleneck factors and year-ago base effects tied to US Dollar weakness. In that regard, it is encouraging to witness a recent reversal in soft (agriculture) and industrial metal commodity price pressures (Figure 6) as well as the accompanying pullback in US inflation expectations (Figure 7). Such price dynamics underscore commodity prices' self-correcting behavior.

***Figure 6. Agriculture and Industrial Metal Commodity Prices Pull Back in Late May along with Peak in Inflation and Growth Expectations***




***Source: MSCI, Bloomberg & Diapason Commodities***

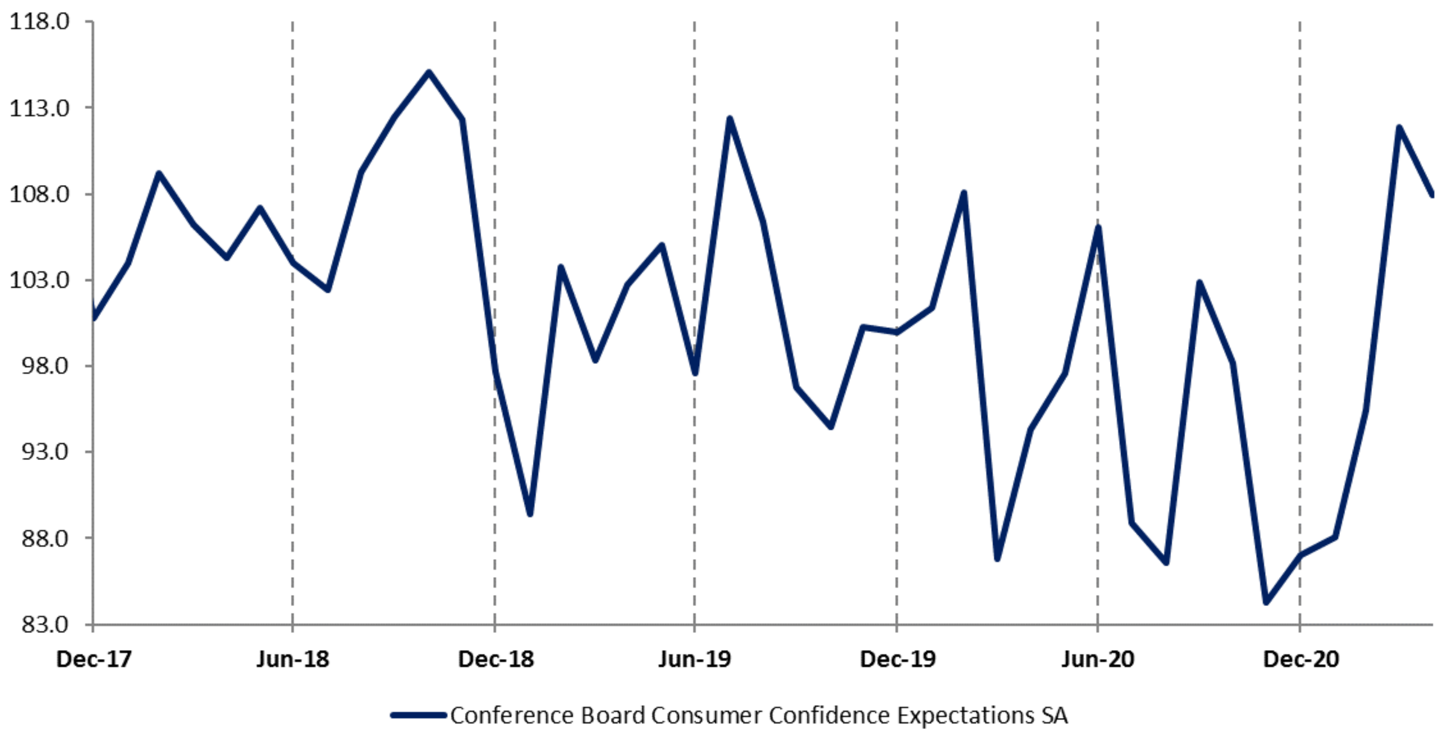
***Figure 7. US market-based Inflation Expectations Pull Back along with Peak in Growth Expectations***




