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Monthly Market Newsletter

Glovista Global Perspectives

This Issue:

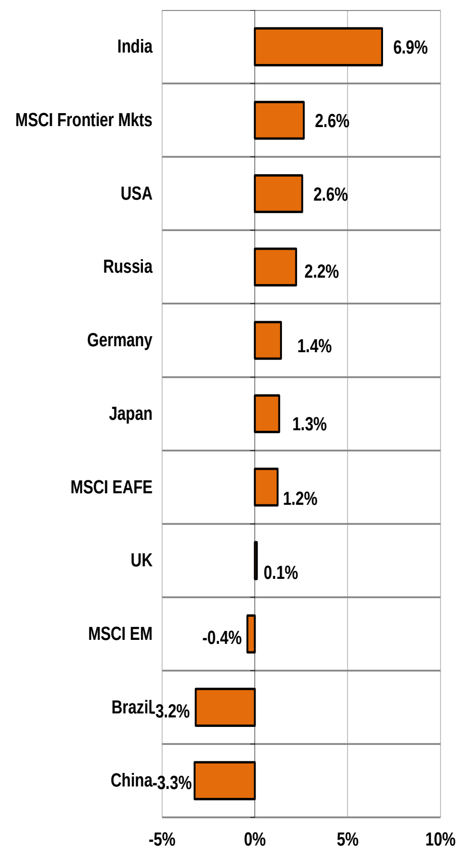
Realized Volatility Picks Up in August as Risk Markets Navigate Fed Tapering and Delta Strain-related Growth Concerns; Glovista Sustains Bullish Value Factor Tilt, including Raising Non-US Equities Allocation

In August, global asset markets have navigated with success two important challenges facing the price and activity outlook. On the price front, the scheduled August 18th release of the minutes corresponding to the July 28th FOMC meeting was widely expected to shed guidance concerning (a) the timing and output-price dynamics conditioning the Fed's initiation of the tapering process of its longstanding asset purchase program as well as (b) details governing the resumption of policy rate hikes later in the decade. The minutes revealed a more accommodating stance by the Fed as it stated that the tapering process could start by the end of this year while some members preferred to wait until early 2022 for the process to begin. In addition, the Fed clarified that the reduction in bond purchase program was not a precursor to an immediate rate hike leading to a muted response from the treasuries market.

On the activity front, investors' economic growth expectations have been impacted by the broader diffusion of the Delta COVID virus strain throughout the USA as well as internationally. Earlier in August, such investor concerns led to increased demand for hedges, as evidenced in the intra-month spike in equity and bond market implied volatility (Figure 1).

The rekindling of investor concerns over the price and activity outlook have coincided with the fading of economic growth momentum reflected in the recent decline seen in hard economic releases as well as soft diffusion sentiment readings, especially since the middle of June. For example, Figure 2 illustrates the sustained deceleration in economic surprise indices for the global economy while Figure 3 highlights a downturn in the business expectations component for Germany's IFO business survey, a reliable barometer for the Eurozone region's economic momentum.

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



Source: MSCI & Bloomberg

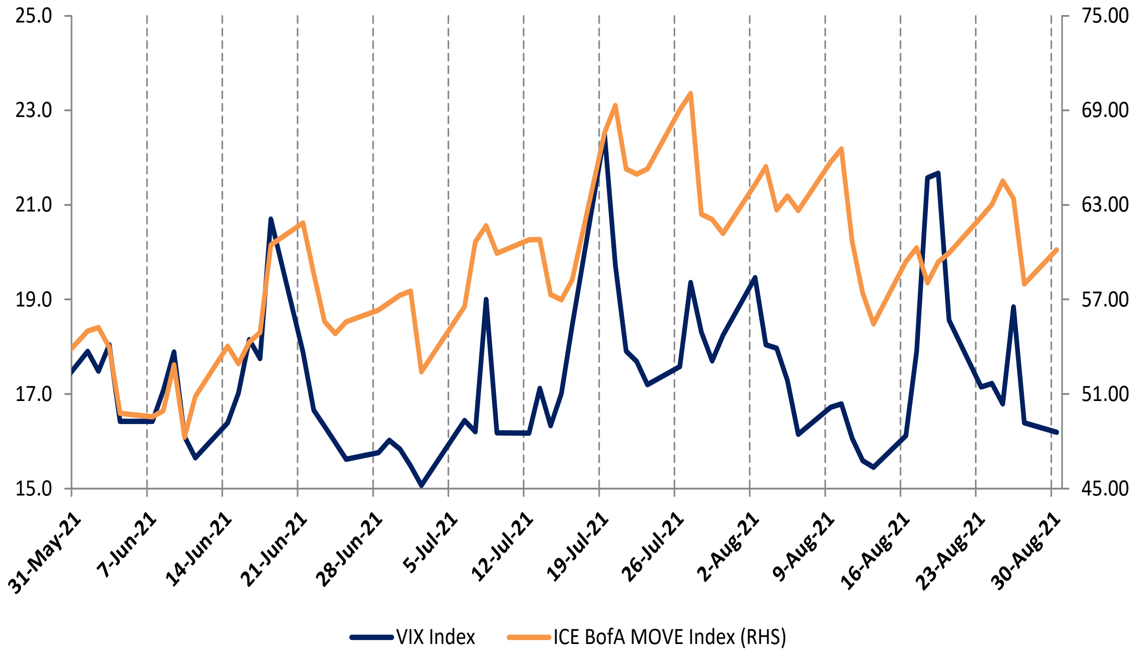
**As of August 27th, 2021*

S&P500 Monthly Sector Performance – August MTD 2021*		
Sectors	% Change	FY1 PE Ratio
Energy	-1.01%	15.3
Materials	2.24%	17.0
Industrials	1.36%	26.8
Cons Disc	0.73%	33.1
Cons Stap	0.56%	21.4
Technology	2.90%	28.2
Healthcare	1.79%	18.0
Financials	-6.66%	13.9
Utilities	3.42%	21.0
Telecom	3.94%	22.1
Real Estate	0.91%	46.8
S&P500	2.60%	22.3

