BNY MELLON

iFlow

MONTHLY

November 2023

November Rebalancing Summary: Fixed income performance throughout November was the biggest driver of rebalancing flow. US dollar demand was strong initially but this likely tailed off towards month-end. BRL and CAD face selling pressure.

Our enhanced iFlow Monthly incorporates new datasets from equities and ESG to generate the following reports (links take 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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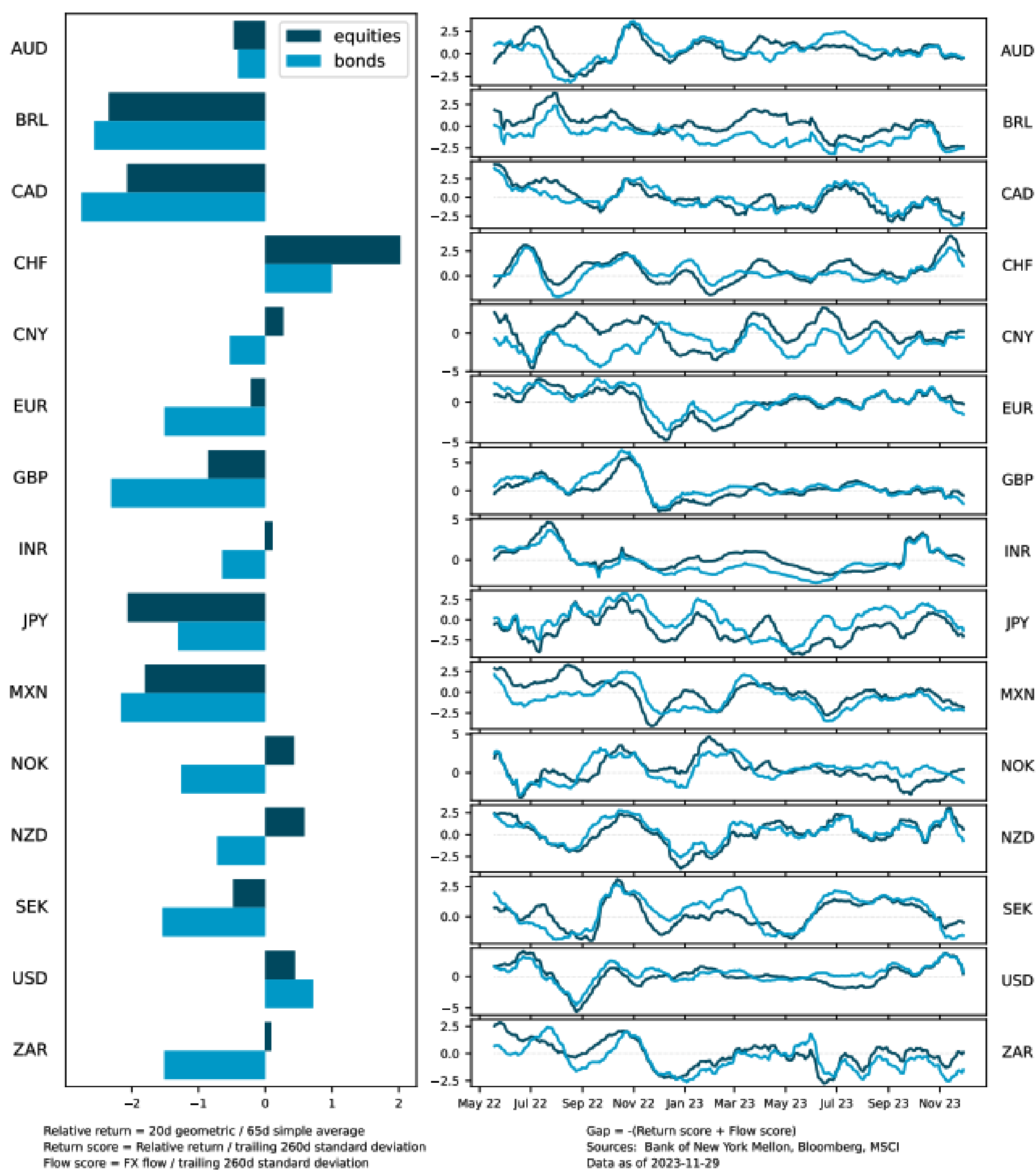
The chart below details rebalancing results into month-end, as well as the evolution in FX flows and returns which drove the imbalance. Click anywhere on it for the full report.



