# Weekly Report and Outlook on Global Markets

27th June 2020

## *A different perspective to Equity Valuation*


**Figure 1: The chart represents ratio of MSCI World Index m-cap to money supply(M2) in US, Europe and Japan(converted in USD)**

Historically PE Ratio has been considered sacrosanct as far as valuation is considered. However in this low rate economic environment it might not reflect the true picture hence one should value the global equity indices using a different parameter. Given the truly unprecedented level of monetary policy support fueling financial markets even some commentators have suggested traders should heed different measures to value equities to incorporate central bank largesse. One method can be level of money supply -- M2. Broadening this approach to include the increase of such a measure in US, Europe and Japan shows global stock valuations are bang on their average of the last 18 years. This fact shows that its not because of the earnings but the liquidity is the reason why the valuations have increased. The question now is that till what time can excess liquidity overshadow the declining fundamentals.

## *Inflation Options Signal U.S. Curve to Out-Steepen Europe*

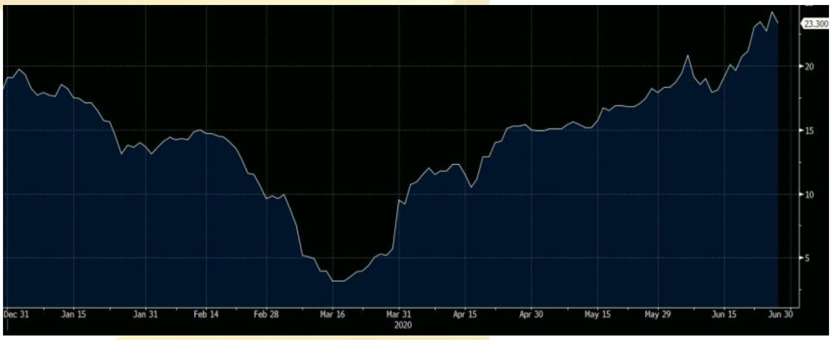



**Figure 2: The chart shows value of premium on 5-year US inflation cap option**

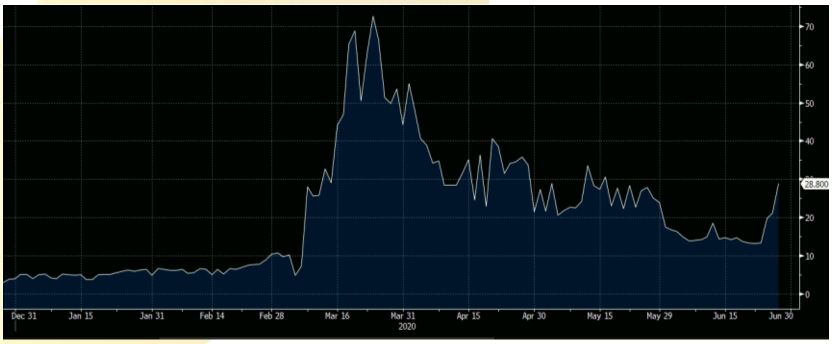



**Figure 3: The chart shows value of premium on 5-Year Europe inflation floor option**

U.S. curve steepeners look like outperforming similar trades for Europe. Growth signals point to pressures for higher long-end yields in both markets, but America faces stronger drivers from supply and inflation.

U.S. inflation markets are showing signs of life. After huge global easing, the option premiums have shifted. A 5-year inflation cap at 2.5% -- an option which pays out when U.S. CPI rises above that level -- has seen premiums creeping higher and now sits above pre-covid levels at 23bps.

Europe is looking at a different story. Option markets are shifting. The value of a 5-year floor struck at 0% -- which pays off if European inflation prints in the negative -- is well above pre-covid levels at 28bps.

So one can conclude that traders are betting on US Inflation to remain above 2.5% whereas they are betting on European inflation to remain below 0%