*As of August 27th, 2021

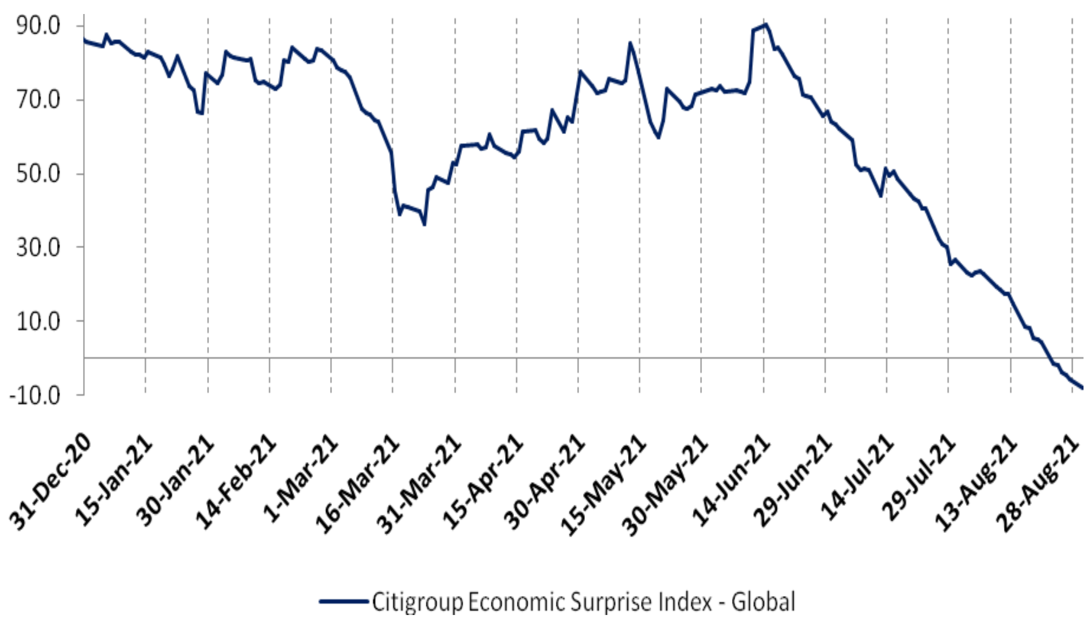
Source: Bloomberg

Figure 1. Equity and Bond Implied Volatility Spikes Higher Intra-month, Fueled by Investor Growth and Rate Outlook Concerns tied to Delta Virus Strain and the August 18th Release of FED Minutes



Source: Bloomberg

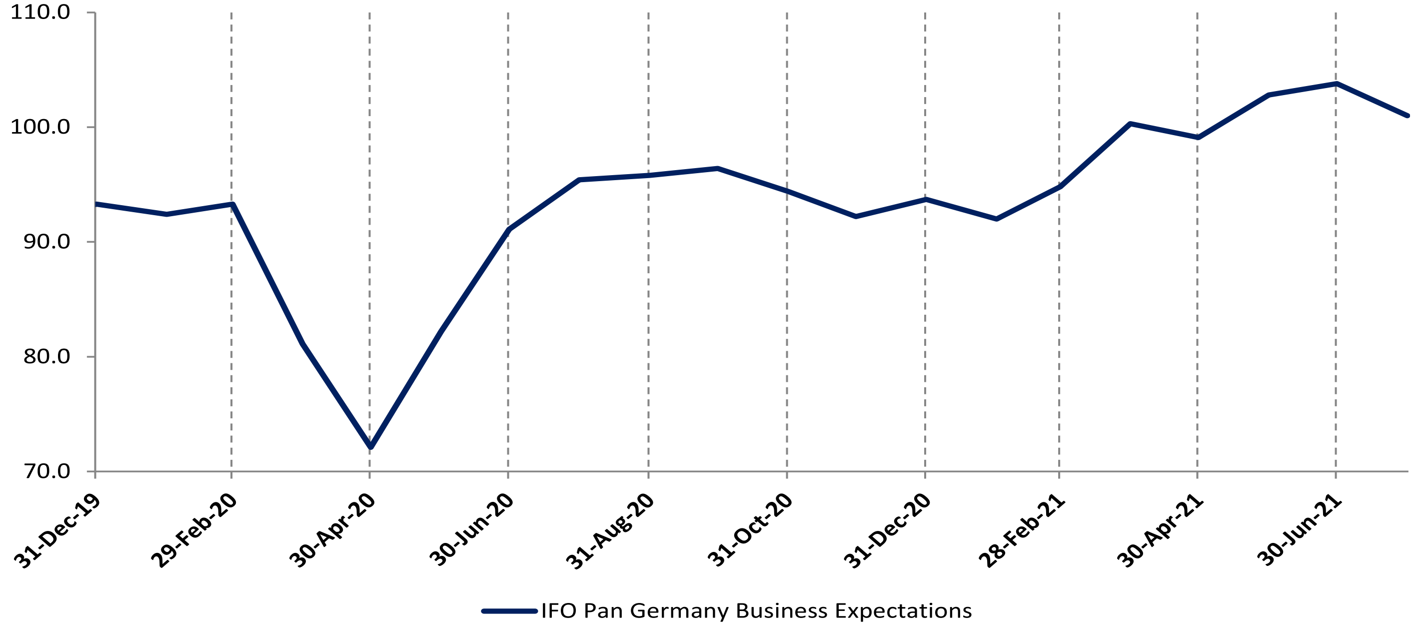
Figure 2. In August, Global Economic Indicators Surprised to the Downside, Extending Downturn Beginning in mid-June



Source: Citigroup

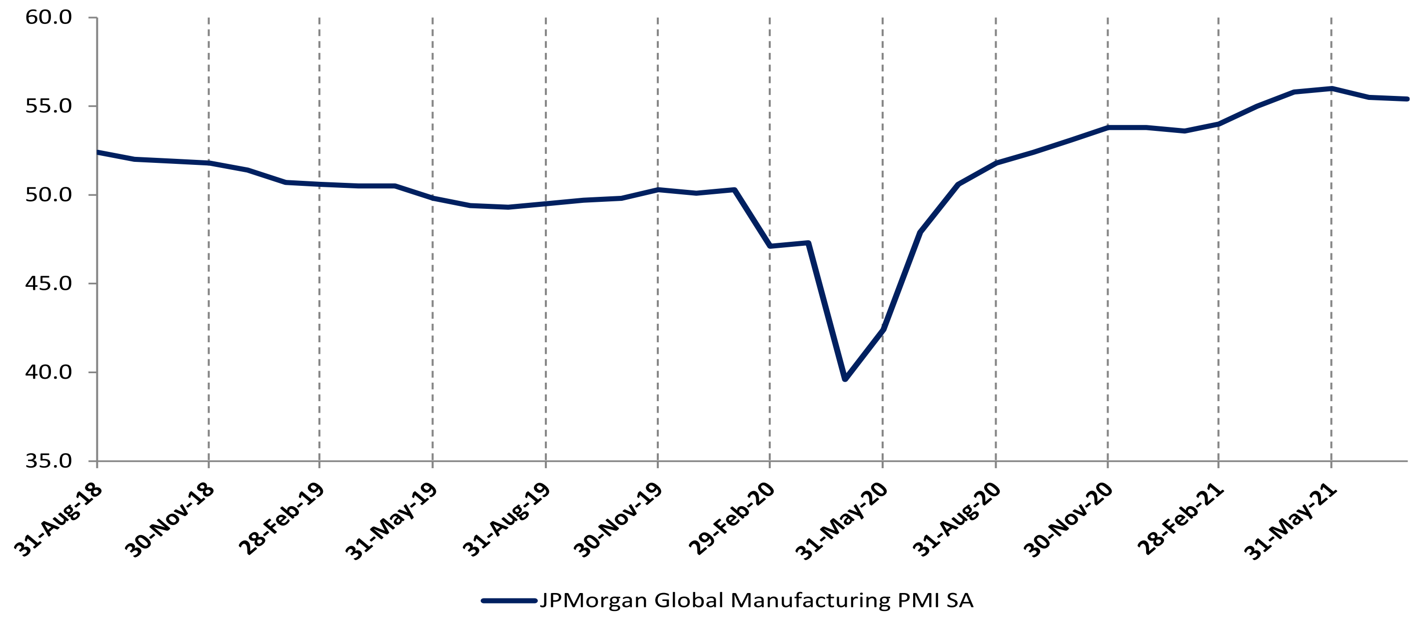
As we assess these recent macro dynamics, it is essential to discern the quantum as well as the underlying source behind the recent deceleration of economic momentum. First, as regards the quantum of the deceleration, it is important to note that the deceleration in economic diffusion indices began from elevated cycle-high levels (Figure 4) with current levels still indicating continued expansion. Figure 4 illustrates such a case for the global manufacturing sector.

