BNY MELLON

iFlow MACRO REVIEW

April 2024

Key Themes

Rebalancing: ZAR and MXN in spotlight amid asset rotation

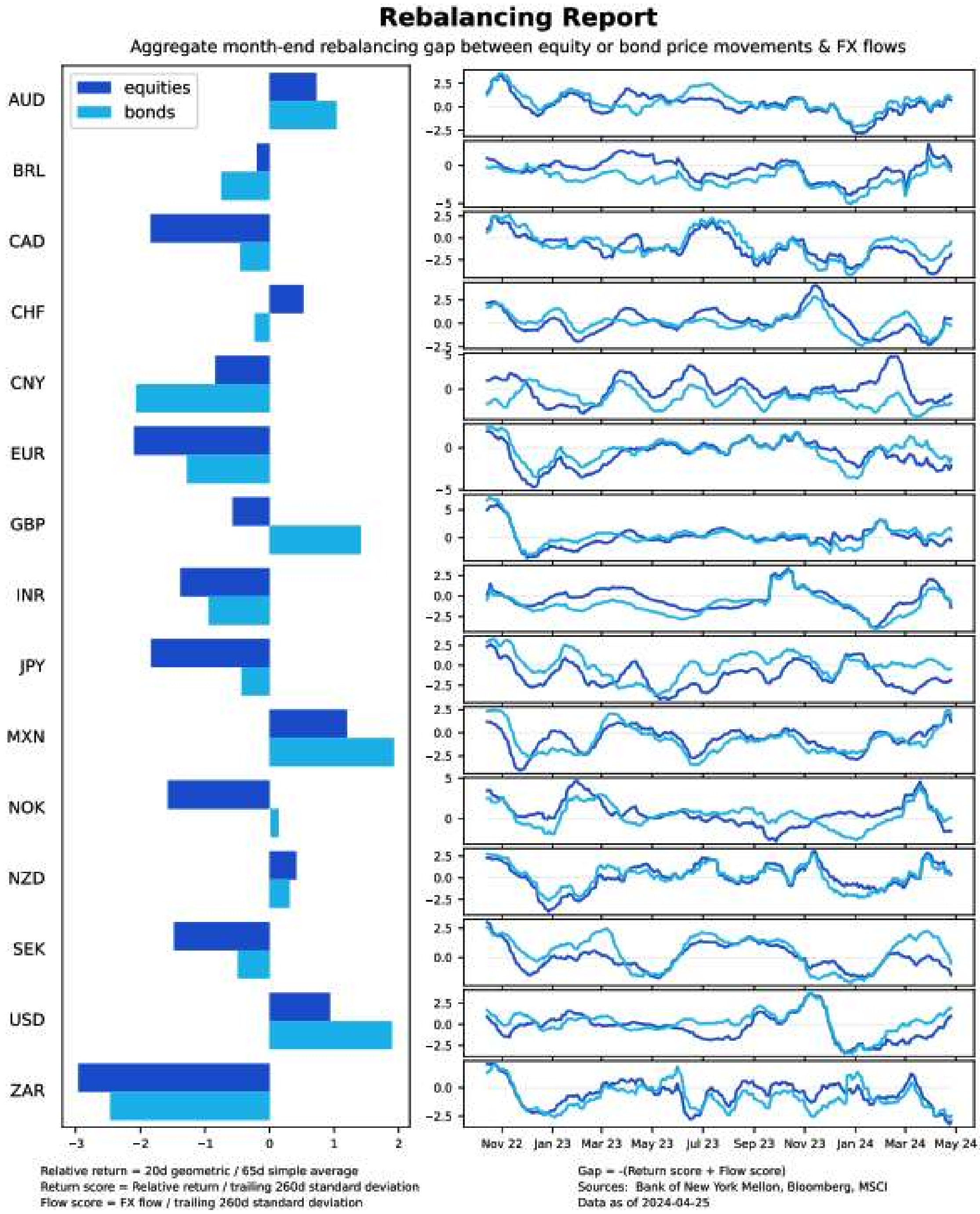
US Equity Styles: Cyclical flows deteriorate sharply

International Equity Styles: European flows point to recovery expectations

iFlow Green: EM ESG alignment remains extremely weak, driven by APAC flows

---

Click on the image below to launch a PDF with all graphics.*



Source:BNY Mellon

Rebalancing Update

April looks set to end on a risk-off note as the combination of higher US yields and bouts of risk aversion have caused some tightening in financial conditions. However, different currencies were affected in different ways and dispersion is still quite evident across the FX market. Despite our ongoing misgivings about the carry trade, which clearly undermined MXN, ZAR was the best-performing currency on a flow basis, though we suspect significant hedge unwinding contributed to the outperformance. Similarly, CAD and EUR remain the key overheld currencies in G10 due to heavy levels of hedging flow by local investors. JPY was net bought as well, though today's BoJ decision could still have major bearing on how the currency finishes the month. We also note that outside of ZAR and MXN, ranges through the month were relatively tight, as 13 of 15 currencies had flow magnitudes below 0.4.