## USDJPY volatility spread signifying more risk ahead in the future than present

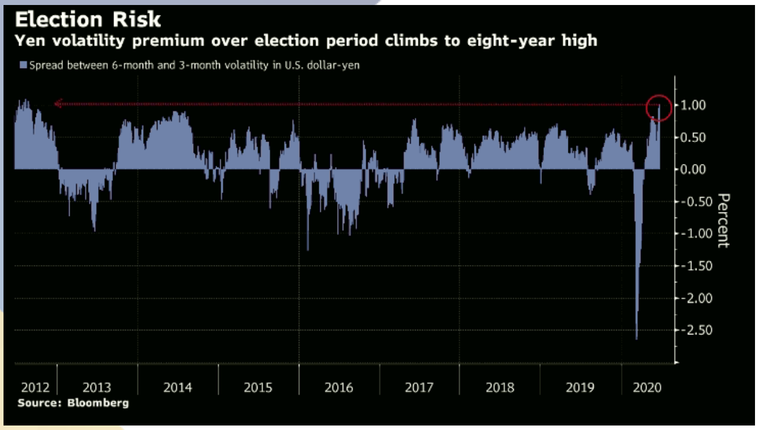



**Figure 4: The chart depicts Spread between 6-month and 3-month volatility in USDJPY Pair**

Traders in the $6.6 trillion-a-day global currency market are starting to contemplate the possible outcome of U.S. presidential election. Most of the national polls have indicated a double digit lead for Joe Biden over Donald Trump. However considering the US Dollar-Japanese Yen volatility spread between 6-month and 3-month once can say that market hasn't given up on Trump yet. A huge level of spread indicates that markets have priced in a huge amount of uncertainty leading to 2020 Elections. That contrasts with the run-up to the 2016 election, when gauges of turmoil reflected only a temporary minor uptick in volatility as investors overlooked the likelihood of a Trump presidency, or any controversy surrounding the results -- leaving them painfully exposed to those events. In fact options contracts for both November and December are pricing in a premium versus October. This signifies that Investors are concerned that the election could spill into late November due to recounts and court challenges.

## Emerging Market currencies to Benefit From Yield Curve Control likely Be Brazilian Real(BRL), Mexican Peso(MXN),Korean Won(KRW) and Indian Rupee(INR)

EM currencies that offer relative value on a real exchange rate basis, along with high yields and light positioning are likely to benefit from the implementation of yield curve control (YCC). In summary, BRL and MXN fit the bill on all 3 counts, KRW is cheap on the valuations angle and equity flows have been very weak, INR also looks cheap and has decent yields on a relative basis too.

The greatest deviations in current Real Effective Exchange rates (REER) from 5-year averages are largely in Latin America. BRL, MXN, COP(Colombian Peso) and CLP (Chilean Peso) -- all 1.5 standard deviation below the average. In Asia, KRW and INR also both are more than 1.2 standard deviations "cheap," according to this measure. The IDR(Indonesian Rupiah) , by comparison, is 1.5 standard deviations expensive.

In terms of high nominal yields, BRL, TRY(Turkish Lira), MXN, RUB(Russian Ruble), ZAR (South African Rand), IDR, and INR stand out.

Positioning, as measured by foreign inflows into local equities and bond markets, is almost uniformly light. KRW and BRL are the stand-outs in the equity flows space, where 12-month flows have fallen 3 standard deviations below the 5-year average. In the bond universe, Indonesia and Thailand are at least 2.3 standard deviations from the 5-year average. Mexico is 1.9 standard deviations below.

# MAJOR MOVES THIS WEEKS

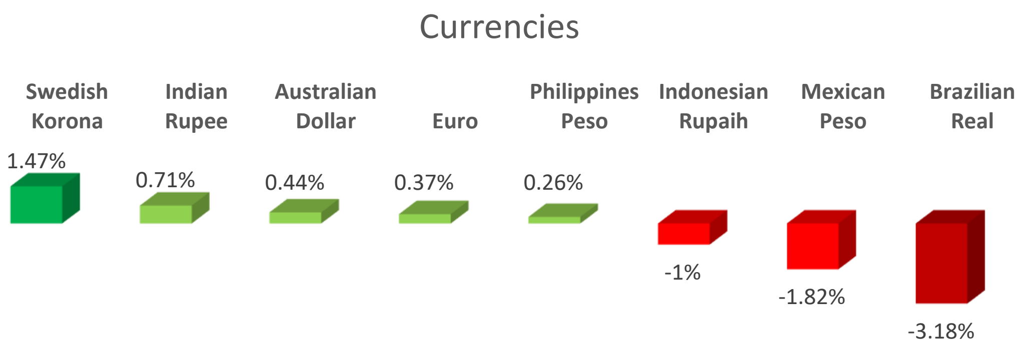



**Figure 5: The graph represents Currency returns with respect to US Dollar as the base currency for this week**

Emerging market currencies showed a divergence this week with Asian Currencies holding up pretty well against USD whereas Latin American currencies giving away their recent gains. One can attribute this development to the rising Covid-19 cases in Latin American countries and also the political instability. Developed market currencies like Australian Dollar and Euro also showed a decent resilience against a slight risk off environment building in the Equity markets.