Figure 3. Germany's Business Expectations Index Edges Lower in August to Still Elevated Levels



Source: IFO Institute

Figure 4. Global Manufacturing Sentiment Readings Decelerate from Cycle High Levels to Levels Signaling Continued Expansion



Source: Markit

With regards to the sectoral provenance of recent deceleration in economic momentum, the role of supply-side factors tied to supply chain disruptions cannot be emphasized enough. Such supply-side factors are tied to the pandemic, recently exacerbated by the spike in the Delta virus strain, impacting both activity as well as intermediate price measures. For example, Figure 5 illustrates the phenomenal increase in cost of freight measures between some of the world's busiest routes (e.g. Shanghai-Los Angeles, Shanghai-Rotterdam). The disruption in the global supply chain carries over adversely both at the activity level (constrained lower) and price domain (constrained higher on account of cost pressures).

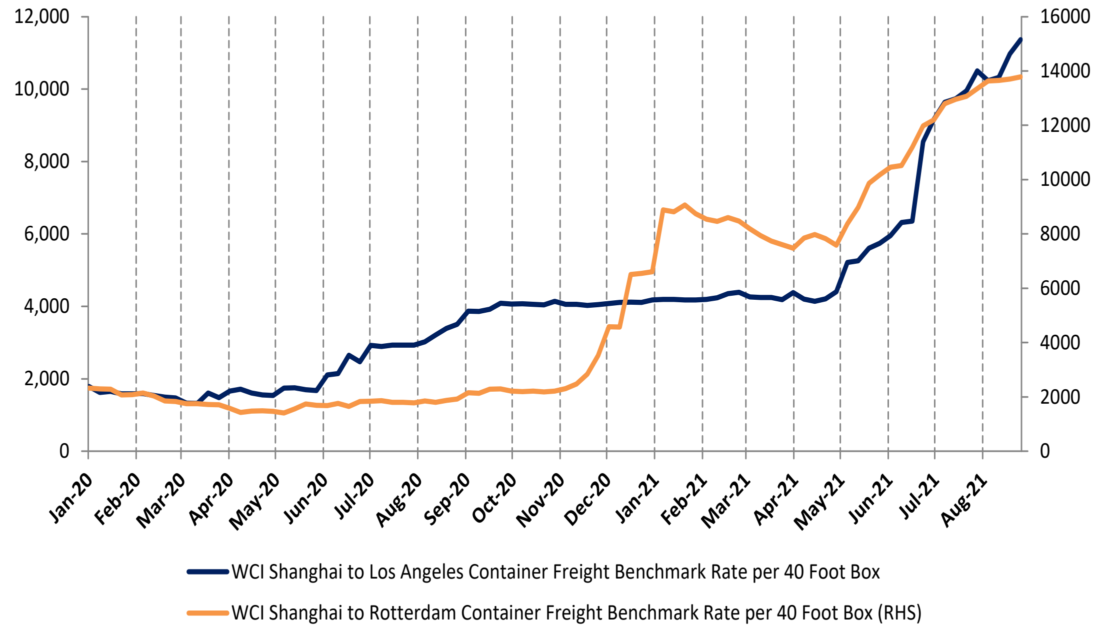
	August 27th 2021	August MTD Change
Gold	1817.57	0.2%
Silver	24.0262	-5.7%
Oil	68.74	-7.0%
EUR	1.1795	-0.6%
JPY	109.84	-0.1%
GBP	1.3764	-1.0%
CHF	0.9113	-0.6%
CAD	1.262	-1.2%
AUD	0.7312	-0.4%
BRL	5.2046	0.1%
MXN	20.2019	-1.7%

Source:Bloomberg

Rates	August 27th Levels
1 Yr CD	0.3%
5 Yr CD	0.42%
30 Yr Jumbo Mortgage	3.11%
5/1 Jumbo Mortgage	2.89%
US Govt. 10 Year	1.307%
10 Yr Swap Spread	0.018%

Source:Bloomberg

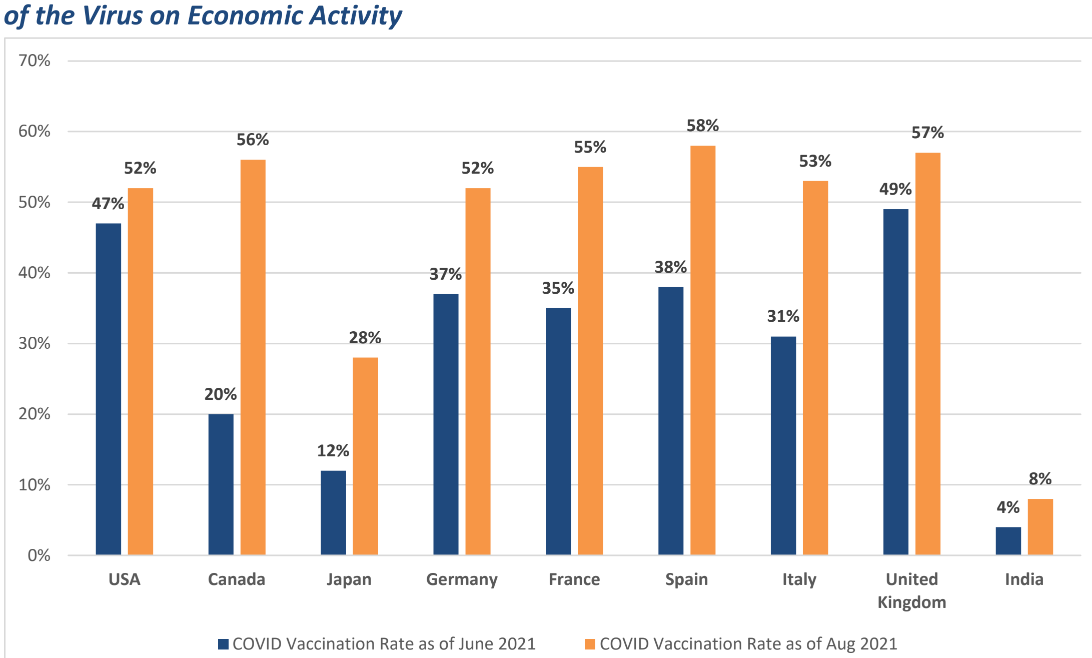
Figure 5. The Role of Supply-side Disruptions in Recent Deceleration of Economic Calendar: Freight Costs Zoom Higher along with Disruption in Supply Flow



