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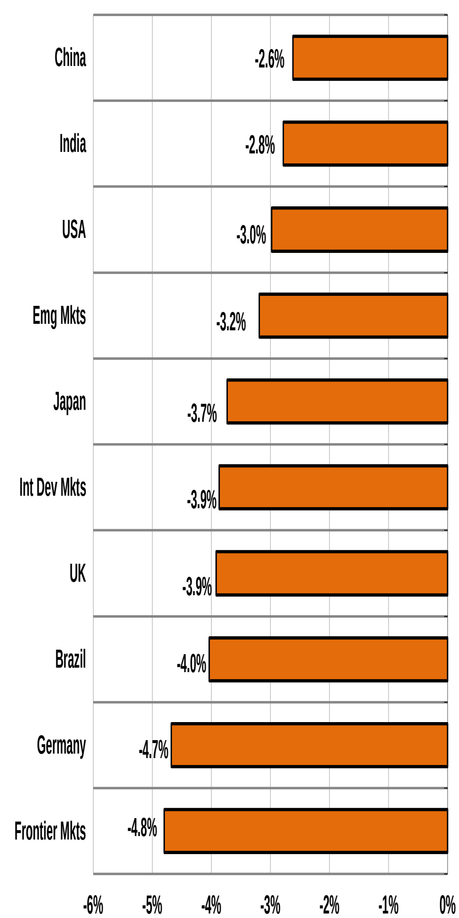
Monthly Market Newsletter

Glovista Global Perspectives

This Issue:

Risk Markets Sell Off Sharply on Further Bond Term Premium Reset, Inauspicious US Corporate Guidance, Geopolitical Risk and Elevated US Valuations; Glovista Sustains Defensive Portfolio Tilts

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



Source: Glovista Calculations
**As of Oct 30th, 2023*

The month of October has been unkind to most risk asset classes globally. We attribute the sell-off to a number of challenging global liquidity, activity cycle, valuation and seasonal factors, including:

- *Global Liquidity:* Quantitative tightening by global central banks along with the recent resumption of US student loan debt servicing and the fading of the extraordinary household savings pools accumulated during the pandemic era has led to a tightening of global financial conditions impacting risk markets adversely;

- *Activity Cycle:* History suggests that the lagged effects from monetary policy tightening onto activity – on average, a 4 to 6 quarter lag factor – should lead to US cyclical economic deceleration starting in the fourth quarter of this year. In addition, the unusual boost to economic activity from Q3 inventory buildup is likely to prove temporary as it largely reflects the impact from recent labor strikes in the US manufacturing sector (particularly autos). Also, early signs of softer than expected (weakest since 2014) final sales outlook from Eurozone corporates during the current third-quarter earnings season, along with adverse effects from the recent period of US Dollar strength, suggests strong headwinds for US corporate revenue growth in the coming quarters;

- *Valuation:* The month of October has witnessed a continued back-up in US bond term premium levels (Figure 1) tied largely to bond investors' diminished appetite for US Treasuries in light of persistently oversized US budget deficits as well as geopolitics (holdings diversification from foreign central banks) and balance sheet considerations (large unrealized losses on Treasury holdings on US Banks' balance sheets). As a result, US equity valuations have become even less attractive versus corporate and government debt. Such a valuation disconnect is not as relevant

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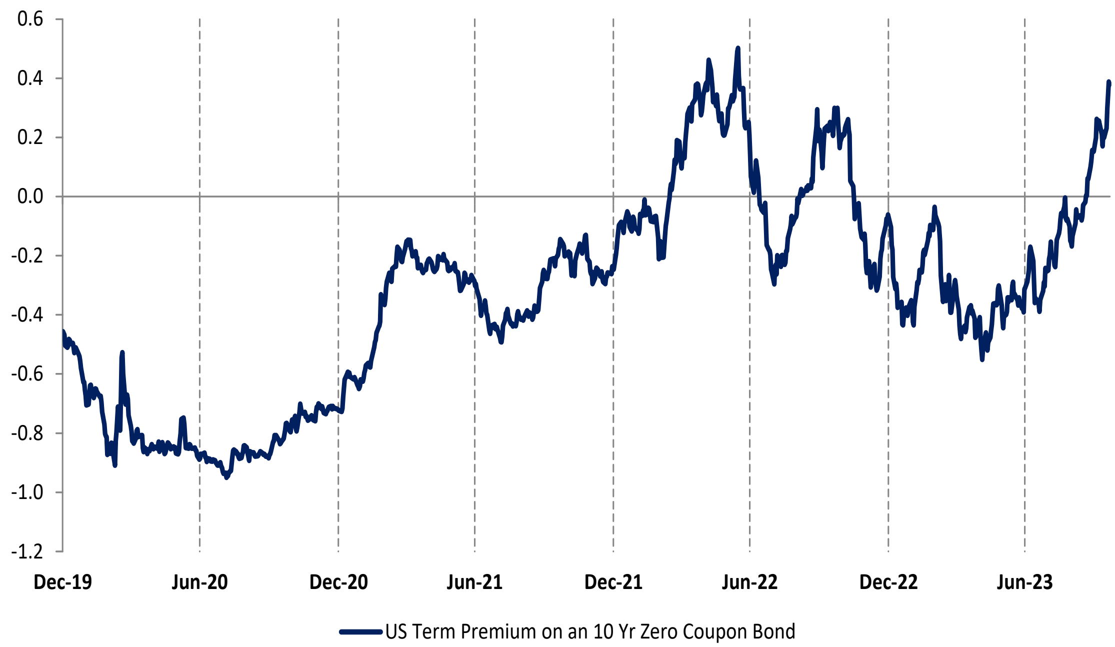
Monthly US Sector Performance – Oct MTD 2023*		
Sectors	% Change	FY1 PE Ratio
Energy	-6.29%	11.0
Materials	-3.65%	17.5
Industrials	-3.71%	18.6
Cons Disc	-5.18%	23.1
Cons Stap	-1.74%	19.2
Technology	-0.62%	27.9
Healthcare	-3.94%	18.7
Financials	-3.68%	13.2
Utilities	0.36%	16.0
Telecom	-2.18%	17.7
Real Estate	-4.87%	31.3
S&P500	-2.83%	19.2