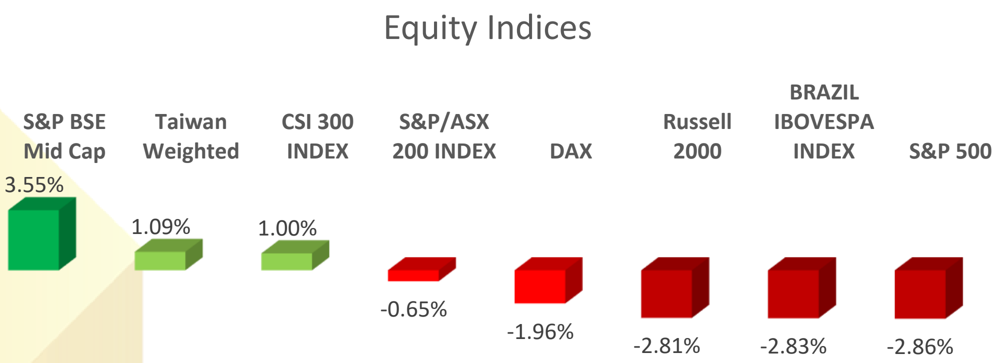



**Figure 6: The chart represents the equity index returns over this week.**

Developed market Equity Indices showed weakness this week as most of them were unable to surpass their previous week's top and ultimately closed in red. However one can see US markets underperforming European markets in this downfall. Rising number of Covid-19 cases in USA and an already inflated Equity Indices are responsible for the underperformance this week. Asian Indices on the other hand seemed pretty stable with decent weekly gains. However this trend might change in case Equity Indices globally continue their downtrend.

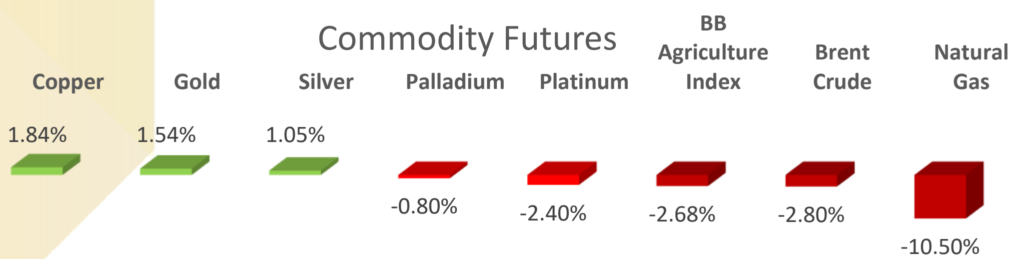



**Figure 7: The chart represents the commodity returns over the week.**

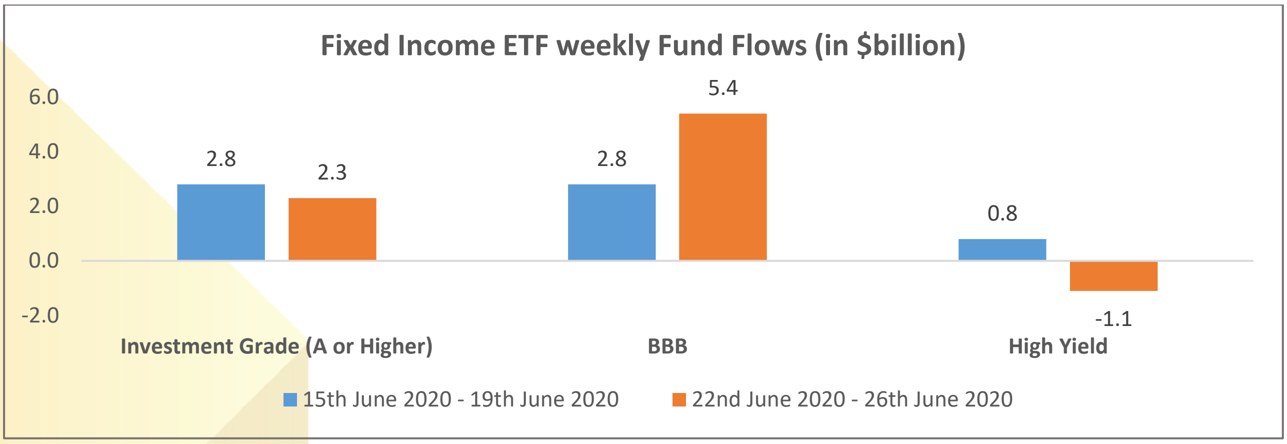
A slight risk off sentiment was also observed in Commodities with haven like Gold outperformed its precious metals' peers like palladium and platinum. Copper was the outlier among Industrial Metal segment which showed a lot of strength this week in comparison to Nickel, Zinc etc. Crude Oil also went down with rising Covid-19 cases and huge inventory build-up and Natural gas continued its massive underperformance as the summer heat has yet to materialize, and oversupplied conditions persist.