Source: Drewry World Container Index

The unusually elevated role of supply-side disruptions on recent downside economic activity surprises, along with the virus' increasingly diminished importance - courtesy of increased vaccination rates around the world and recent data suggesting a peak in the pace of Delta virus infection rates - leads us to embrace a highly constructive global economic outlook for the fourth quarter 2021 and 2022. For example, in the USA the vaccination rate for the general population has reached 52 percent while for those aged 65 years and older the vaccination rate now hovers at 82 percent. Figure 6 illustrates the marked rise in vaccination rates for a number of large economies around the world from lower levels prevailing in early June.

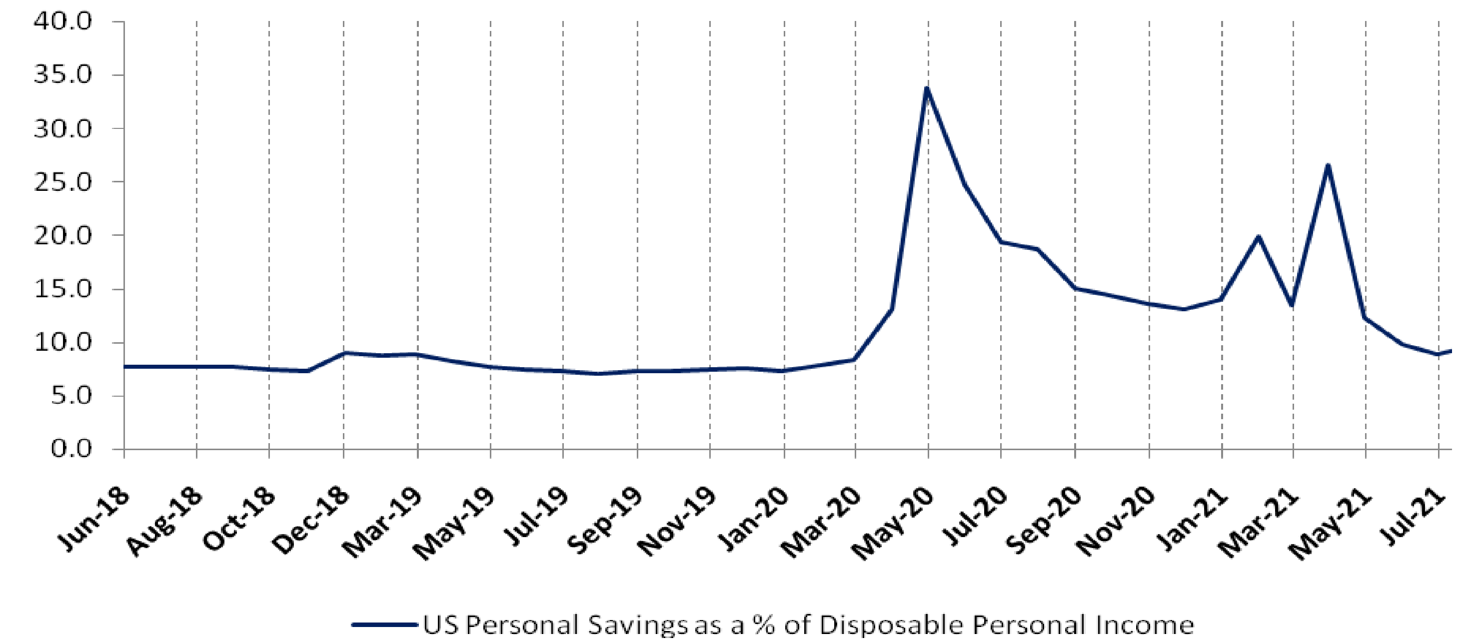
Figure 6. Steady Increase in Vaccination Rates Ensures Increasingly Diminished Importance of the Virus on Economic Activity



Source: Bloomberg

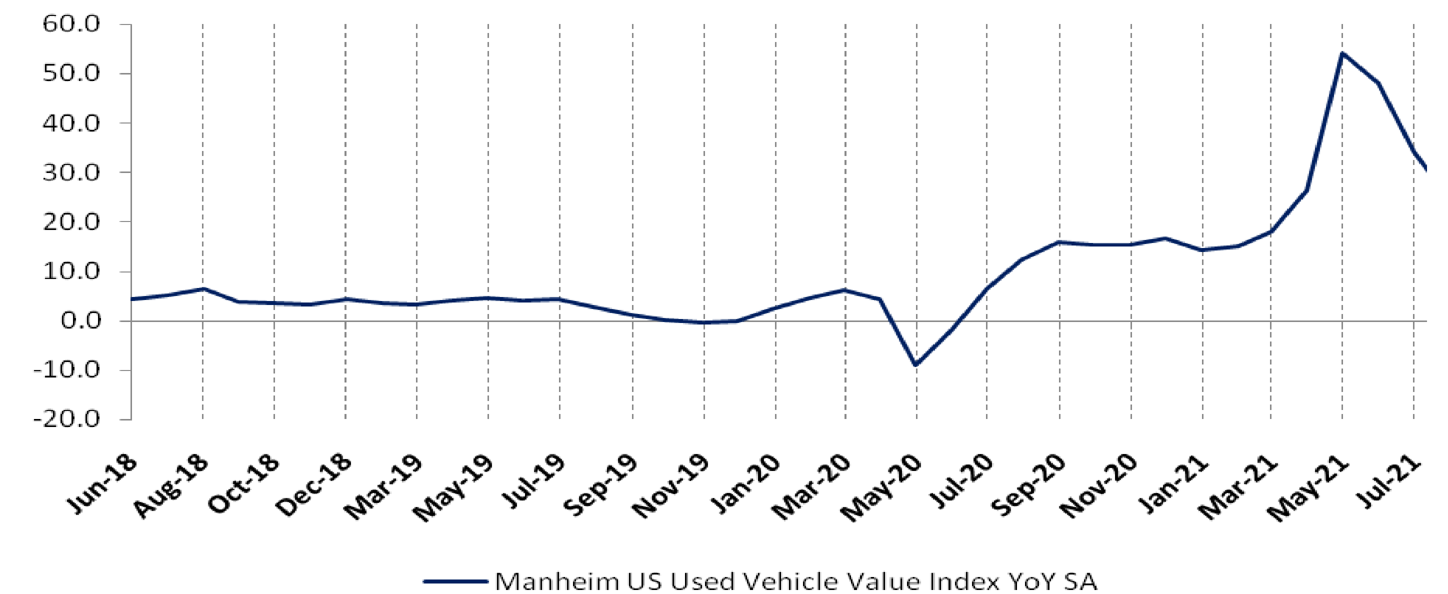
As we look ahead, we expect the pace of economic momentum to sustain above expansion levels on the back of a pick-up in mobility metrics, courtesy of the waning importance of the Virus. Against such backdrop, the recent passage of fiscal expansionary measures in the USA (tied to the infrastructure spending bill) along with the scheduled fiscal expansion to unfold in the Eurozone should combine to reinforce expansionary dynamics at a global level. Overlaid against such dynamics, the state of household finances is sufficiently strong to validate the willingness to raise discretionary and non-discretionary expenditure levels over the coming quarters. Figure 7 reminds us of prevailing above average US personal savings rate levels, expressed as percentage of disposable income.

