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Newsletter

GLOVISTA INVESTMENTS

Glovista Global Perspectives

This Issue:

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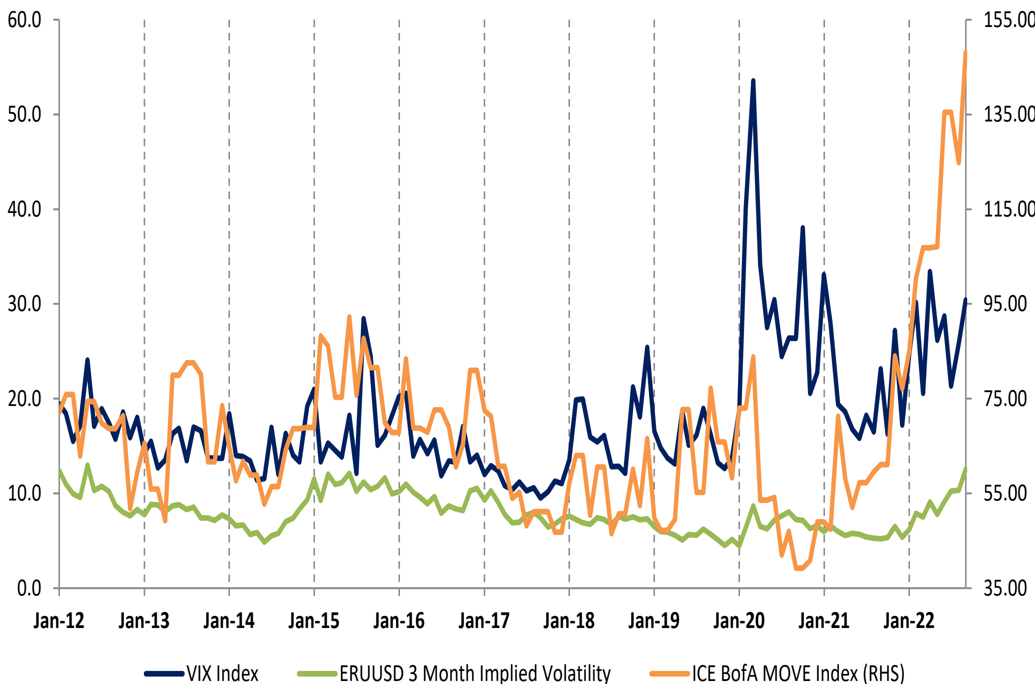
Risk Markets Decline Sharply in September on Mounting Recession Risks fueled by Hawkish FED Guidance and Further Weakened Europe Outlook; Glovista Sustains Strong Defensive Tilts

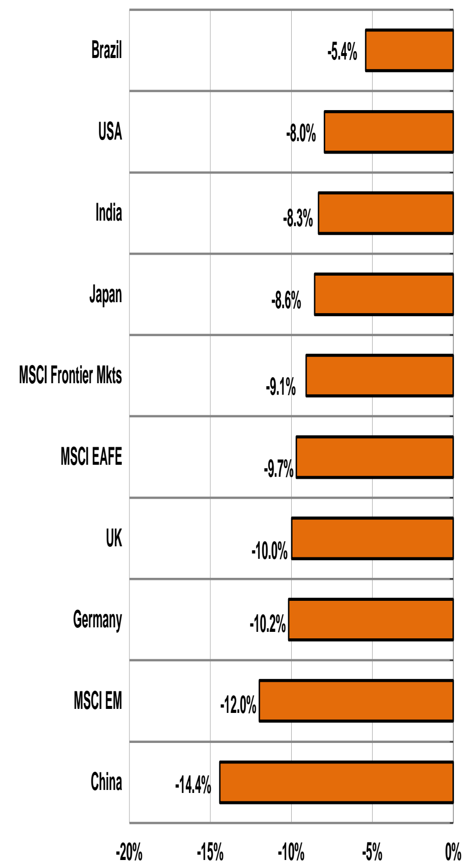
The month of September has witnessed sharp price declines across a growing number of risk asset classes, including equities and now extending more considerably to credit, commodities and currency groups. Moreover, such sharp asset price declines have been accompanied by escalating risk premium measures, as captured by Figure 1 that illustrates the quantum of the increases recorded in implied volatility.

Figure 1. September Posts Sharp Spike in Risk Premium Across Major Asset Markets: FX, Fixed Income and Equities



Source: Bloomberg

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



Source: MSCI & Bloomberg

**As of September 29th, 2022*

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S&P500 Monthly Sector Performance –Sep MTD 2022*

Sectors	% Change	FY1 PE Ratio
Energy	-8.86%	7.1
Materials	-9.30%	11.8
Industrials	-9.38%	17.3
Cons Disc	-6.37%	26.2
Cons Stap	-6.66%	19.7
Technology	-10.30%	19.9
Healthcare	-1.36%	15.1
Financials	-6.91%	12.5
Utilities	-9.77%	19.1
Telecom	-10.68%	14.2
Real Estate	-14.49%	30.0
S&P500	-7.95%	16.3

**as of Sep 29th 2022*

We believe the above noted September spike in risk premium levels is largely the result of two principal developments unfolding during the month. Specifically:

- At its September 21st meeting, the US FOMC raised its reference Federal Funds policy rate by the expected amount of 75 basis points. However, the significance of the meeting was contained in the unambiguously stagflationary tone of the FED's revisions to its summary of economic projections consisting of inflation and GDP growth projections for the coming years. Moreover, such revisions were accompanied with considerable upward revisions to the FED's projected path of adjustments to its Federal Funds policy rate target.