*as of Oct 30th 2023

Source: Glovista Calculations

Figure 1. Equity Valuations Remain under Continued Pressure as Bond Term Premium Levels Edge Higher amidst Weakening US Corporate Guidance and Unattractive Valuations



Source: Federal Reserve

in the international context. As a result, it is not surprising to see that international equities have outperformed their US peers over the past several weeks.

- *Seasonality:* Historically, the month of October has proven to be one of the most challenging for risk markets, owing partly to seasonal liquidity and positioning considerations. Arguably, such considerations have played an unusually powerful role this year.

Given such macro and market considerations, we maintained a highly defensive positioning across our multi-asset and fixed income portfolios. Despite the large magnitude of the recent sell-off and indications that risk indices are oversold over a short- and medium-term, we sustain an overall defensive stance. Our decision to maintain such portfolio stance stems predominantly from our expectation for a valuation reset between corporate debt and equities – in favor of US corporate debt – in line with our assessment of an impending US economic slowdown. An added consideration underlying our decision to sustain a defensive portfolio stance derives from the ongoing geopolitical crisis in the Middle East, the outcome of which remains unclear both in terms of its horizon as well as its severity.

From an asset class perspective, we remain overweight fixed income, underweight equities with some exposure to precious metals. Within global equities we continue to favor exposure to defensive sectors and low volatility factor. From a geographical perspective, we expect international equity indices to outperform US peers both on account of a larger downside economic surprise potential facing US equities but also the tailwind effects on international equities from a potential weakening of the US Dollar, a dynamic we expect to unfold over the coming months.

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Emerging Market Perspectives

EM Equities Perform Approximately in-line with US Equities, Outperforming International Developed Peers Through October Market Sell-Off

In October, emerging market equities outperformed international developed peers despite the prevailing risk-off phase in global markets. For example, through October 30th session close, the MSCI EM equities index returned -3.19%, performing in-line with MSCI USA which returned -2.98% and outperforming MSCI EAFE index which returned -3.87%. Notably, some of the emerging market currencies – including the Polish Zloty, the Thai Baht and the South African Rand - strengthened versus the US Dollar.

In our view, emerging market equities' recent performance resilience versus developed peers is likely to sustain over the coming quarters owing to a number of factors, including:

(1) Growing signs of US economic deceleration starting in the fourth quarter, leading to the increased potential for considerable economic growth underperformance versus emerging market peers. Such relative growth deceleration is likely to unfold courtesy of a number of US economy-centric developments, including: (a) weaker consumption outlook owing to the fading of the support to US household finances from Covid-era US government transfers; (b) the October 1st resumption of student loan repayments and its contractionary impact on household finances, and; (c) the lagged effects from the large magnitude tightening in policy interest rates that started early in 2022.

(2) The EM equity market outlook is also likely to benefit from the growth-enhancing effects resulting from (a) the potential for sustained policy interest rate cuts in EM economies, most of which have seen core inflation already converge to target levels, in stark contrast to their developed country peers; (b) the increased purchasing power afforded EM households by strengthening EM currencies, a dynamic already in place since the second quarter of the year, and; (c) the direct and indirect effects on EM economies – especially those in the Asia Pacific region – from Chinese government authorities' newly found commitment to implement counter-cyclical fiscal and monetary policy stimulus measures.

Against the above backdrop, and also (a) given increased signs of rotation in economic momentum leadership away from service to goods sectors; (b) attractive relative valuations, and; (c) improved relative earnings and sales revision expectations, we expect North Asia Emerging Markets, including China, to outperform EM peers in the coming months. Within the EMEA region, we favor Polish equities while Brazil remains our top country pick within the LatAm region.

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