

# iFlow

## MACRO REVIEW

January 2024

### Key Themes

**Rebalancing**: Surprisingly strong performance in EM duration and FI point to unwinding in BRL, CNY and INR

**US Equity Styles**: Cyclical now strongly outperforming Defensives

**International Equity Styles**: Cyclical strength also apparent in Developed APAC

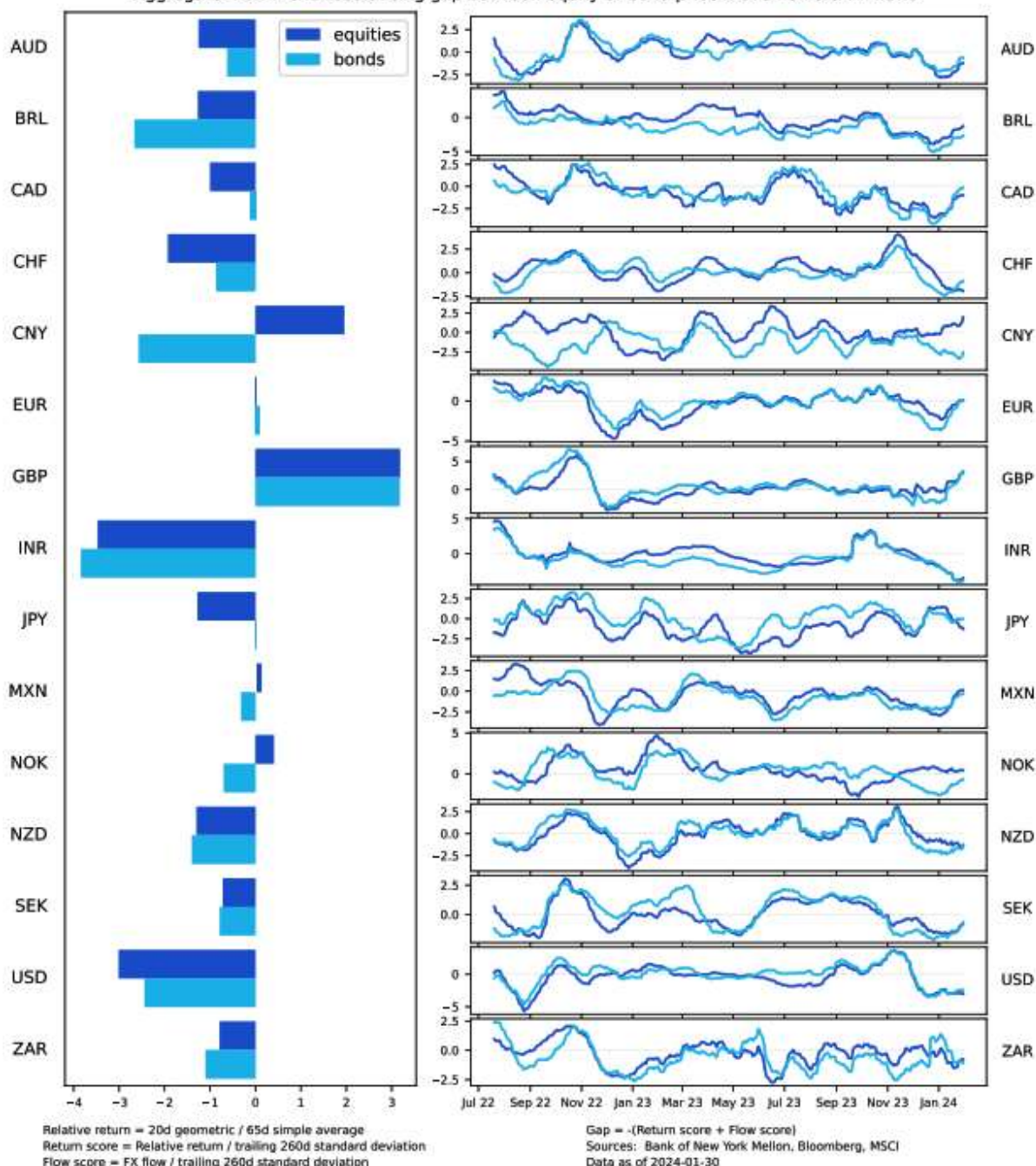
**iFlow Green**: DM EMEA flow alignments with ESG factors weakens further

