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Monthly
Market
Newsletter

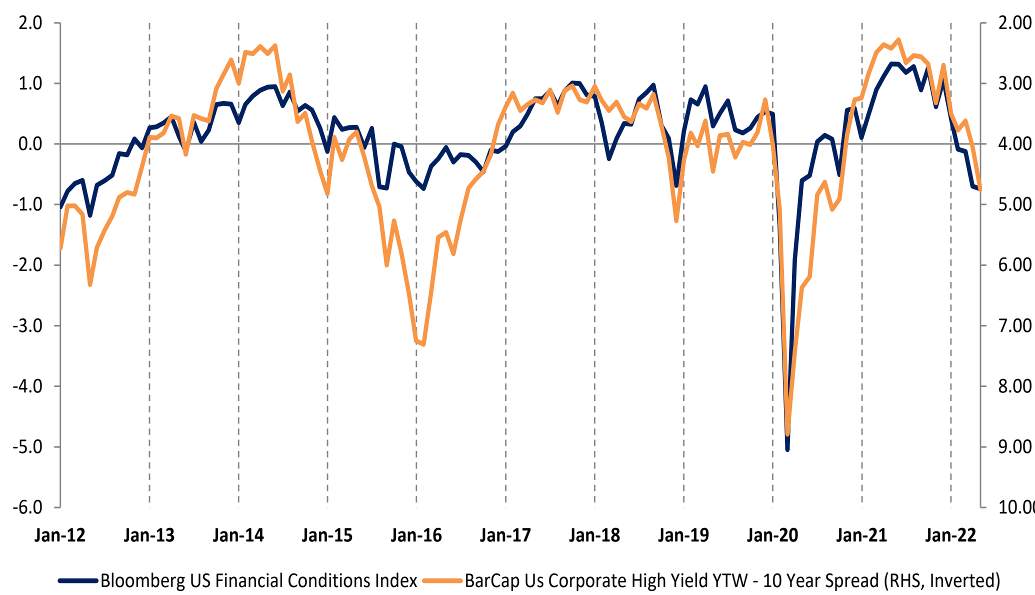
Glovista Global Perspectives

This Issue:

China Lockdown, Ukraine War and Hawkish FED Guidance Fuel Recession Concerns; Glovista Sustains Overweight Value Tilts, Upgrading Bond Duration

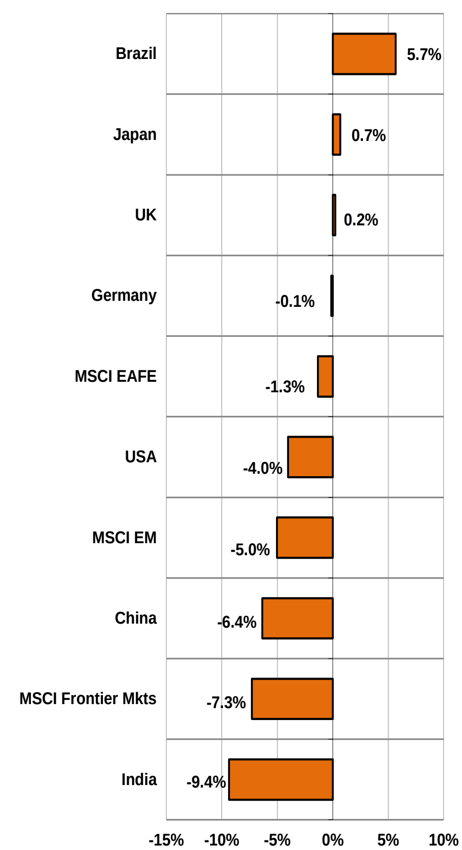
The month of May has witnessed a toxic cocktail of risk factors, including the escalation of China lockdown measures, sustained geopolitical developments tied to the Ukraine War and heightened hawkish guidance from the US Federal Reserve as well as ECB and Bank of England. Such developments have combined to depress financial conditions to the tightest levels since the pandemic while adversely impacting business and consumer confidence. Moreover, recent corporate earnings releases confirm the adverse impact on profit margins and top-line revenue growth visibility from ongoing cost-push inflation dynamics – tied primarily to energy costs, with wage inflation still remaining a secondary factor. Figure 1 illustrates the extent of the recent tightening in US financial conditions along with the widening of corporate credit spreads.

