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Monthly
Market
Newsletter

Glovista Global Perspectives

This Issue:

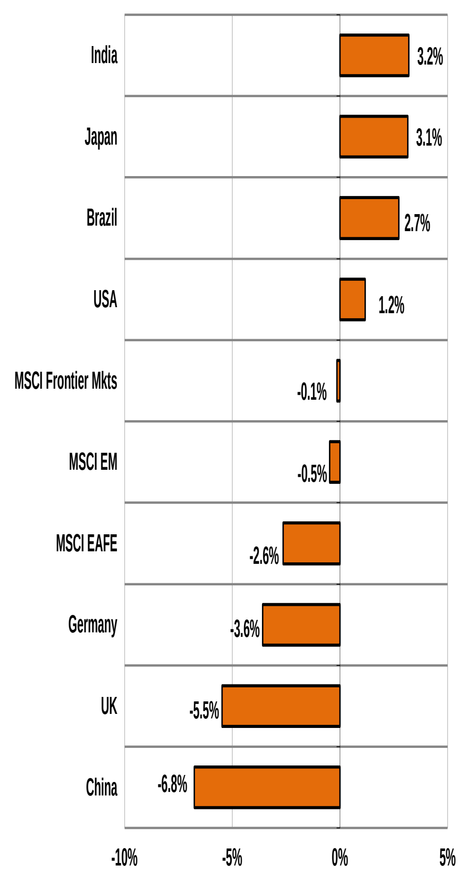
Global Equities and Bonds Sell Off in May on US Debt Ceiling Concerns, Persistent Inflation and Softening Manufacturing Sector Data; Glovista Sustains Defensive Portfolio Tilts

May 2023 has been unkind to major global risk indices, including equities, fixed income and commodities. Figure 1 illustrates the May month-to-date return performance for a number of major asset index groups. Within global equities, the two sole significant pockets of strength have been Japanese and US artificial intelligence (AI) stocks. In turn, those two groups have been supported by benign liquidity/valuation/earnings momentum in the case of Japanese equities and investors' strong upgrade of AI stocks' long-term earnings expectations, following Nvidia's May 24th consequential 'beat-and-raise' first quarter earnings release.

In the activity domain, the May economic calendar has brought about downward revisions to 2023 economic growth estimates for the world's major economic regions, as highlighted in a considerable softening of Citigroup's economic surprise activity indices and the broad-based softening of manufacturing sector data across multiple regions. Admittedly, service sector related indicators have manifested considerable resilience. However, economic history reminds us that service sector cycles are more coincidental with the state of labor market conditions, thus lagging manufacturing sector indicators. In that regard, labor market conditions in the USA continue to soften while the first quarter corporate earnings season showed an incipient decline in firms' profit margins. More generally, we expect US labor market conditions to soften steadily over the coming months, owing to a number of interrelated dynamics, including:

- Continued softening of corporate loan demand outlook – as highlighted in the latest US senior loan officers' survey. Such dynamic is likely to intensify on the back of lagged effects from the recent string of regional banking sector bankruptcies and the accelerated rise in year-to-date corporate bankruptcy filings as refunding conditions become increasingly challenging for small and mid-size corporates, especially unprofitable firms;

