BNY

iFlow MACRO REVIEW

June 2024

Key Themes

Rebalancing: Carry unwind to end; CHF selling likely significant

US Equity Styles: Cyclicals flows continue to outperform Defensives, most styles still flat

International Equity Styles: Cyclical and Growth flows accelerate in APAC

iFlow Green: EM ESG alignment still negative but EM EMEA turning more favourable

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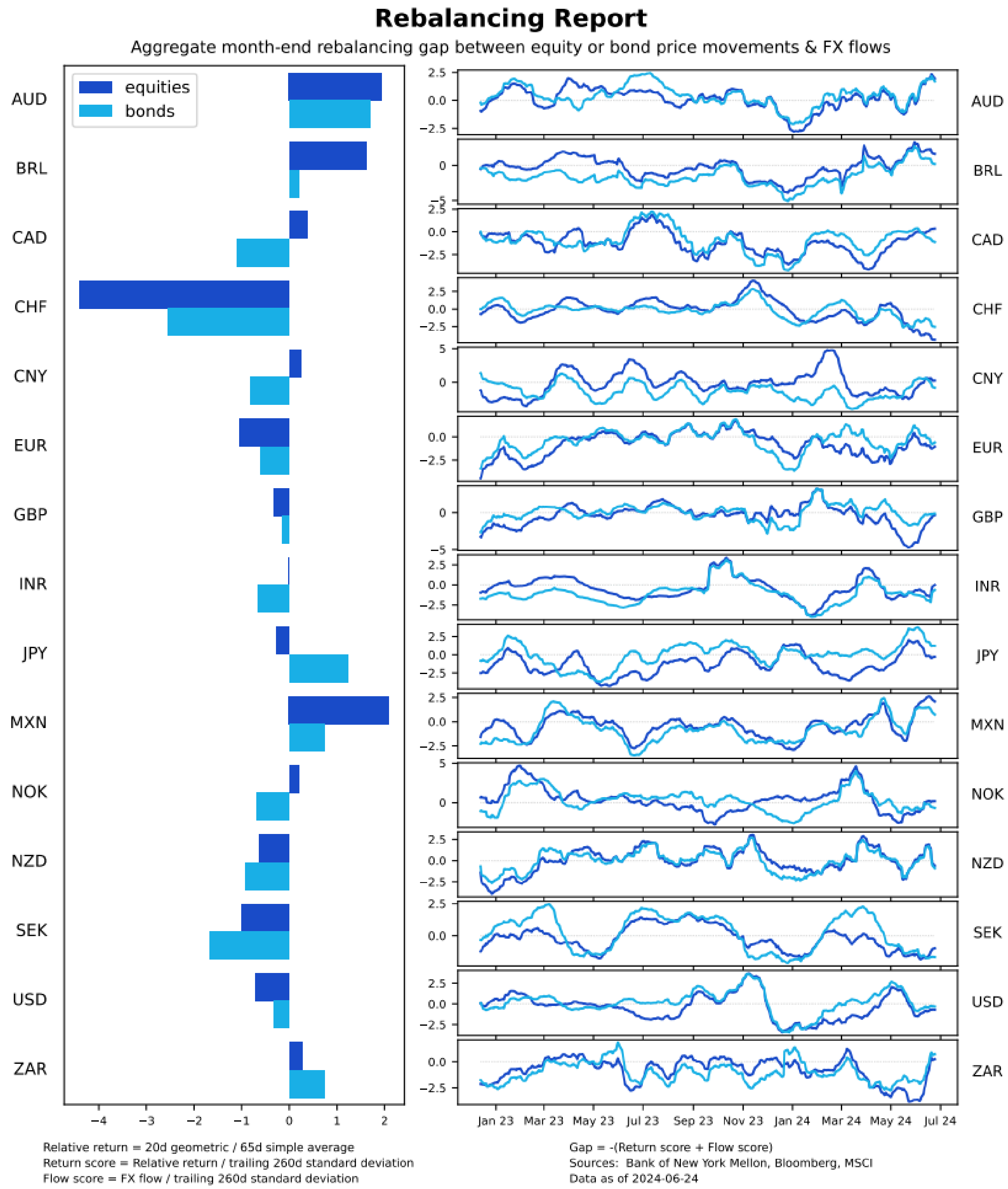

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Rebalancing Update

Risk aversion has been a major theme for markets throughout June – first stemming from elections in emerging markets and then from well-documented developments in Europe which moved sovereign risk back onto the agenda for the first time in many years. As is the norm, the latter would result in very concentrated flows into CHF, so it is no surprise that currency is the month's outperformer by far. Its average flow score during the month is almost three times the level of the next-best performer, SEK, which may also have benefitted slightly from reallocation flows, though this month's policy shifts may have also played a role. At the other end of the spectrum, it is EM and high-beta currencies which have continued to struggle, also not a surprise given the combination of political risk and carry unwinding coming through markets. We note, however, that USD has not benefitted materially, suggesting that these holdings were not excessive in the first place and that there are more relative-value positions out there than the market is giving credit for.

