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Monthly
Market
Newsletter

Glovista Global Perspectives

This Issue:

Global Perspectives **P.1**

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Risk Markets Rally in February, Boosted by Strong US Tech Earnings and Bounce in Cyclical Indicators; Glovista Sustains Quality Tilts

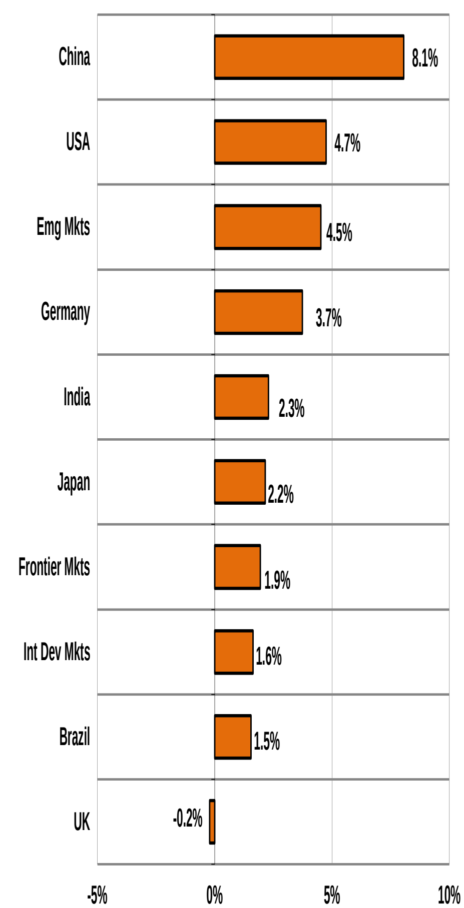
In February, risk markets have posted solid gains across asset classes and geographic regions (Figure 1). To many market observers, such recent performance is rather puzzling as it stands in the face of (a) sharp reset in implied real interest rates to higher levels, (b) negative Q4 2023 year-on-year earnings performance for the majority of US corporates, (c) a strengthening US Dollar and (d) recent confirmation of recession status for several major economies, including Germany and the United Kingdom.

We attribute the February strength in risk markets primarily to the recent upturn in a number of diffusion cyclical sentiment readings across regions, especially North Asia and the USA. Such upturn in sentiment readings has been centered predominantly in the technology sector, most specifically the semiconductor space, historically viewed as an early cycle sector globally. Examples of recent sentiment index readings that have surprised to the upside includes the US ISM manufacturing index both at the composite level as well as the ratio of new orders to inventory levels, a metric historically associated with forward earnings cycle turns.

A second factor further fueling the February spike in risk indices is that of solid Q4 2023 corporate earnings season for the US technology sector companies, particularly the semiconductor industry for which datacenter-related sales for the largest bellwether name (Nivida) derive predominantly from four of the US Magnificent 7 technology companies. Such statistic highlights the concentrated nature of the positive earnings surprise for the US market and questions the reasonableness of drawing broad cyclical inferences from recent strength derived from secular growth areas of the economy. In this light, it is important to note the negative year-on-year earnings performance, close to -10 percent, posted for Q4 2023 for the SP500 universe excluding the top 7 names. We believe such questions are especially relevant at a juncture in which the following dynamics are at play:

- Continued signs of softening US labor market conditions (e.g. rising breadth in the number of US states recording rising unemployment rate levels, continued declines in hire rates and quit rates, among others);

Country-wise Monthly Performance in USD terms (Feb 2024)*



Source: Glovista Calculations
**As of Feb 28th, 2024*

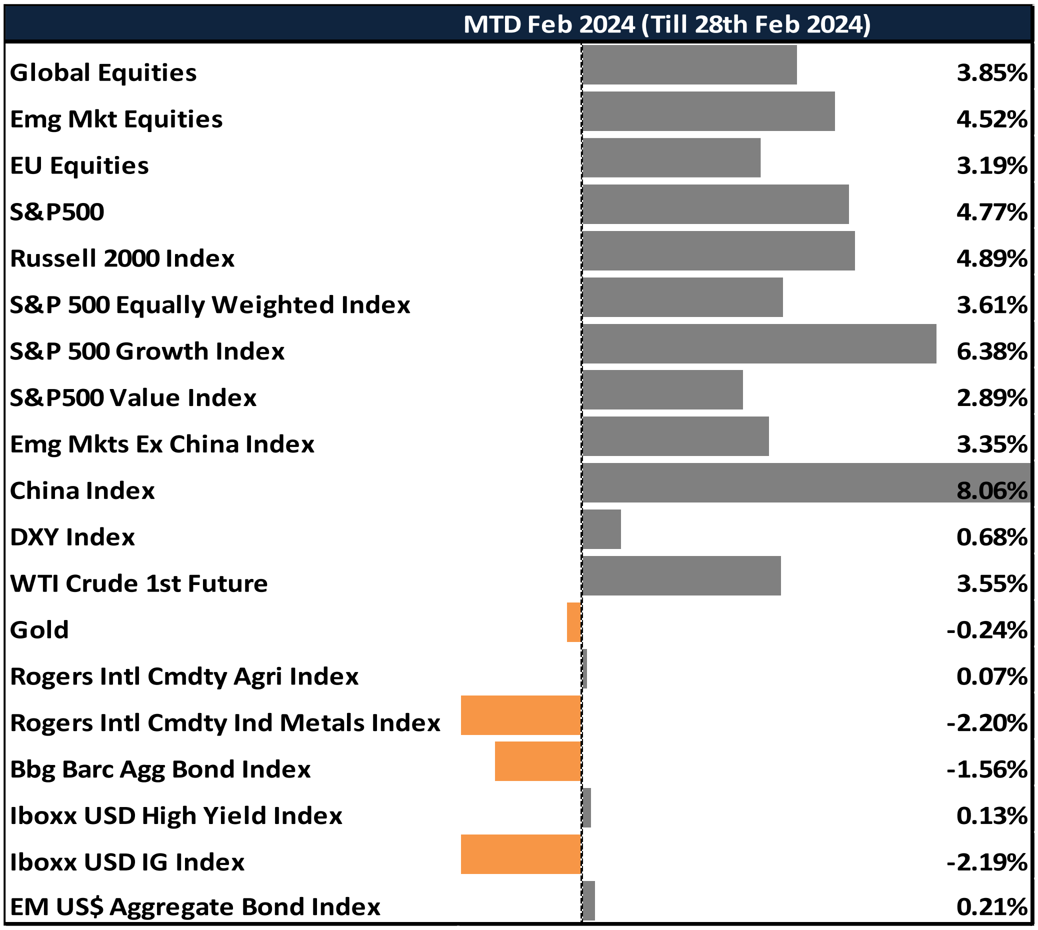
Monthly US Sector Performance – Feb MTD 2024*