Country-wise Monthly Performance in USD terms (May 2023)*



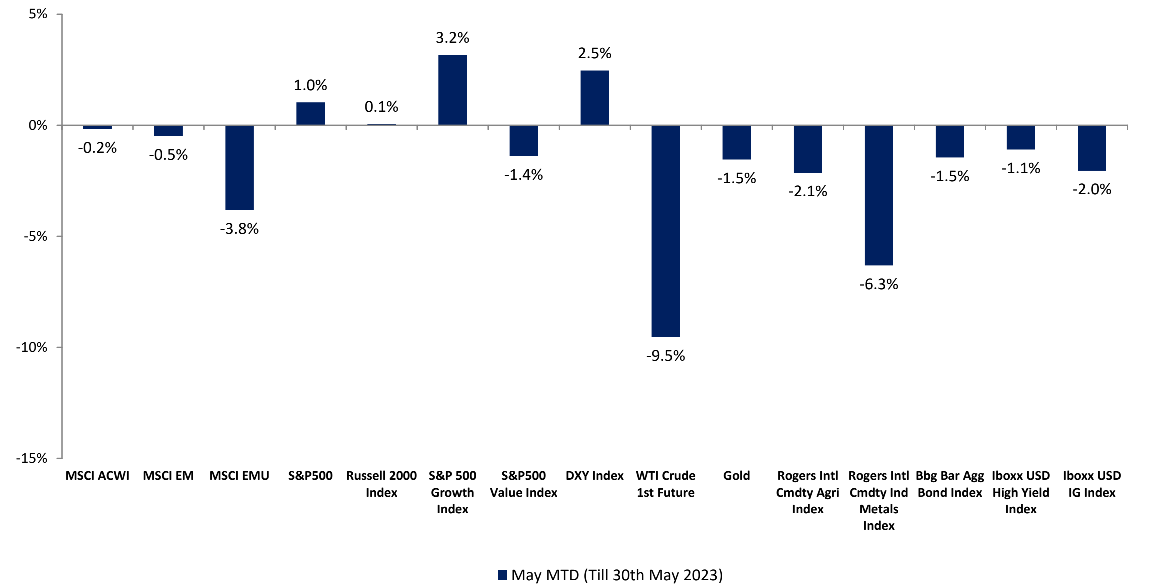
Source: MSCI & Bloomberg

**As of May 30th, 2023*

S&P500 Monthly Sector Performance – May MTD 2023*		
Sectors	% Change	FY1 PE Ratio
Energy	-8.90%	10.2
Materials	-6.05%	16.5
Industrials	-2.08%	18.6
Cons Disc	4.04%	24.7
Cons Stap	-6.27%	20.0
Technology	10.50%	28.9
Healthcare	-5.25%	17.2
Financials	-3.37%	13.0
Utilities	-7.25%	17.0
Telecom	6.26%	17.7
Real Estate	-5.26%	33.9
S&P500	0.86%	19.2

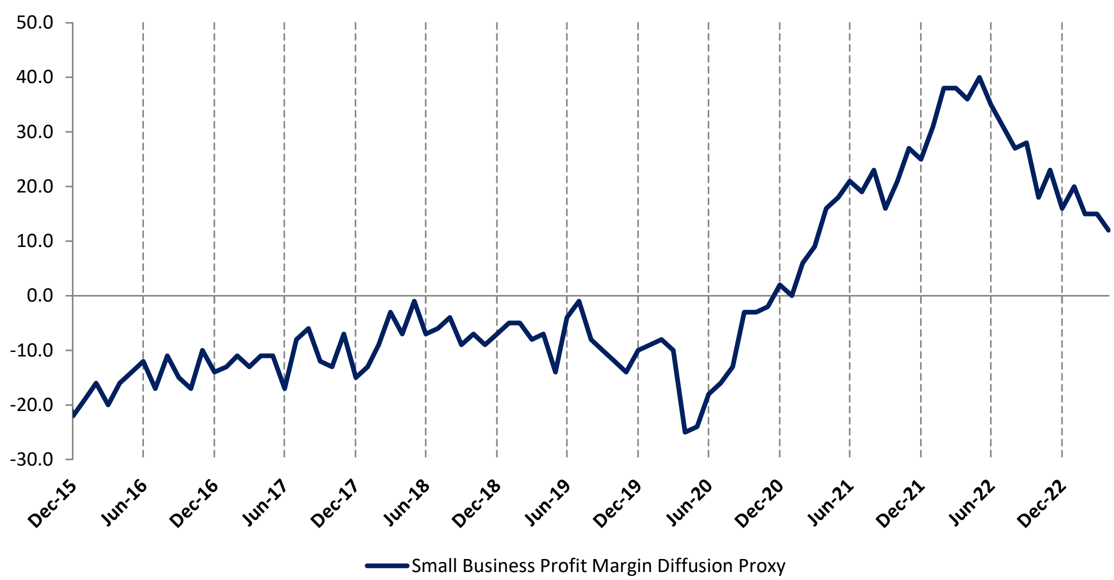
*as of May 30th 2023

Figure 1. Major Risk Asset Groups Post Considerable Declines in May, fueled by US Debt Ceiling Concerns, Persistent Inflation and Softer Manufacturing Sector Data