Figure 7. Visibility of Expenditure Growth Acceleration Reinforced by Healthy State of US Household Finances



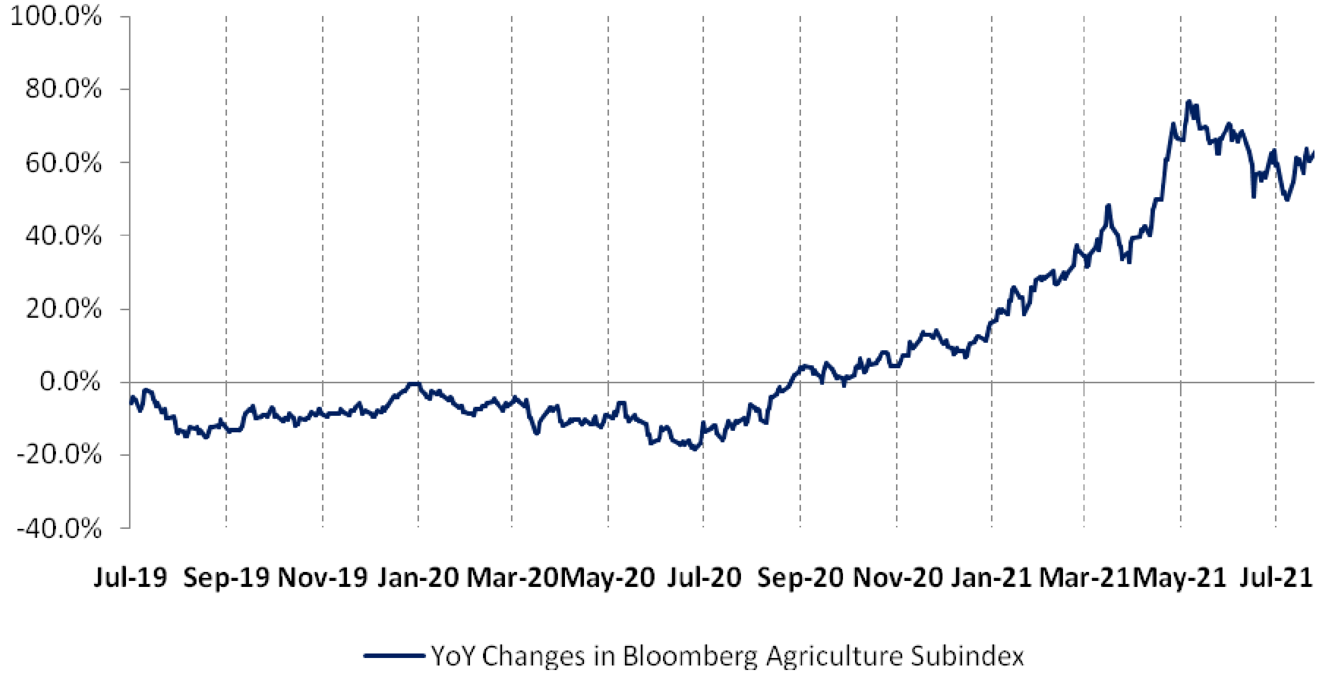
Source: Bureau of Economic Analysis

Figure 8. US Used Car Price Inflation Decelerates Sharply since May



Source: Manheim Auctions

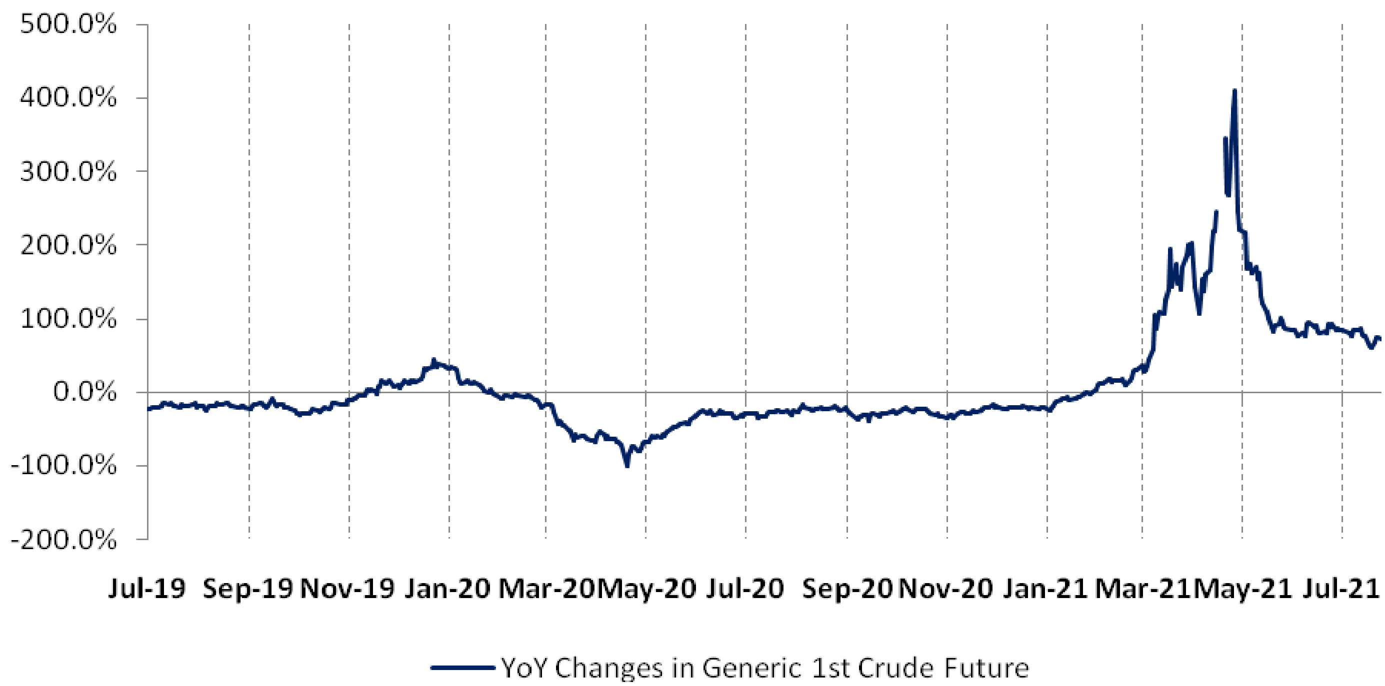
Figure 9. Food Inflation Likely to Decelerate on the Back of Softening Agriculture Price Inflation