- Europe's economic outlook worsened during the month of September, fueled primarily by the alleged Russian government-orchestrated sabotage of the Nordstream1 pipeline. Such development adds to concerns over the outlook for the region as reflected in the announcement of a number of shutdowns across industrial plants throughout Central Europe, especially Germany. In addition, in the United Kingdom, new Prime Minister Truss' government has sponsored a fiscal package widely perceived by market participants to produce deep imbalances in the economy's outlook. As a result, market response – across the British currency as well as credit markets – has been sharp, rendering deep UK recession risks higher.

The two above-mentioned developments have combined to produce lower equity prices via the equity multiple compression effect resulting from higher discount rates while a worsened activity outlook has set off downward earnings revisions by analysts, further reinforcing recent equity price declines. In addition, investors' increased concerns over recession scenarios in 2023 have fueled a considerable rise in credit spreads these past two weeks. For example, the Barclays US High Yield less US Treasury 10 Year Spread has widened by more than 110 bps since the 12th of September.

Against the above-mentioned dynamics, the Glovista investment team further trimmed overall portfolio risk exposures to the most defensive levels held in several years. Specifically, such rebalancing actions have entailed increases in cash balances, lower equity allocations, lower beta and higher quality factor exposures, among others. As we look ahead to the rest of the year, we expect to maintain such defensive stance until we get greater clarity on several fronts, including:

- the state of US labor market conditions whereby signs of weakening conditions would result in risk asset price rebounds as in such scenario the US FOMC would be expected to be closer to a dovish pivot;

- the state of the natural gas market in Europe;

- the upcoming US corporate earnings season that starts in the middle of October; Of special interest to Glovista's analysts will be the level of resilience (or lack thereof) shown by corporates in the profit margin dynamics, more so than top-line performance;

- the direction of the US Dollar, particularly versus the Euro.

From a seasonality perspective, market history reminds us that the potential of market bottoms increases as we approach the third week of October. If such seasonality is accompanied by a reversal in "news" or fundamentals in the positive direction, risk asset markets could post considerable recovery in the balance of the year, particularly as investor sentiment levels are exceedingly bearish. The Glovista team will continue to monitor developments very closely as we approach the upcoming weeks and will navigate market exposures with caution pending a reversal in policy, macro, financial and geopolitical fundamentals.

Finally, on US Fed policy, we continue to harbor the view that policy rates have become exceedingly restrictive and thus we expect a dovish FOMC tilt within a three to six month horizon. Our view reflects the exceedingly high levels of implied inflation-adjusted bond yields across various tenors vis-à-vis trailing 10-20 year average levels at a juncture in which growth suppressing financial conditions – including real yields, the US Dollar, credit spreads and asset price changes – have tightened considerably, the effects of which on the real economy are well known to exert themselves with a lag.

Emerging Market Perspectives

EM North Asia Markets Extend Underperformance as Semis Sell Off on Recession Concerns; Glovista Sustains LatAm Overweight, North Asia Underweight while Raising ASEAN Exposures

In September, emerging market equities sold off approximately in line with EAFE peers. The regional composition of EM performance – with EM North Asia markets harboring elevated information technology sector exposures - accorded closely with sector returns within developed markets as semiconductor and software technology stocks led the sell-off. The sell-off in information technology sector stocks has been fueled by rekindled recession concerns following the pair of macro developments (e.g. September FOMC meeting and Europe economic and policy developments) that unfolded over the past several weeks, discussed above.

Latin America and South Asia markets (especially India) continue to outperform the rest of the emerging market equities space as well as US and international developed market peers. This follows primarily from those economies' more insular growth models (less correlated to developed economies' business cycle), stronger economic growth momentum versus China (a country that is undergoing a secular decline in GDP growth rate) and currency resilience (owing to Latin American currencies' higher inflation adjusted interest rates).

We continue to hold overweight tilts to Latin America and South Asia markets along with underweight allocations to North Asia markets and neutral allocations to Gulf regional indices. We continue to monitor global macro and financial developments, awaiting increased clarity on the timing of rate policy turns in the US and the magnitude of the ongoing growth deceleration so as to properly rebalance our EM regional and sector exposures in a manner consistent with our revised macro views. Owing to the unusually elevated levels of global macro and policy uncertainty, we are currently keeping overall portfolio tracking error at below average levels.

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