***Source: The Federal Reserve Bank of St. Louis***

As we look ahead, we also expect US economic growth momentum to have peaked in the second quarter of this year owing to: (a) year-ago base period effects, (b) fading of the binary- or digital-like effects of economic reopening and (c) the withdrawal of transitory transfer payments to the household sector introduced most recently by the Biden administration. We believe such considerations underlie the recent deceleration in US consumer confidence (expectations sub-component), illustrated in Figure 8.

***Figure 8. May US Consumer Confidence Expectations Soften from Recent High Levels, Likely Reflecting the Fading of Transitory Boost Factors, especially Transfer Payments***

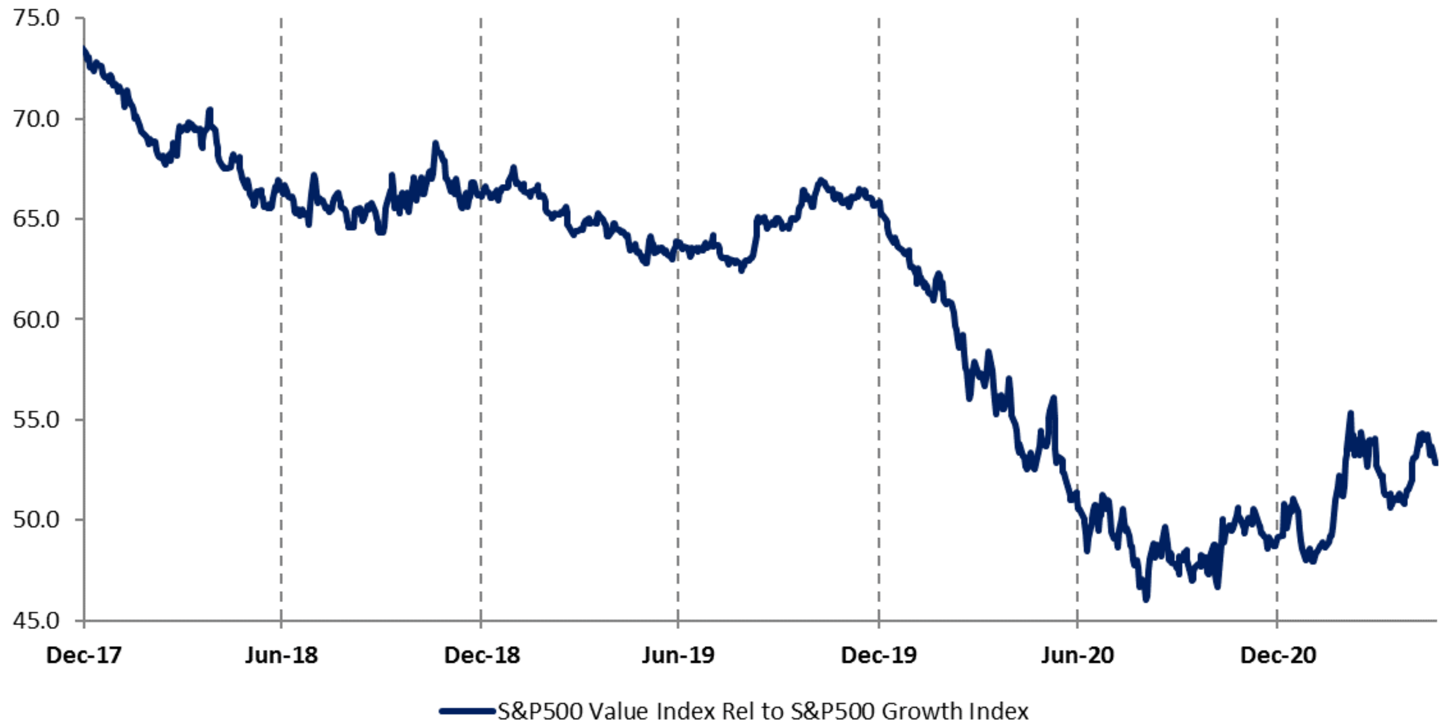



***Source: Conference Board***

Under a scenario of decelerating economic and inflation momentum, we expect asset risk premium levels to remain at average or below-average historical levels as we expect the economic expansion to extend well into 2022 courtesy of the expenditure growth visibility afforded by the stock of pent-up household and business demand, both domestically as well as from the rest of the world.