On a marginal basis, there are no material changes to FX flow rankings, only a slight switch of places for INR and AUD at the bottom, but the CHF's high positive marginal flow scores have clearly been amplified. As CHF has been structurally underheld, it means that inflows were not the norm so such a large inflow on the month would clearly have an outsized impact on flow scores. By our standards in rebalancing, it is very difficult to offset such a return score with a large asset return score, so CHF would certainly appear at risk of rebalancing-based selling, likely what the Swiss National Bank has been trying to achieve with its monetary policy. At the other end, INR and AUD should find some buying interest, though India's good asset performance would offset total-return exposures almost perfectly.

Equity markets normalised in June insofar as we are seeing dispersion again. There have been some cases of uniform outperformance over the past few months, but we never view those as a healthy development. However, with Brazil and Mexico the key underperformers, it is likely local or regional politics driving sentiment, rather than earnings or broader macro developments per se. Markets appear more sanguine about Mexico's incoming government, so that would have offered some mean-reversion opportunities in any case, but the large marginal outflows would have strengthened the case even more. Switzerland and the US have been outperforming. India and South Africa have managed to defy initial concerns about election results. Expectedly given the strong CHF inflows, equity rebalancing likely requires very large CHF sales. This also supports our view that if there are signs that carry unwinding has run its course for now (iFlow Carry was only briefly statistically significant and negative), then CHF-funded positions could be back in favour. CHF may also replace JPY as a funder given the Bank of Japan's/Ministry of Finance's language on JPY volatility having picked up noticeably in recent weeks towards far less tolerance. MXN and AUD have just about generated some inflow demand through equities; valuations and real-rate profiles for both point to some confidence in recovery flow up ahead.

Fixed income also performed well, especially in EM, but as the US has not led the way with duration gains, the improvements are again mostly due to idiosyncratic factors and reflect some repricing of political risk. India and South Africa again saw gains as the market, for now, need not worry too much about the direction of real rates. The US has also registered positive return profiles which would not adversely impact the global risk narrative with a 'higher for longer' shakeout that we have seen in the past. But this is a relatively low bar as positioning in these markets is also relatively light. Japan was the only notable underperformer, and we expect this to remain the case as long as BoJ meetings are 'live'.

As for rebalancing flow, once again the strongest signal is in CHF sales, though the rebalancing score is not as strong as in equities. This is a bit of a surprise considering that the SNB was dovish and strong CHF appreciation or inflows would normally affect the SMI due to export earnings exposure. Nonetheless, the FX flows alone would likely have generated a rebalancing need in any case. Due to offsets, there are no other currencies which have generated strong rebalancing needs, as they fall short of our usual thresholds. India fixed income in particular has performed strongly enough to offset the FX outflows. Australia fixed income was flat on the month, which also means that AUD selling was not meaningful enough to cause a significant reversion. This is another example of self-rebalancing coming through the month which limits any material FX flow impact for asset allocators. Overall, it appears that in a carry context, the upcoming week would be more a question of removing low-yielding longs rather than buying back high-yielding carry.

iFlow Equities 2.0 Style Indices - Flows Of Significance

1. US Equity Styles

- Notwithstanding the Tech correction towards month-end, Cyclical themes have been outperforming Defensive flows despite no sign of a robust pickup in US data. There is some sign of flows being 'stopped into' US equities due to the lack of alternatives.
- Stable risk sentiment has not enabled Growth to outperform Value materially, as some less-favoured parts of the market may have also faced purchases as asset rotation continued to move into the US.
- Inflation and Leverage flows broadly flat – may speak to uncertainty around Federal Reserve policy. Restrictive rates preclude leverage growth and inflation unlikely to surprise strongly to the upside, but downside risk is not prevalent either.

2. International Equity Styles

- The most significant development in thematic flow is the good performance of Cyclicals vs. Defensives in both developed and emerging Asia. The trend has been in place in the former for several months now, but there is still some distance to the highs of the beginning of the year. Strong flows into the likes of South Korea are helping offset a renewed downturn in interest in China.

- Most EMEA themes remain flat, but there is a noticeable retracement in Cyclical vs. Defensive flows in Emerging EMEA. South Africa has struggled post-election. CEE is also being affected by renewed risk aversion emanating from the Eurozone.

3. iFlow Green

- On an aggregate basis, changes remain limited compared to May. EM factors are almost uniformly negative, but this is mostly led by APAC factors deteriorating strongly. In contrast, EM EMEA has turned around materially, with only Global Compact-Human Rights as a factor indicating negative alignment between changes in portfolio exposures and ESG factor scores.
- Developed markets remain lightly negative, though ESG-Governance is a strongly positive factor, led DM Americas and EM EMEA flow. EM Americas is showing good flow alignment between UNGC Human Rights and Labour Rights factors.

*iFlow Macro Review PDF contains the following:**

- Monthly Rebalancing index, based on marginal equity and fixed income returns, offset against marginal FX flow scores generated by iFlow.
- US Equity Styles, detailing US equity purchases across different style indices.
- International Equity Flows, assessing 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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