BARCLAYS

Asset Allocation Research

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Investor Intel

Positioning amid China, oil, Europe vol

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Given recent outsized moves in EM assets, China equities and oil, as well as relative resilience in euro area and UK assets amid headline risks, we assess investors' exposures across these popular trades.

EM mutual funds are underweight, but flows are the key to sustained performance. As we highlighted in our *Global Outlook*, there was a tactical window for EM assets to perform; indeed, EM debt and equity performance has been strong since late March. Despite the rally, we find that EM equity and bond mutual funds (MFs) are both underweight relative to their benchmarks; EM debt fund betas are 1.5 std below average while EM equity MF exposure is 0.5 std below average. On the other hand, EM hedge fund positioning is extended. Overall, EM fund positioning is moderately supportive, but inflows to EM funds are the key to sustained solid performance.

Chinese equity positioning is now extended at foreign hedge funds and mutual funds. After robust buying by domestic Chinese and foreign investors, the surge in Chinese equities (both A and H-shares) has left foreign institutional investors significantly overweight. Shanghai-Hong Kong stock connect net trading flows have been considerable in both directions, with April southbound net flows running at the 2010-11 boom pace of total EM equity inflows. With 81% of Chinese financial assets in cash, domestic buying can continue (particularly given the H-share discount), but more exposed foreign investors are likely to rebalance into other EM and maybe DM equities.

Energy sector positioning is still underweight. While WTI speculative positioning has risen towards nine-month highs, mutual funds and hedge funds are still notably underweight energy stocks as the sector has outperformed. Short interest in energy stocks is also still high. However, funds' relative performance has been in line with the benchmark, suggesting the size of the energy underweight is not excessive.

Euro area equity positioning is fairly neutral amid Greek headline risks. The dip in euro area equities last week raised concerns that investor positioning had gotten ahead of itself on renewed Greek headline risks. However, despite bullish sentiment and continued solid data/earnings, positioning in euro area equities has stayed close to neutral. Europe-dedicated mutual fund beta is slightly below average while global equity fund exposure to euro area equities is close to average. Fund flows to European equities have slowed, but have room to catch up (~$50bn) to the very large inflows to European bond funds.

GBP positioning is notably short, but UK equity positioning is not underweight ahead of UK elections on May 7. As election risks remain an overhang, speculative positioning in the pound has stayed considerably net short, and relatively unchanged, for a number of weeks. Our strategists expect high levels of GBP volatility before and after the election (see *UK election series*). However, UK dedicated equity mutual fund exposure is above average levels despite the risk, while pan-European funds also have an above-average exposure to UK equities. This suggests that there could be downside risks to UK equities, particularly since recent outflows from UK equity funds are notably less than the outflows prior to the Scottish referendum last year.

Appendix

EM MFs are underweight, HFs overweight – waiting for flows

The bounce in EM currencies, debt and equities, highlighted by the extraordinary rise in Chinese stocks, has caught many investors by surprise. But the potential shift in momentum within EM has also generated renewed interest given that EM assets have underperformed for over four years. As we highlighted in our global outlook (see *A chance to move out the risk curve*), EM fundamentals continue to face headwinds but EM valuations are attractive, and a more stable macro backdrop provided a tactical window for EM heading into Q2.

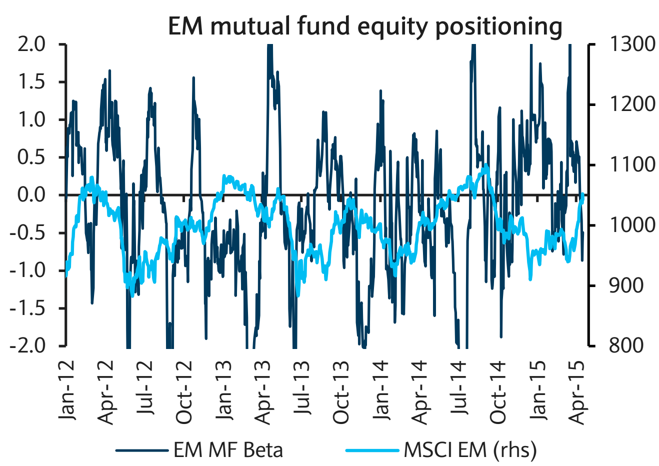
We analyze how investors are positioned within EM to assess whether the recent rally has legs or is at risk of losing momentum once again. We find that EM equity and bond mutual funds (MFs) are both underweight relative to their benchmarks while EM hedge fund risk exposure is extended. Although it is challenging to gauge currency positioning, the covering of net CFTC futures shorts in MXN to a now neutral position suggests a similar pattern in FX (Figure 39). With positioning at EM dedicated funds on net mildly supportive, EM inflows, which have been conspicuously absent since 2011-12, are the key to sustained performance.