Equity markets were generally good performers on the month but with idiosyncratic drivers again in play. The FTSE hit a record high but considering the UK, Norway and Canada are in the top four, a degree of energy-related interest likely came through as these equity markets are uniquely exposed to energy companies' performance. However, that the price gains also took place during periods of risk aversion may not guarantee the earnings to justify the performance, especially if global growth is going to be heavily affected. China also performed well, though this is likely a classic case of mean reversion after heavy declines through Q1. We stress that abnormal returns in equities were also generally low outside the top five, with magnitudes all below 1.0. Brazil was the only equity market which underperformed but the decline was not significant. Ultimately, CAD, EUR and ZAR were the only currencies with strong rebalancing signals, mostly due to the currency leg. However, Eurozone and Canada equities both had abnormal return scores in equities above positive one, which would have generated some degree of offset demand into month-end. The positions of Eurozone and Canadian asset managers are likely over-edged at present. For some normalisation, either larger amounts of equities in target markets are needed to boost NAVs (which would have a positive currency effect), or hedging levels will need to come down as NAVs decline with equities most likely to struggle up ahead.

Fixed income markets have continued to normalise. Even though the pushback in Federal Reserve easing expectations has led to steepening in general, the declines were not material. The US, South Africa, Mexico and Japan all performed poorly: the US and Japan's predicament was clearly policy-led, while South Africa and Mexico will have electoral risk coming through, potentially generating future fiscal profiles which could be highly detrimental to their government bond markets. The only material outperformer was China – continued its good run of form as yields continue to decline. However, the PBoC is now concerned about the signalling of excessively low yields and is starting to push back verbally. Even so, talk of material easing in the form of asset purchases or a significant ramp-up in liquidity provision is helping to support the market. Switzerland performed well, likely due to the surprise rate cut March, and is now the only G10 economy with a deeply disinflationary growth profile, which could also demand a policy response. MXN and ZAR (just about) are the only two currencies with a significant rebalancing signal, requiring purchases and sales, respectively. Despite the rand's strong abnormal FX flow score, it was almost pushed into a smaller rebalancing position because of the weak performance of South Africa bonds in the first place, and the two proved offsetting. We have already highlighted that the selling flow in SAGBs was also seen in iFlow, so this is congruent asset allocation already. Sales of MXN coupled with exits from the Bonos market has pushed down MXN exposures. We note that the currency has corrected its holdings materially and is no longer extreme. From a real rates point of view, recovery flow is no longer out of the question.

iFlow Equities 2.0 Style Indices - Flows Of Significance

1. US Equity Styles

- The push into Cyclical flows finally faltered in the US as equities struggled amidst sustained tightening in financial conditions. A defensive approach was sought, and this forced relative performance of Cyclicals vs. Defensives to the lowest levels since January 2023. Ironically, this took place as manufacturing ISM continues to recover.
- There was also a corresponding pick-up in inflation flows – no surprise considering the direction of travel for price data. This is the first upward move from negative to positive in inflation flows this year and comes as breakevens revisit mid-2023 levels.
- Growth vs. Value flows and Leverage flows are relatively flat, largely unchanged from March. Strong data is welcome, but the prospect of a hawkish Fed reaction is also limiting Leverage.

2. International Equity Styles

- Europe is clearly recovering in a Cyclical direction as both DM and EM EMEA Cyclical vs. Defensive performance approach multi-year highs. We still struggle to see the fundamental case for such performance given any data improvement in Europe is purely services-driven.
- Flows in APAC are divergent: DM APAC continues to struggle but there is some life in Cyclicals. However, growth performance in EM APAC fell sharply towards month-end, so the signalling from flows is still mixed for more sustained growth.

3. iFlow Green

- We have not seen any improvement in ESG alignment over the past month. If anything, all ESG factors are now deeply negative across EM, led by APAC, indicating that exposures to highly rated companies continue to decline. There are some pockets of strong positive alignment in EM Americas, such as in ESG-Social, which also reflected in strong alignment in UN Global Compact Human Rights and Labour Rights flows.
- Developed markets are largely flat, though alignment is generally strong in developed Americas; ESG-Governance is an exception in the region. Developed APAC is also the weakest-performing region for ESG factors, led by declines in the environment 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

Disclaimer & Disclosures

Please direct questions or comments to: iFlow@BNYMellon.com

Geoff Yu

EMEA MACRO STRATEGIST

CONTACT GEOFF

This message was sent from an unmonitored email box. Please do not reply to this message.