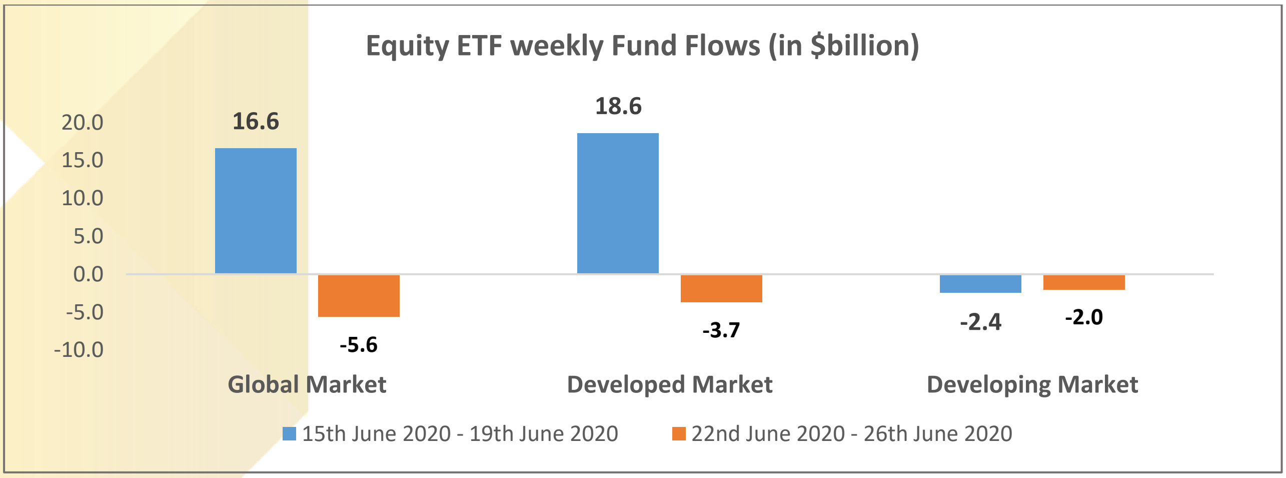
# GLOBAL FUND MANAGERS' STATEMENTS

1) Jim Rogers (Co-founded, Quantum Fund) : "These things (referring to Technology Stocks) often winds up in a mania or a bubble and that looks to me what is forming in the US and maybe in some other places as well. Bonds have never in world history been this expensive and I see a bubble forming in them too. Commodities are the cheapest asset class series right now and I will continue to own them and accumulate more along with gold and silver" – Interview with ETNow on 25th June 2020.

2) Scott Minerd (CIO & Chairman of Guggenheim Partners) : "Despite market strength, stocks are far from being out of the woods. The past 3 months may only be a prelude to entering the Coronavirus Forest. High yield and investment grade credit offer better risk-adjusted returns." - Tweeted on 25th June 2020.

# GLOBAL ETF FUND FLOWS




*Please note that the Global ETF fund flows under Equity ETF weekly flows category will not be equal to the sum of their respective sub-categories which are mentioned on their right side since there are other sub categories as well*

# PACE 360'S FUTURE OUTLOOK

"While US equities last week were seeped in red ink across the board, the most notable development was the peaking out of Nasdaq 100 on Tuesday. We believe that the great Nasdaq bubble has popped and it is headed for a significant fall over the medium term. We might see Nasdaq facing more losses in the coming week with other indices largely remaining range bound with a downward bias. Gold has broken out of a multi month range and is headed for further gains over the near term."

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