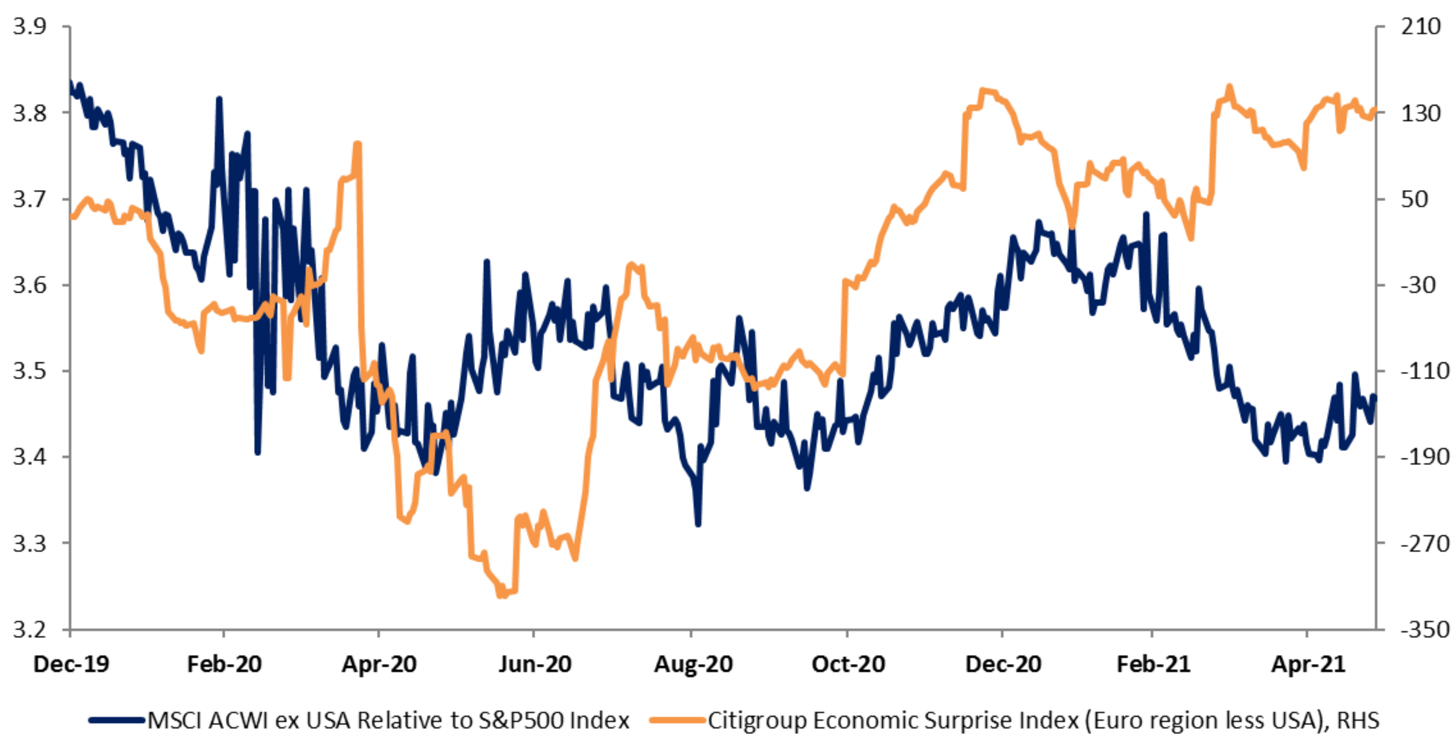
The breadth and strength of economic activity indicators globally along with the pick-up in the pace of vaccination rates across the world is lending additional support to value stocks' attractiveness both within the US market context as well as globally. While we expect US economic growth and inflation momentum to decelerate over the coming months, we continue to expect long-term bond yields to remain pressured upwards as a normalization in real bond yields has not yet occurred. Such continued upward pressure to long-term real yields are likely to lend support to value oriented markets. As for the month of May's market development across styles, Figure 9 illustrates US value stocks' robust outperformance over growth peers while Figure 10 illustrates non-US equity markets, predominantly value sector-oriented, recording solid outperformance versus US equities, whose benchmark index is predominantly growth sector-oriented.