Source: Bloomberg

Figure 2. Proxy Margin Diffusion Indicator shows an increasing number of firms are facing margin pressure (Indicator: % of firms with plans to raise prices less % of firms with plans to raise wages)



Source: NFIB and Glovista Calculations

- Signs of weakening corporate profit margins reflected via proxy margin indicators (e.g. gap between plans to raise prices and plan to raise wages contained in the US NFIB indicators, Figure 2);

- Tight liquidity conditions, as reflected in persistently outsized yield curve inversion (e.g. 10 years-to-3 months US Treasury curve hovering at close to its most inverted ranges since early 1908s). Also, at the household level, recent consumer expenditure resilience has come at the expense of lower savings rate.

In the price domain, recent developments have been mixed. In the US, the Federal Reserve's preferred inflation metric – the core PCE deflator – has proven resilient, with the April release coming out slightly above consensus expectations. In the Eurozone, wage pressures have remained persistent as well. In addition, long-term US consumer inflation expectations have remained elevated, well above the US Federal Reserve's comfort levels. Against such backdrop, and given our baseline case of a mild US recession later this year, we expect the Federal Reserve to pause its rate hike cycle at the June meeting but unlikely to produce rate cuts later this year, absent a sudden and sharp deceleration of economic momentum and price pressures. As we look ahead, we expect a reversal of benign liquidity conditions derived from two sources: the US Treasury's drawdown of reserves at the FED (owing to debt ceiling concerns), and the emergency Fed lending to troubled banks. Such benign liquidity conditions effectively unwound close to half of the 2022 tightening of liquidity conditions, via the FED's QT program. Going forward, the tightening of liquidity conditions should accelerate disinflationary pressures - supporting long duration fixed income exposures - and adversely affect high valuation areas of the equity market as well as credit sectors.

Within global equities, it is worth noting the string of unprecedented divergences within major indices such as exceedingly narrow breadth (e.g. the equally weighted SP500 index up 0.38% for the year while the market capitalization weighted S&P500 index posting a 10.25% return, exclusively driven by the seven largest stocks in the index). Similarly, the divergence between US equities' year-to-date performance and medium-term high-grade corporate bond yield levels (as a proxy for debt cost of capital) stands at several standard deviations away from historical normal levels.

Against the abovementioned macro and market backdrop, we continue to favor defensive portfolio tilts, including underweight equities, overweight high-grade bonds and overweight high-quality, strong balance sheet equity plays, as well as tactical exposures to gold and energy.

Emerging Market Perspectives

Glovista Raises Taiwan/S. Korea to Overweight on Improved Semi Sector Outlook, at Expense of ASEAN, while Investors' Elevated China Growth Concerns Unveil Attractive Service Sector Value Plays

In May, emerging market equities performed approximately in line with developed market peers. However, the index's largest constituent – China – significantly underperformed both global as well as emerging market peers, posting a May month-to-date decline of around 6.4 percent. Thus, the average emerging market stock strongly outperformed developed peers in May. Chinese equities' strong May underperformance owed much to heightened investor concerns over a weakening of activity momentum during the month. In that vein, the Chinese Renminbi was one of the worst performing emerging market currencies during the period.

Early in May, we closed our underweight Taiwan, followed by our South Korea, market allocations owing to improved relative valuations following a period of return underperformance for both those markets. In addition, the broadening acceptance of artificial intelligence related services led our analysts to expect improved demand for the chip sector. At this time, we maintain overweight allocations to Taiwan and Korean equities. On China, the Glovista investment team continued to hold neutral China country allocations in May, thus avoiding any excess performance detraction stemming from the recent period of Chinese equities' underperformance. We believe investors' concerns over continued downside economic surprises for China appear unjustified. As a result, we believe the recent period of China equities' underperformance has unveiled much value for a number of service sector plays.

In Latin America, we continue to favor Brazilian equities and further raised our overweight allocations during the month. We have trimmed our Chilean equity market overweight exposures on earnings concerns. Over the coming months, we expect North Asian markets to outperform global peers on ownership, earnings and valuation considerations. Our constructive outlook on energy prices keeps us neutral on Gulf markets while earnings concerns lead us to maintain a modest underweight allocation to South Africa and Central Europe.

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