

# iFlow

## MONTHLY

June 2023

Month-end rebalancing in FX is likely to fall disproportionately on the high-yield EM likes of BRL, INR, MXN and ZAR with carry bought strongly this month. Fixed income in several markets, Australia in particular, likely requires purchases to offset selling caused by hawkish central banks. Among equity styles, the ongoing recovery of US Cyclical vs. Defensives supports the improvement in risk appetite. Growth continues to underperform Value in Emerging and Developed EMEA, and in Developed APAC.

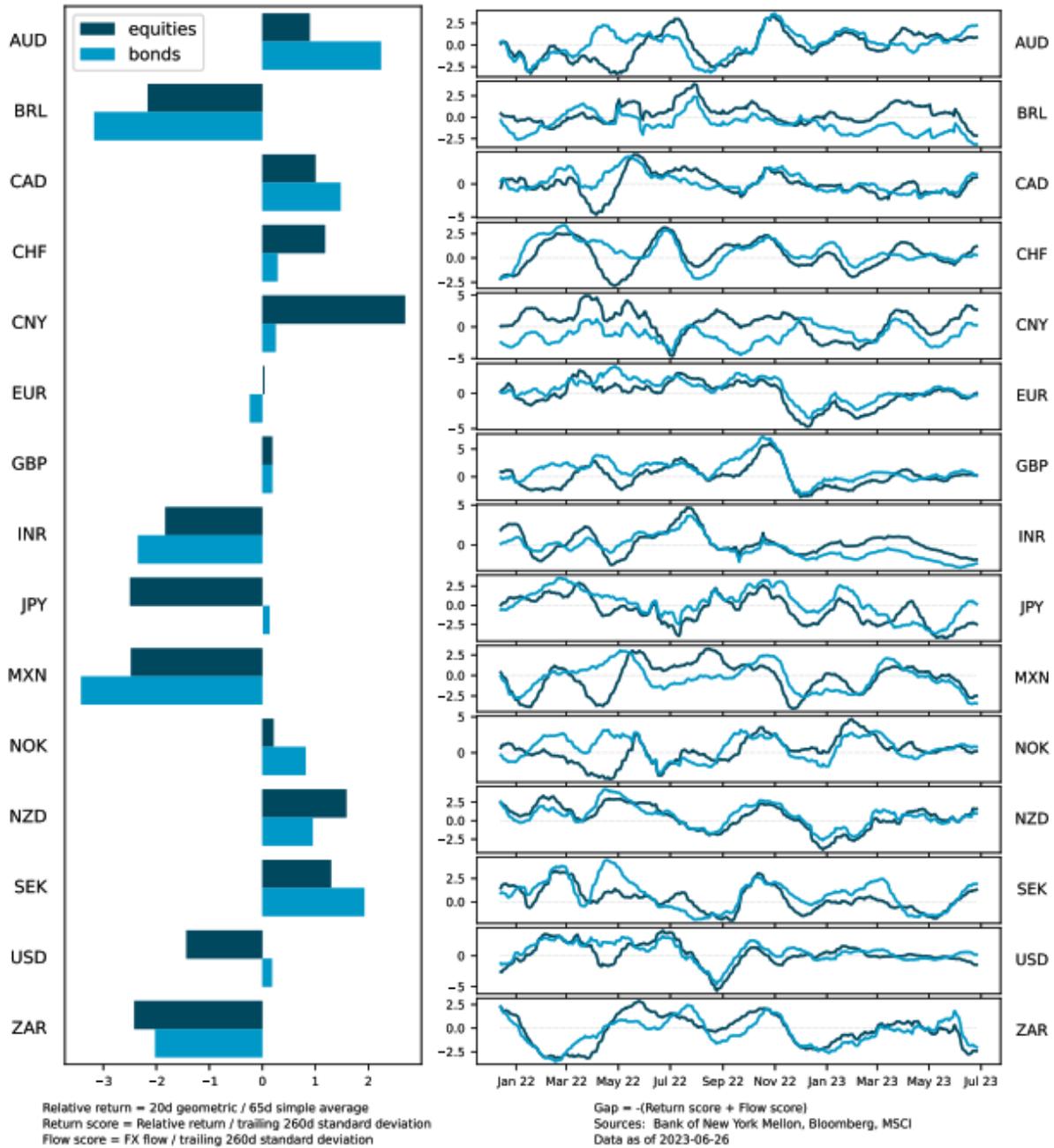
Today, we are pleased to provide the newly enhanced iFlow Monthly. This version incorporates new datasets from equities and ESG to generate the following reports, with corresponding links to white papers detailing index methodology:

- Monthly Rebalancing index, based on marginal equity and fixed income returns, offset against marginal FX flow scores generated by iFlow.
- [US Equity Styles](#), details US equity purchases across different style indices
- [International Equity Flows](#), assesses asset allocation preferences across developed and developing markets on a regional basis
- [iFlow Green](#), assesses alignment between ESG factor flows and general equity flows

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The chart below details rebalancing results heading into month-end, as well as the evolution in FX flows and returns which led to the imbalance. Click anywhere on it to view iFlow Monthly.