*Figure 9. US Value Stocks Extend Solid YTD Outperformance versus US Growth Peers as Economic Growth Accelerates and Long-term Bond Yields Normalize Higher*




***Source: Bloomberg & Glovista Calculations***

*Figure 10. Non-US Equities Record Solid Outperformance Versus US Peers in May, Boosted by Non-US Equity Benchmark's Dominant Value Tilt and Eurozone Region's Strengthening Economic Growth Differential versus USA*




***Source: Bloomberg, MSCI, Citigroup & Glovista Calculations***

## *Glovista Sustains Bullish Outlook Towards Value Factor, at the Sector and Market Index Level, especially Non-US Equities; Underweight Bond Duration Stance is also Sustained*

As we look ahead, the Glovista investment team sustains a bullish outlook on global equities, favoring value-oriented sectors and market indices globally, including emerging market equities, US value sectors (especially financials, materials and selected industrial groups) as well as selected US mega-cap high quality, secular growth stock groups.

While we continue to favor emerging markets over international developed peers, over the past several weeks we have embraced a more constructive outlook towards Eurozone regional equities on several considerations, including:

- the region's expected economic growth acceleration over the coming months, following the pick-up in vaccination rate across the bloc;
- the regional equity benchmark's dominant value-oriented sector tilt, given our bullish outlook towards the value factor globally, and;
- the recent passage of fiscal stimulus measures, especially the European Recovery Fund, with a shelf life measured in years and favoring especially periphery countries, such as Italy and Spain.

As always, the investment outlook is not bereft of risks, including: the potential for a sudden reversal in the Fed's policy stance from dovish to a hawkish orientation; geopolitical developments, especially out of the Middle East and North Asia (China, Taiwan, North Korea). From a short-term perspective, we believe risks are two-sided as equities' poor June monthly seasonality backdrop is paired against indications of a bottoming in liquidity tightening measures out of China (introduced early in the year) and the ongoing reopening of the European economy.