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

## Rebalancing Report

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



Source:BNY Mellon

### Rebalancing Update

Much of January has been characterised by a reversal of some of the flows that took place in December, especially within fixed income markets. While data has provided some fundamental justification for the moves in yields, positioning has likely played a role as well. Given the moves in November and December, it is no surprise that USD has performed very strongly as part of the adjustment process. We have highlighted in iFlow that its gains against MXN and JPY would have contributed strongly to a recovery in holdings on a trade-weighted basis. However, looking at our flows in key FX markets through January, it is surprising that much of the pronounced activity has revolved around the high-yielding EM currencies. INR, ZAR and BRL are in the top 5 of most-bought currencies. MXN, however, had the largest outflow over the past four weeks.

As equity markets continued to do well, currencies net sold on the month generated sufficient offsets and limited scope for purchase signals. Even GBP, with an abnormal flow score at -2.5, was sufficiently offset by the UK equity market's recovery; its total equity gap score fell below 2.0. Only USD and INR generated sufficiently strong rebalancing signals, with sell flow likely required in both. Both US and India equity and FX markets were top performers in January, pointing to strong total-return interest and thus large offsetting flows.

Similarly, the good performance in many fixed income markets meant that many signals were offset by the currencies which faced sales. Consequently, there are no rebalancing signals which support inflows: GBP's gap score in fixed income is even lower than the equity figure. Within the net selling group, we can see that USD likely requires offsetting as well, but ZAR, BRL, CNY and INR all face net selling flow due to the strong performance in fixed income. These signals support one of our main asset-allocation views for the year: iFlow indicates that EM duration is heavily under-owned; even the likely advent of a Federal Reserve easing cycle has yet to generate materially strong asset-allocation flows into these markets. However, January has marked a strong start for many markets. While some have idiosyncratic factors, such as China and India, duration appears attractive in these economies due to easing and a softer dollar environment. Even so, we expect hedge ratios to remain high due to strong carry performance last year. In the case of BRL and INR – two currencies consistently overheld last year – the risk seems particularly acute.

## **iFlow Equities 2.0 Style Indices - Flows Of Significance**

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

- Although financial conditions began to tightening again in January as Fed easing expectations were pushed back, equity performance and flows were resilient. The earnings season may have been more muted for Tech, but the strong recovery in Cyclical relative to Defensive stocks points to a good pick-up in sentiment.
- Comparatively, Growth stocks were less robust and only stabilized performance against Value stocks late in the month. Our data indicate there remains a significant performance gap to make up as Leverage continues to do well, undoubtedly reflecting broader expectations that financial conditions would continue to ease.
- Inflation-related flows softened further as hopes rise that the US will achieve a soft landing. The Fed is trying to push against expectations of earlier easing as this risks an excessive recovery in equities and loosening in financial conditions. We expect inflation flows to shift to flat for now and await greater clarity on Fed expectations.

### **2. International Equity Styles**

- Divergence is becoming clear between Developed and Emerging EMEA. The latter is showing expectations of severe deceleration – Cyclical underperformance has reached the most extreme levels in over four years. In contrast, Developed EMEA Cyclical equities are performing strongly. Considering the supply chain linkages between the two regions, we do not see such divergence as sustainable.
- Developed markets in APAC also generated strong interest in Cyclical stocks relative to Defensives, where relative performance is close to flat. There may be a reaction to additional easing by China, including more direct intervention in equity markets, but this also may not be sustainable unless Beijing delivers on fiscal stimulus.

### 3. iFlow Green

- On a regional and factor level, iFlow Green shows greater dispersion. Globally, United Nations Global Compact Anti-Corruption is the weakest performing ESG factor, with strong negative flow alignment in Developed EMEA and Emerging Americas. All EMs have shifted to negative flow alignment for this factor.
- On a regional basis it is Developed Americas which continues to perform strongly: positive flow alignment is strong in almost all ESG factors, except for ESG - Governance. Overall, the end of 2023 and early 2024 have shown some convergence between all factors globally towards a more neutral level. Similar seasonality took place towards end-2022 before more significant relationships between flows and ESG factors were established towards Q2 and mid-2022.

#### **\*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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