EM equity mutual fund beta exposure has fallen below average levels. Based on our sample of dedicated EM equity mutual funds (MFs), beta exposure has fallen to 0.5 std below average (Figure 1), suggesting that funds reduced exposure after the broad rally in EM equities since mid March. Still underweight positioning at EM equity funds provides some fuel for further upside although some fundamental headwinds remain.

EM bond fund beta is 1.5 std below average. After sizeable outflows around year end, EM bond MFs cut exposure as EM bonds started to rally and have seemingly lagged their benchmarks through the recent bounce (Figure 2). Similar to EM equity funds, still notably underweight positioning should provide further support against a backdrop of low rates, high EM risk premiums, a dollar pause and central bank support.

FIGURE 1

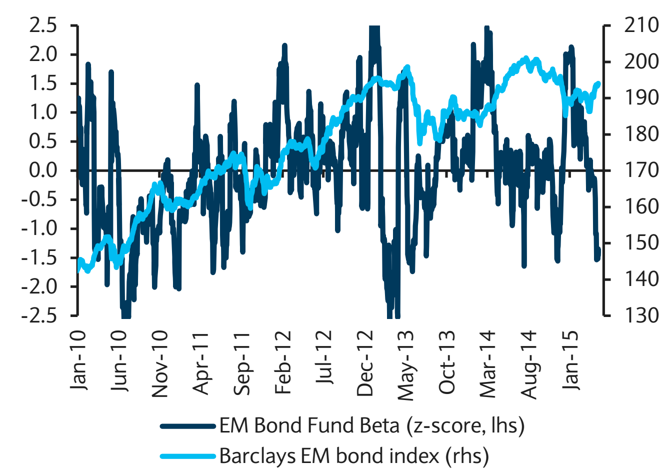
EM equity mutual funds are modestly underweight



Source: Bloomberg, MSCI, Barclays Research

FIGURE 2

EM bond fund positioning is well below average

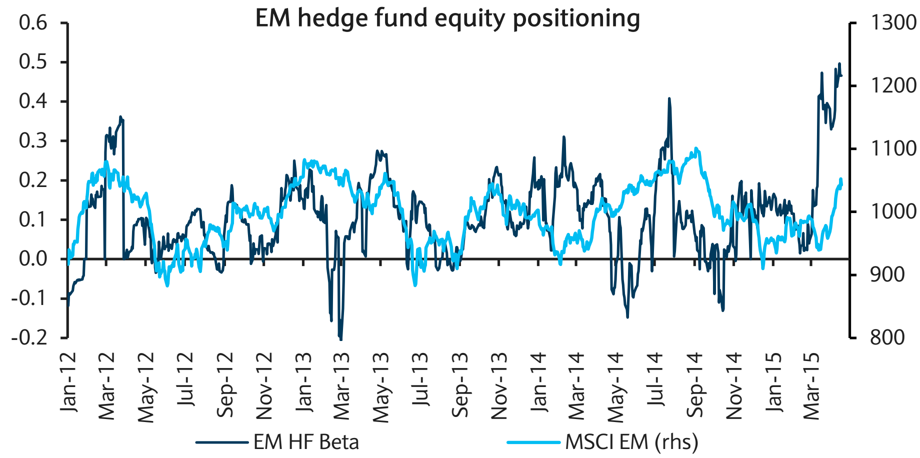


Source: Bloomberg, MSCI, Barclays Research

EM dedicated hedge fund positioning is now extended. Based on an index of dedicated EM hedge funds, we find that the beta to EM equities has risen to nearly 0.5, the highest level data is available starting in 2012 (Figure 3). Elevated risk exposure at EM hedge funds is an overhang should volatility pick up once again. However, EM hedge fund positioning has been a good leading indicator for EM performance, so we will monitor when and how much risk exposure is cut.

FIGURE 3

EM hedge fund positioning is extremely high

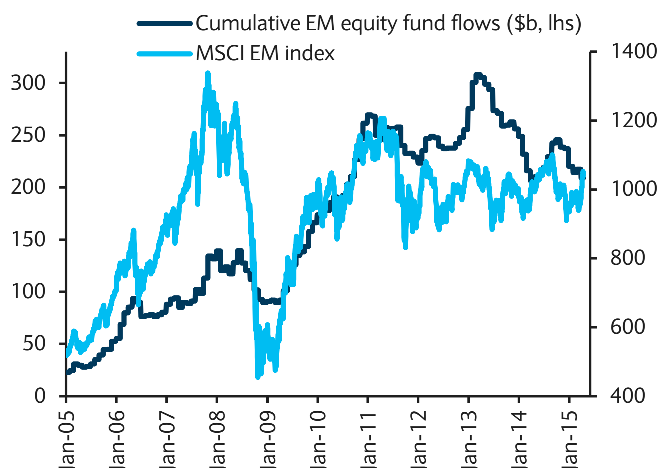


Source: Bloomberg, MSCI, Barclays Research

EM outflows abated, but inflows are key to sustained EM performance. EM bond and equity funds have each had massive outflows since the taper tantrum, with no net inflows to EM funds since 2011-12 (Figures 4-5). Overall, we find that EM outflows through the dollar surge since June were relatively benign. Importantly, EM bonds have benefited from solid inflows recently, while EM equity funds had a modest inflow last week.