Aggregate month-end rebalancing gap between equity or bond price movements & FX flows



Source: BNY Mellon

**June Rebalancing Summary: Carry Unwind To Take Precedence**

As expected, with carry currencies strongly bought throughout the month and risk generally performing, rebalancing needs for June fall disproportionately on high-yielding emerging market currencies. Due to strong marginal inflows over the month, strong selling is likely for BRL, INR, MXN and ZAR. JPY has the only strong selling signal among G10 currencies, this

largely due to the performance of Japanese equities. Even though JPY was net sold on the month, the magnitude of its abnormal flow score was less than one, but the abnormal returns in its equity market, with a magnitude above three, outperformed every other market we track.

In fixed income, we expect some purchases in Australia. The surprise hawkish turn by the RBA meant Australian fixed income underperformed heavily and requires purchases to offset the selloff, especially as AUD was moderately sold on the month. Norway was in a similar situation. Its fixed income market also suffered from a hawkish central bank, but NOK did find some marginal buying, which ultimately generated a slightly lower net purchase gap. We are also watching for inflows into SEK, conveniently ahead of the Riksbank decision this week, as the combination of fixed income selling and SEK funding demand has led to portfolios falling into an underweight position. In equities, material CNY purchases seem needed as middling equity performance was heavily offset by CNY selling and requires rebalancing. In contrast, Chinese fixed income performed very strongly on the back of PBoC easing and almost fully offset the CNY selling through the month.

*methodology: Using the 'markets are made at the margin' principle, rather than take outright asset returns against marginal FX flow we look at the marginal return against the marginal FX flow to determine the incremental hedging needs generated by larger-than-expected moves. Using the same methodology as iFlow Hedge, we construct a set of marginal monthly returns using the 20-day exponential moving average against the 65-day simple moving average. Subsequently, we calculate scores for these marginal returns and flows by dividing the return and flow sets by their rolling 1-year standard deviations – the same methodology we use in iFlow. To proxy for hedging needs, we simply take the difference between the flow scores and chart the 'distance' that the FX flows are needed to make up for hedging the return profiles.*

## **iFlow Equities 2.0 Style Indices - flows of significance:**

### **1. US Equity Styles**

- Cyclical equities have continued their recovery against Defensives, which supports the general improvement in risk appetite and suggests a robust economic outlook. However, ISM is performing very poorly and the generally poor performance of soft data of late suggests that optimism over the economic cycle could prove misplaced.
- Leverage flows continue to pick up despite Fed hawkishness, but this in part may support the Fed's view that financial conditions remain loose relative to inflation and

inflation expectations. Meanwhile, despite the strong performance of various Technology stocks, the general Growth complex is underperforming Value, supporting the view that the current rally is narrowly-led.

- Inflation-related flows are at the highs of the year despite softer break-evens. Even though price growth has likely peaked in the US, markets are maintaining vigilance on inflation, especially with labour markets remaining generally strong.

## **2. International Equity Styles**

- EMEA Cyclical are outperforming Defensives. However, given weakness in soft data, as confirmed by the latest Ifo survey, we expect some downside adjustment as global industrial demand remains weak. Growth continues to underperform Value in both Emerging and Developed EMEA, but the level of weakness has come off recent lows.
- APAC Defensives continue to perform better amid fading hopes for a strong China stimulus to kickstart the cycle. However, led by strong performance in Japan, Cyclical demand is improving in Developed APAC, though much of this likely owes to earnings translation. Yet, Growth in Developed APAC is heavily underperforming Value, underscoring the re-emergence of Japan as a long-term value play, rather than re-rating based on a cyclical pick-up or a new round of capex-driven investment growth.

## **3. iFlow Green**

- Most regions are showing good flow alignment with individual ESG factors. The exception is ESG-Governance, which shows weak alignment with flows across developed markets and also on a global level.
- EM Americas is also showing the weakest ESG Flow alignment across multiple factors, suggesting that the recent round of performance has been driven by preference for listed equities with poor ESG scores, which tends to happen when commodity-related equities are in demand.
- On a global level, ESG-Governance has the poorest alignment with general equity flows as companies globally with poor governance scores are seeing preference. Within the United Nations Global Compact Factors, Anti-Corruption is also performing poorly, albeit only showing neutral alignment with general equity flows.

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