Source: Bloomberg & Glovista Calculations

As we look ahead, our constructive outlook on the global activity cycle is married with a favorable, though lower conviction, outlook on the inflation front. Specifically, as look ahead at the inflation outlook, we identify a number of factors that are likely to combine in putting forth a benign lower inflation trajectory. Among these, we include the ongoing sustained deceleration in used car prices (close to 4 percent weighting of US urban CPI index), agriculture prices (food, 14 percent weighting) and energy prices (7 percent weighting). For example, Figure 8 illustrates the ongoing decline in US car prices while Figure 9 and Figure 10 do the same for agriculture and crude prices.

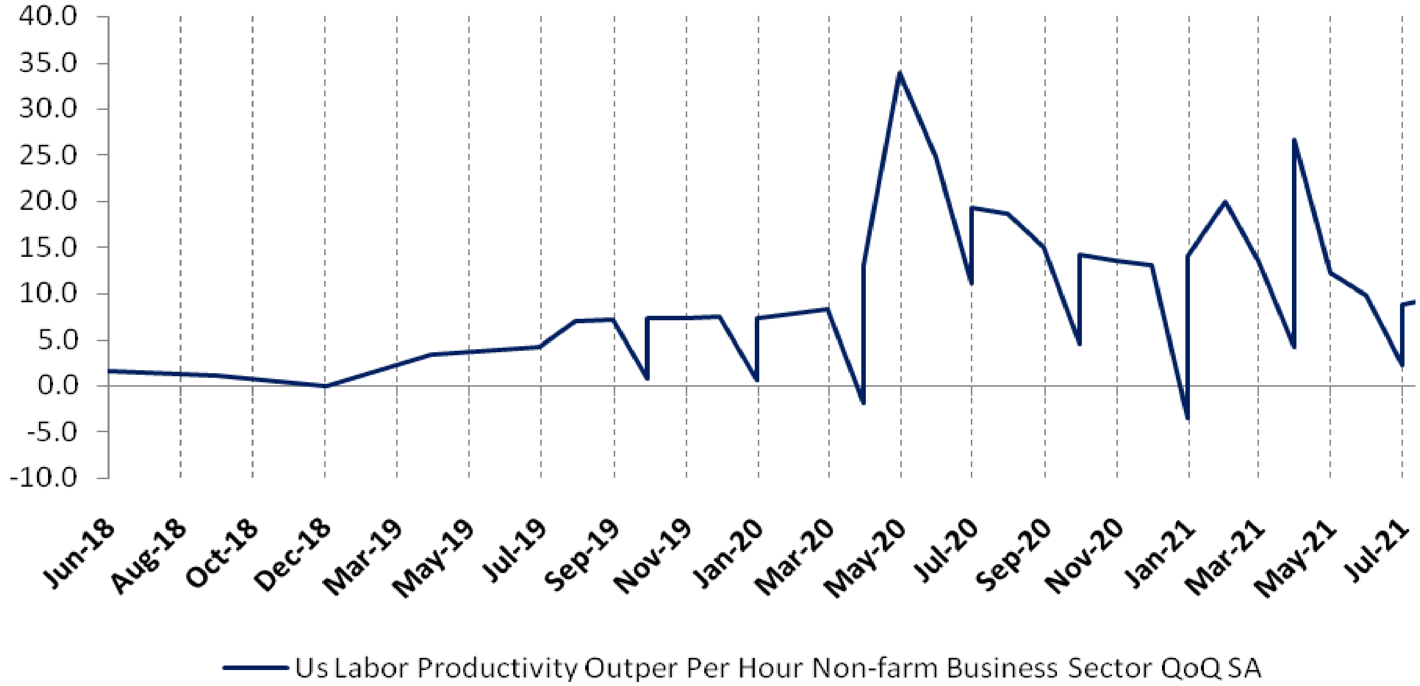
Figure 10. Decelerating Energy Price Inflation Likely to Exert Broader Disinflationary Pressures