## *Emerging Markets Perspectives*

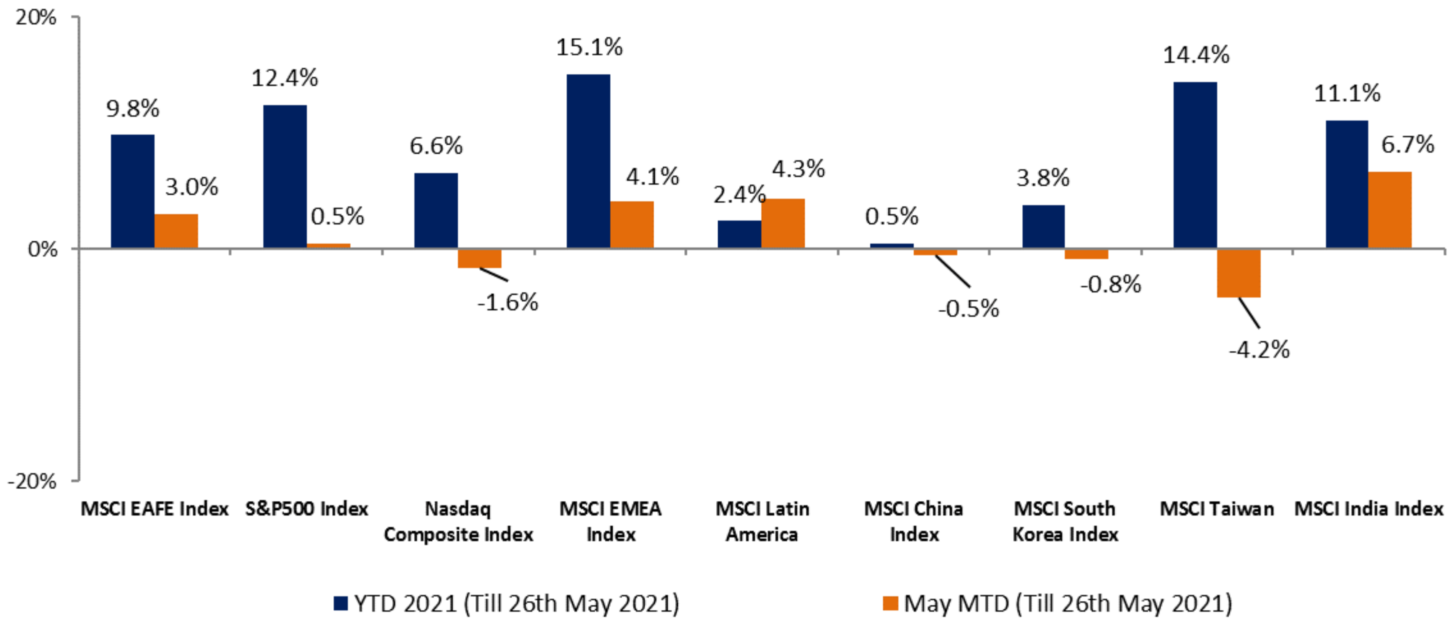
### *Latin America, EMEA and India Post Strong May Outperformance versus Developed and EM North Asia Peers; Glovista Trims North Asia Underweight while Sustaining India/South Africa Overweight Tilts*

The month of May is best described as a 'tale of two cities' period in the emerging market equities space, in which Latin America, EMEA and India markets recorded strong return performance while developed and EM North Asia peers underperformed. Figure 11 illustrates the magnitude of such excess performance.

The stark cross-regional and country return performance summarized in Figure 11 reflects the value factor's strong outperformance at a global level during the May period, as discussed above. Within the emerging markets space, Latin America, EMEA and India markets are more heavily represented by value-oriented sectors, including materials, industrials, energy and financials. As we have discussed in prior columns, the Glovista investment team favors overweight allocations to value-oriented markets in 2021. Within such value-oriented markets, we favor the India market most strongly, followed by South Africa, Russia and Brazil. Country-level policy and macro considerations, along with benchmark index's leading constituent level company considerations account for such selection by our investment team.

Given our global macro outlook, both medium- and near-term, although we continue to favor overweight allocations to value-oriented markets, the quantum of the group's recent outperformance of growth oriented peers has resulted in the offering of attractively valued growth plays, especially out of China. Consequently, over the past several sessions we have raised our China country allocation to overweight while sustaining India and South Africa overweight tilts. Our China country allocation raise was funded primarily via a reduction in Latin America country allocations.

*Figure 11. May EM Regional Performance: LatAm, EMEA and India Outperformance*




***Source: Bloomberg & Glovista Calculation***

As we look ahead to the coming months, we expect emerging market equities to outperform developed peers on the back of: strengthening earnings growth outperformance, as a growing number of countries reopen from the pandemic era-related shutdowns; currency resilience versus the US Dollar, a dynamic we expect to sustain itself at least over the coming two years, given our views of no Fed rate hike before 2023, and; emerging market equities' under-owned status, and attractive valuations, especially on a cycle-adjusted basis.

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