Source: BNY Mellon

It may come as no surprise that funding or haven currencies were the weakest performers in November. The USD was heavily affected by a move lower in US yields on the view that inflation had peaked. The CHF was also likely seen as in a prime position in G10 to commence easing due to Eurozone growth struggles and broader valuation pressures affecting the franc. However, it wasn't EM currencies or other high-beta developed market currencies which benefited the most. The JPY was moderately bought and CAD had another strong month. We we suspect much of the CAD flow was hedging-related due to the strong flows back into US-based risk (equities and fixed income) from Canada asset managers.

However, this would have generated an imbalance in the opposite direction as investment into Canada assets may now be at risk of being caught in the flow and attaining excessive total return exposure.

In contrast to the lack of signals in equities in recent months, for November the moves in the underlying indices require some FX adjustments. CAD and BRL will face selling pressure against the CHF and USD. This is also consistent with our view that some mean reversion in carry or carry-linked positions needs to come through. We note that iFlow Carry itself has already moved away from positive statistical significance. Despite a risk-on environment, US equity markets have not generated very strong outperformance relative to other markets which were relatively under-positioned into November, thereby generating recovery demand. Swiss markets are clearly being affected by weak Eurozone sentiment, and coupled with FX sales (and holdings also weak), additional FX buying is needed.

For fixed income, the USD had a buy signal heading into month-end but the gap was generally closed. Strong Swiss fixed income performance offsets selling in the franc. For many markets in Europe, a lack of FX purchases or outright sales have offset duration strength so flat signals are prevalent for month-end. This is generally how the framework is supposed to behave as FX selling is generated by weaker policy expectations, which in turn supports duration inflows. The process generally worked well through November, though the marginal purchases in BRL, CAD and MXN, most likely due to positive FX-based hedging or rotational flows from USD sales, has led to some excess positioning on a total return basis. As such, these currencies appear at risk of selling into year-end, we believe CAD and MXN particularly so due to excessive holdings; these two are holding up a USD holdings recovery in TWI terms.

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

- Cyclicals vs. Defensives remains neutral but the trend has been one of recovery. This is incongruous with the renewed decline in manufacturing ISM, indicating some degree

of misalignment between equity sentiment and the outlook for demand.

- Leverage flows have rebounded to neutral after persistent declines from July through October. This does not imply that asset allocation is favouring a robust earnings recovery based on the state of the credit cycle, but easier financial conditions are probably playing a role. Growth/Value flows are deteriorating again.
- Inflation flows have fallen back to neutral after a tactical recovery through much of Q3, indicating that the market is no longer looking at related protection trades. This is in line with the recent adjustment in global policy expectations, which sees inflation peaking and allowing central bank rate cuts to be priced in around the world.

2. International Equity Styles

- In EMEA, Cyclical flows have deteriorated in both EM and DM markets but the former is struggling a bit more. Considering their place in the supply chain and liquidity constraints, we view this as higher-beta flows to the industrial outlook in developed EMEA markets, where data continues to point to contraction. Growth vs. Value performance across EMEA continues to deteriorate.
- In APAC, Cyclical flows are underperforming Defensive counterparts in both developed and developing markets as China's growth outlook continues to suffer from a lack of momentum. Growth vs. Value flows in APAC, however, is showing some more divergence in favour of developed markets.

3. iFlow Green

- iFlow Green flows have shifted back into a regional bias as Developed EMEA is showing stress across multiple ESG factors, particularly in Environment and United Nations Global Compact – Anti-Corruption. Only strong Governance-related flows have helped sustain the broader ESG factor flow.
- DM Americas is showing strong flow alignment with multiple ESG factors. Environment and Social flows are firm, while in the UNGC categories, environment and Human Rights are leading the way. Developed APAC is also showing improving exposure across all ESG categories.
- Globally, UNGC-Anti-Corruption is the weakest performing factor, with three regions indicating deteriorating equity exposures. Developed EMEA aside, Emerging Americas flows are also weak in this factor. There is currently no single factor positive across all regions, though alignment is generally strong for Environment flows, with Developed EMEA the major exception.

Geoff Yu

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