Source: Bloomberg & Glovista Calculations

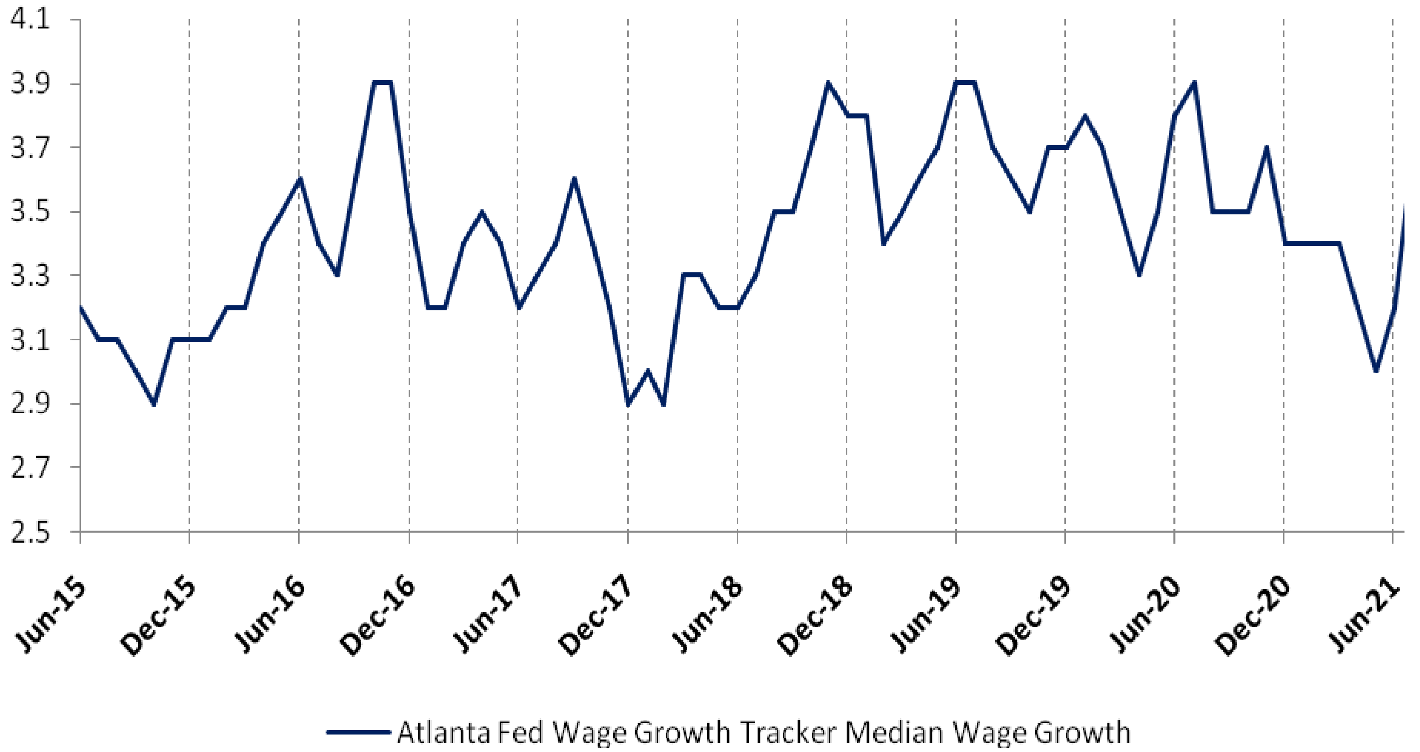
Against such ongoing benign goods inflation backdrop, the outlook on wage inflation also remains benign as illustrated by persistently high labor productivity figures (Figure 11) and approximately unchanged year-on-year median wage growth momentum (Figure 12)

Figure 11. Persistently High Labor Productivity Growth Sustains Benign Wage Inflation Outlook



Source: Bureau of Labor Statistics

Figure 12. US Median Wage Inflation Remains Unchanged over the Past Five Years, while Labor Productivity Growth Remains Equally Resilient



Source: Federal Reserve Bank of Atlanta

Glovista Sustains Bullish Outlook on Global Equities, Favoring Value and Cyclically-oriented Sectors along with Selected High Quality US Mega-cap Growth Stocks

Our macro baseline case, summarized above, leads us to reaffirm an overweight allocation to global equities and underweight allocation to bond duration plays on the basis of relative valuation grounds along with our expectation for a sustained and broadening cyclical acceleration around the globe. Within global equities, we continue to favor value-oriented sectors and markets along with selected high quality US mega-cap stocks. Within commodities, we continue to favor gold exposure on risk management considerations along with our expectation of continued low (inflation adjusted) interest rates in the developed world, albeit at less negative levels.

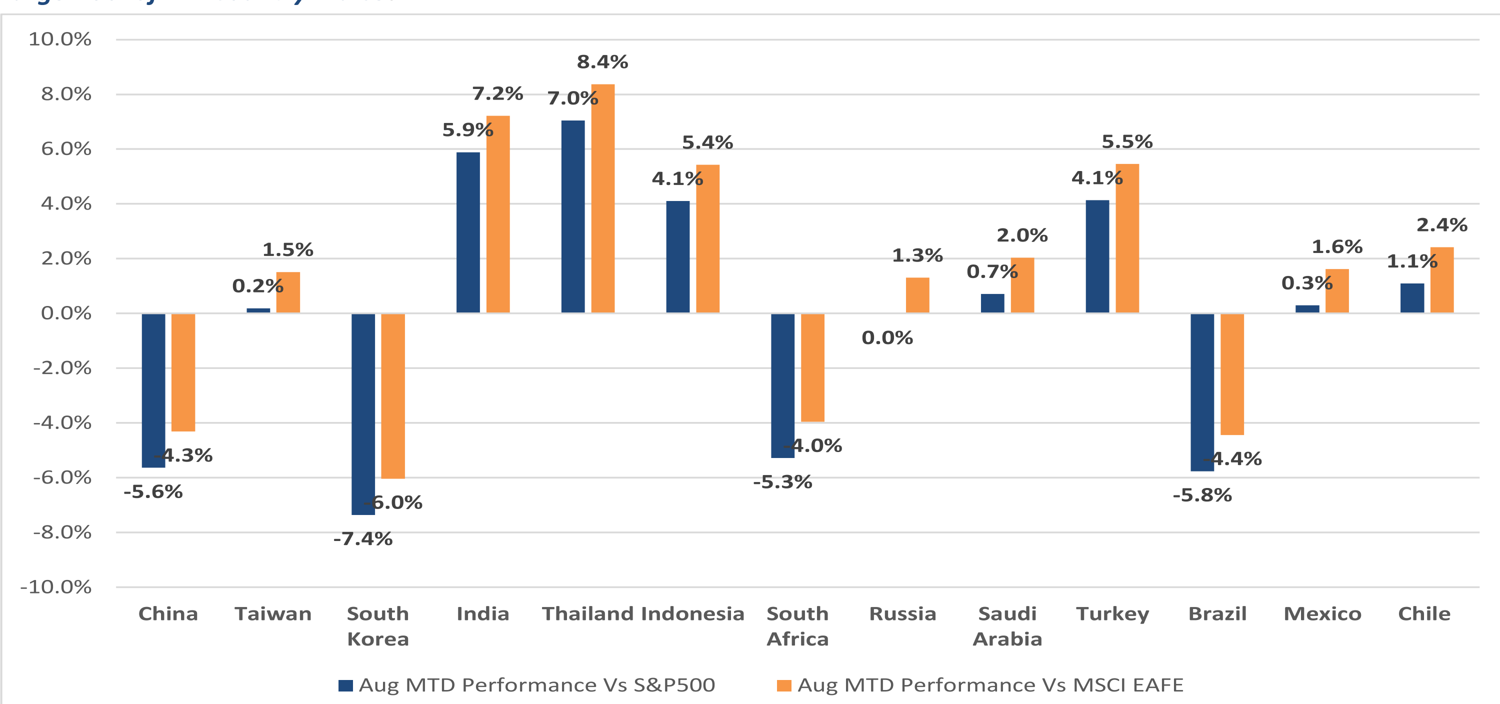
As we look ahead, our constructive investment outlook remains conditioned to a number of downside risks, including geopolitical (especially North Korea and the Middle East) and policy (central bank mistakes or premature fiscal policy tightening).