Figure 1. US Financial Conditions Tighten Considerably along with Widening Credit Spreads as Recession Concerns Become Increasingly Discounted



Source: Bloomberg

Country-wise Monthly Performance in USD terms (May 2022)*



Source: MSCI & Bloomberg

**As of May 25th, 2022*

S&P500 Monthly Sector Performance –May MTD 2022*

Sectors	% Change	FY1 PE Ratio
Energy	13.66%	10.0
Materials	-1.50%	13.8
Industrials	-3.86%	18.3
Cons Disc	-12.95%	23.0
Cons Stap	-6.13%	21.2
Technology	-5.93%	21.4
Healthcare	0.54%	16.0
Financials	-1.11%	13.1
Utilities	3.45%	21.5
Telecom	-3.22%	15.0
Real Estate	-6.38%	38.7
S&P500	-3.71%	17.5

as of May 25th 2022

That current cost-push inflation dynamics are impacted largely by the ongoing Ukraine War – especially the impact of sanctions on the global supply of energy and industrial commodities – results in diminished visibility with regards to the duration of downward pressure on profit margins as the duration of the war is itself an unknown. Against such backdrop of elevated inflation pressures and early signs of adversely impacted business and consumer expenditure demand, at a juncture in which pandemic era fiscal stimulus assistance measures were withdrawn earlier this year, the bond market increasingly discounts a recession scenario as baseline case. Such concerns have resulted in a considerable compression of government bond yields since the beginning of May, with 10 year US Treasury yields falling from 3.12 pct to 2.75 pct since May 6. Most of such decline in nominal yields is the result of declining intermediate-term inflation expectations.

In May, the Glovista investment team has sustained the highly defensive stance taken at the beginning of the year which has resulted in alpha generation for our portfolios for the year-to-date period. The only meaningful rebalancing taken during the month corresponded to the purchase of high-grade corporate bond duration, for the first time since last year. We took such action on the back of the asset class' vastly improved valuations, following one of the worst year-to-date performances since the great financial crisis of 2008, reinforced by our view that intermediate government bond yields have topped out. Within equities, we continue to favor value-oriented stocks, having recently upgraded international equities' exposure. Finally, we continue to hold exposure to precious metals, especially gold.

Emerging Market Perspectives

LatAm Markets Post Solid May Outperformance of EM and Developed Peers; Glovista Further Raises LatAm Overweight Tilt at Expense of India Allocations

In May, emerging market equities – as represented by the MSCI EM index benchmark – participated in global equity price declines on the back of mounting growth, rate and geopolitical concerns discussed above. During the month, Latin America equities extended their strong year-to-date return outperformance versus emerging market and developed market peers. We credit such outperformance to regional stocks' exceedingly cheap valuations, at a juncture in which global investors favor value factors, robust and visible earnings growth momentum, along with the Latin America region's favorable standing within the current geopolitical risk narrative shaping investor appetite.

As we look ahead, we expect the asset class – with participation from north Asia and EMEA markets – to initiate a period of strong return outperformance versus developed peers. We harbor such view on the basis of several considerations, including:

- Emerging market equities' attractive relative valuations versus developed peers, with emerging market equities currently trading at close to 30 percent 1 year forward P/E discount versus developed peers, versus a historical average discount factor close to 20 percent;

- Emerging market corporates' stronger top-line and bottom-line growth outlook versus developed peers, as the majority of emerging market countries' central banks completed their policy rate hike cycles in 2021 – in contrast to US and European counterparts currently digesting policy rate hikes out of the US Federal Reserve, Bank of England and European Central Bank (likely to start in the Fall). Moreover, emerging market economies' outlook also stands out versus developed peers when taking into consideration that lower support measures by emerging market country governments during the pandemic era necessarily translates into a much smaller 2022 and 2023 fiscal drag factor on economic growth for emerging market countries vis-à-vis developed country peers;

- Over the past several weeks, Chinese authorities have announced a set of monetary and fiscal stimulus measures that provide a cushion to the slowdown resulting from the lockdown measures implemented throughout a large part of China over the past two months. Such policy actions effectively curtail negative growth tail risks facing the Chinese economic outlook;

- Emerging market equities are significantly under-owned on the part of global investors, with allocations close to 6 percent versus a close to 9 percent historical average, per JPMorgan equity research. The benchmark weight of emerging market equities within global equity benchmarks is close to 11%;

- According to our assessment of global capital flows, the timing of US Federal Reserve policy rate actions and the impending end to China's lockdown period (in response to Covid), we expect the US Dollar cycle to enter a sustained bear cycle over the coming months. In fact, such phase may have already begun earlier this month with the sharp trimming of 2023 implied Fed Fund rate hikes on the part of futures market participants, at a juncture in which the European Central Bank is likely to initiate its rate hike cycle later this year. History reminds us that US Dollar bear cycles are supportive of global economic growth as well as emerging market return outperformance versus developed market equities.

In May, we have sustained overweight value factor tilts at the regional, country and sector levels. In fact, we have further raised our Latin America overweight allocations at the expense of India market allocation. We have taken such rebalancing action both on account of relative valuation, earnings growth considerations as well as our bearish intermediate-term US Dollar outlook. As we look ahead, we believe the triad of factors fueling investor concerns (Ukraine War, inflation/US Fed policy, China lockdown) are likely to diminish in magnitude, particularly the latter two.

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