Sectors	% Change	FY1 PE Ratio
Energy	2.14%	11.8
Materials	5.43%	20.9
Industrials	6.61%	21.3
Cons Disc	7.63%	25.0
Cons Stap	2.41%	21.1
Technology	4.96%	36.7
Healthcare	3.86%	19.4
Financials	3.97%	15.7
Utilities	0.48%	15.2
Telecom	4.40%	18.3
Real Estate	1.59%	36.5
S&P500	4.62%	21.0

as of Feb 28th 2024

Source: Glovista Calculations

Figure 1. Risk Indices Post Solid Gains in February, led by US Technology Sector Names



Source: Glovista Calculations

- Signs of potential forward declines in corporate operating margins, fueled by rising interest rate expenses (given upcoming loan resets), lower nominal revenue growth and delayed labor cost adjustments;

- Growing signs of stress impacting lower quintiles of the US household sector from fading or already depleted excess savings (depending on the quintiles in question) accumulated during the pandemic period courtesy of overly generous US government transfers and lockdown behavior. Examples of such rising stress levels appear in the sustained rise of loan delinquency ratios as well as increasingly cautious discretionary spending behavior.

From a public policy perspective, such signs of potential weakness in the world's largest economy (and, along with Japan, only one of two developed economies thus far averting recession or close to recessionary conditions) are further complicated by the unlikely ability for the US FED to initiate a sustained path of policy rate cuts given the marked strengthening in financial conditions brought about by strong asset market performance.

From a market perspective, the above macro-level observations need to be contrasted with prevailing US equity valuations that at 21x forward (1-year) multiple no longer discount recession or low growth scenarios in 2024 or 2025. Against such a backdrop, we continue to favor defensive positioning in global equities, with a particular emphasis on quality (including in the US technology) sector and cheaply valued securities. Recent economic activity surprise indicators suggest the recent reset in market interest rates will soon cease to be supportive of the US Dollar, thus likely resulting in a resumption of the US$ downtrend that started in September of 2022. Such development, if sustained, is likely to favor international equities, including emerging markets. A reversal in relative performance between US and international equities at the corporate margin level, combined with resumed US$ weakness and international equities' vast investor under-owned status, should bring about relative strength for international equities in the balance of the year.

Emerging Market Perspectives

EM Equities Solidly Outperform Developed Peers in February, led by Chinese Stocks; Glovista further Raises Asia Overweight via further LatAm Regional Cuts

In February, emerging market equities strongly outperformed developed market peers, led by Chinese equities. China's equity market was boosted by signs of consumer expenditure resilience along with stronger than expected corporate earnings results. Moreover, the Chinese government's embrace of a number of additional market-friendly policy actions during the month has served to underpin Chinese equities' re-rating at a juncture in which the group stands at one of its most under-owned levels in decades. As a result, the contemporaneous impact of favorable bottom-up, macro, policy and investor positioning considerations have served to bring about an impressive rally in MSCI China index stocks during the period.

Over the past several weeks, the Glovista investment team has further increased our overweight tilt to North Asian equities – particularly Taiwan and Korea – at the expense of Latin America equities. Such portfolio rotation is predicated on a number of considerations, including north Asian markets' improved cyclical stance versus Latin America peers on account of continued confirmation of a sustained upturn in semiconductor industry activity momentum globally. In addition, Mexican corporate earnings have been somewhat underwhelming during the past quarter, resulting in a richening of relative valuations.

As we look ahead, we expect US interest rate markets to stabilize further following the recent bout of volatility as the interest rate futures market now reflects approximately the same number of upcoming Federal Funds rate cuts as those reflected by FED staffers via the so-called FED dot plots. Thus, a period of lower interest rate volatility – and quite possibly, lower policy rates by the ECB and the FED by mid-year – would further enhance emerging market equities' outperformance quantum versus developed peers.

As we look ahead, the principal risks conditioning the outlook remain primarily geopolitical in nature along with possible policy mistakes out of the G10, most importantly in the form of a higher for longer policy interest rate stance by the FED and ECB.

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