Emerging Markets Perspectives

Breadth of EM Country-level Outperformance vs. US and EAFE Peers Picks Up in August; EM Benchmark Looks Poised to Resume Solid Outperformance versus DM Peers despite China Country Risk Premium Spike; Glovista Sustains Overweight Value Factor Tilts

The month of August has entailed a 'tale of two cities'-like period for EM equities as regards relative return performance versus US and EAFE peers. Specifically, the month of August witnessed a growing number of EM country indices posting solid return outperformance versus DM (developed market) peers through a period afflicting the largest EM country constituent, China, with a spike in country risk premium courtesy of a succession of investor-unfriendly regulatory changes.

Figure 13. August Brings about a Strong Pick-up in Breadth of Relative Return Outperformance versus DM Peers for a Large Pool of EM Country Indices



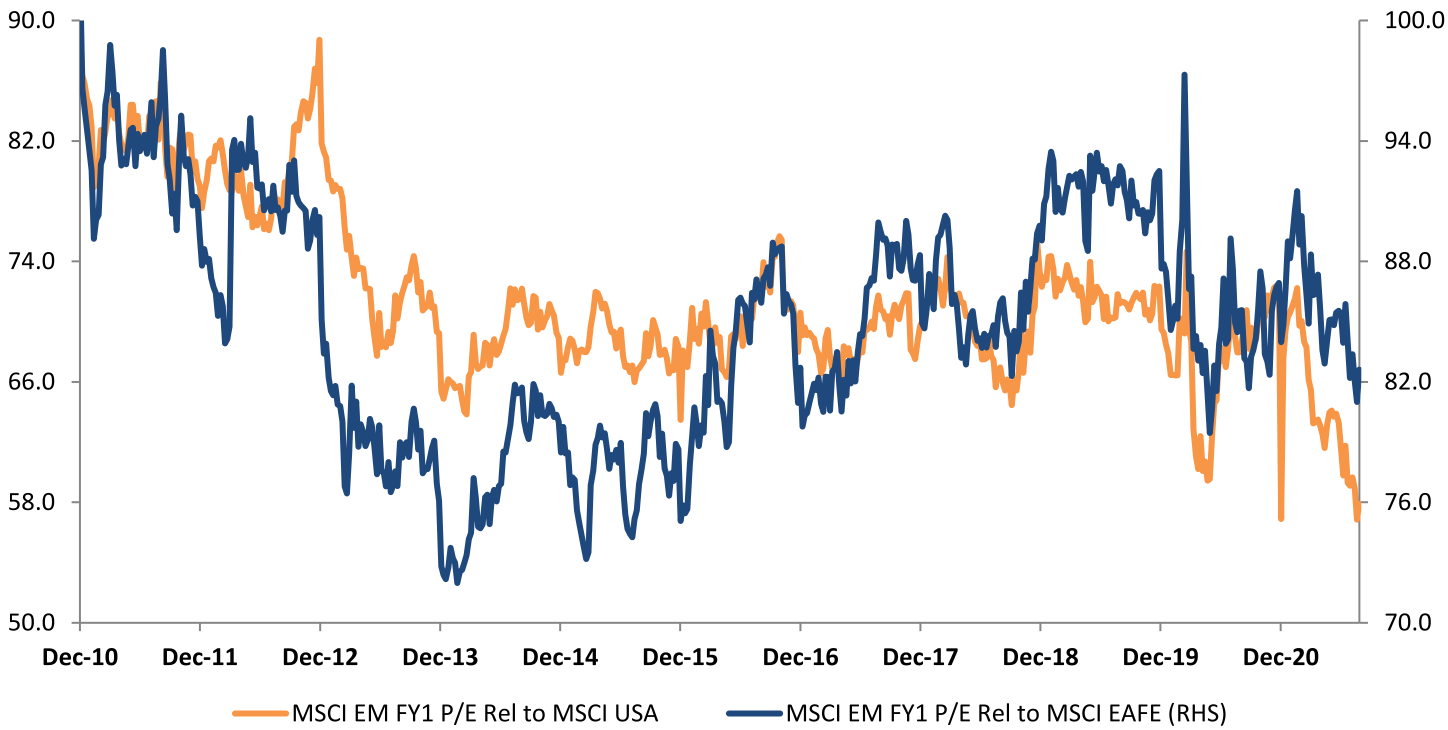
Source: Bloomberg, MSCI & Glovista Calculations

Figure 13 illustrates August month-to-date relative return performance with the SP500 and MSCI EAFE indices for a large pool of EM country indices comprising approximately 94 percentage of the MSCI EM benchmark index's capitalization. Specifically, the figure illustrates the bifurcated nature of August relative performance with a large number of outperforming country indices out of the Latin America, EMEA and Asia regions standing against a smaller pool of EM country indices – notably China and South Korea – that lagged DM peers for the month.

Our last month's commentary addressed our stance with regards to the recent succession of surprise China regulatory changes, framing such events in the context of historical precedent entailing rare yet episodic shocks impacting EM country premium levels (e.g. Russia's Ukraine invasion, India's 2006 surprise election results, Mexico's 1994 surprise devaluation). From that vantage point, market history reminds us of the sustained yet gradual normalization of country risk premium levels over a period of months. We expect a similar path to unfold with China's country risk premium as we look ahead.

That EM equities managed to post robust and broadening return outperformance versus DM peers during a period of continued regulatory headline news afflicting the EM benchmark's largest country constituent (China) attests to EM equities' compelling investment case. In fact, as we highlight in Figure 14 and Figure 15, EM equities' relative valuations versus developed peers hover a considerably below average historical levels while the increased reopening of the global economy, resulting from continued rise in global vaccination rates, are likely to favor disproportionately EM economies.

Figure 14. EM Equities Relative Valuations versus US Peers Hover Below Historical Average Levels, at Cyclical Juncture Likely to Favor EM Growth Outperformance as well as Reflationary Effects from Weaker US$



Source: Bloomberg, MSCI & Glovista Calculations

Beyond the compelling valuation and cyclical acceleration considerations favoring EM equities' outlook versus DM peers over the balance of the year and 2022 one needs to also consider EM equities' under-owned status as well as the sustained strengthening in EM currencies this year through the spike in China country premium and EM countries' lagging vaccination rate versus the USA (Figure 15). As we look ahead at the fourth quarter 2021 and 2022 such factors are likely to become headwinds for the US Dollar.

Figure 15. EM Currencies Strengthen versus the US Dollar in August, despite Spike in Delta Virus Strain Infection Rate and China Country Premium Rise

Source: Bloomberg

As we look ahead, we continue to favor overweight exposure to value oriented markets in Asia, EMEA and Latin America as such markets offer the largest relative valuation discounts along with more direct participation in the re-rating of value factors globally as real yields reset higher in response to more accelerated reopening of economic activity. Over the past several weeks we have raised exposure to South East Asia and Latin America at the expense of North Asia.

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1 Evertrust Plaza Suite 1102
Jersey City NJ 07302
Tel: 212-336-1540
Website: www.glovista.net