FIGURE 4

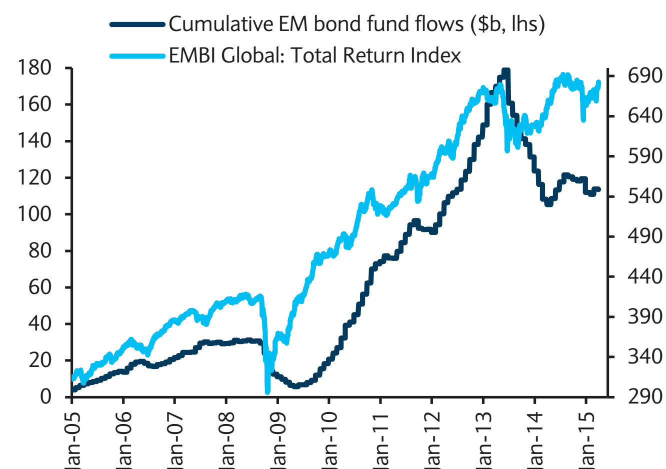
EM equities have stalled since 2011 amid net outflows



Source: EPFR, MSCI, Haver, Barclays Research

FIGURE 5

EM bonds held up despite big outflows, which have abated



Source: EPFR, MSCI, Haver, Barclays Research

China positioning appears stretched

After the National People's Congress in early March, policy has acted to boost domestic confidence, and central bank easing has been supportive of China equities. The surge in Chinese equities reflects significant domestic buying, coupled with sizeable net trading flows via the Shanghai-Hong Kong stock connect (both A and H shares). Indeed, the monthly average of net trading flows to Shanghai stocks (~US$3bn) and to Hong Kong stocks (~US$1bn) from December to March was considerable (Figure 6), with southbound flows to H-shares picking up notably in April and northbound flows turning negative.

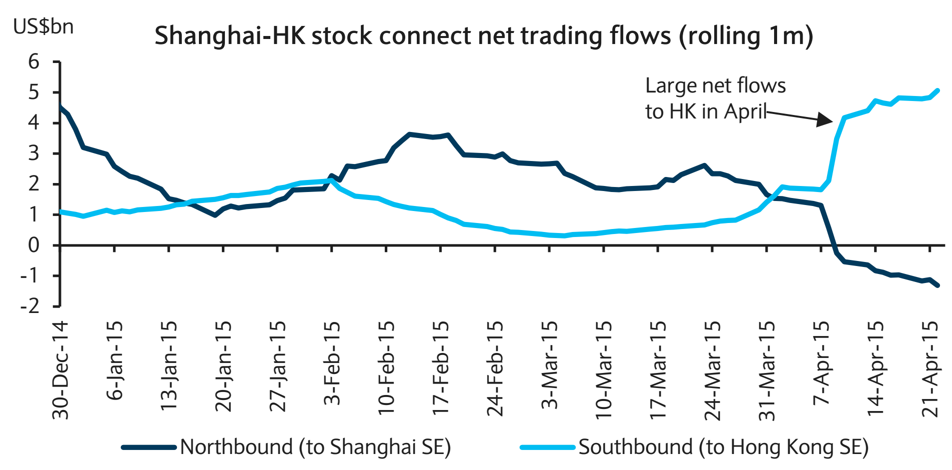
While the reallocation by Chinese investors out of cash to equities and bonds could have much further to run, tactical positioning in Chinese equities by foreign mutual funds and hedge funds appears to be fairly elevated. The rally in Chinese equities is likely to lose some steam with MFs and HFs now notably overweight. As Chinese equities have rallied, investors have pulled money out of China equity funds, suggesting that foreign investors are reluctant to put new capital into the rising equity market as domestic investors are buying; the disconnect between China outflows and outperformance is similar to 2007. The outflows are indicative of rebalancing out of outperforming China, and the second-order rebalance flow to other EM equities could be a notable positive, given weak performance and FX.

Southbound net trading flows in April have been running at a similar pace to the boom pace of total EM equity inflows in 2009-11

The reallocation out of cash (81% of assets) will likely have a large effect over the medium term. According to a McKinsey study (*Emerging equity gap*, December 2011), cash balances account for 81% of Chinese financial assets. Still-elevated real deposit yields in China support high cash holdings, but expected capital market reforms could lead to continued reallocation shifts, with outsized effects on asset prices. The surge in Chinese equities points to the sizeable effects that reallocations by Chinese investors can have on asset prices. For comparison, total EM equity inflows averaged $6.5bn per month through the boom times of late 2009 to mid-2011, and net southbound flows have been running at about a $5bn pace in April.

FIGURE 6

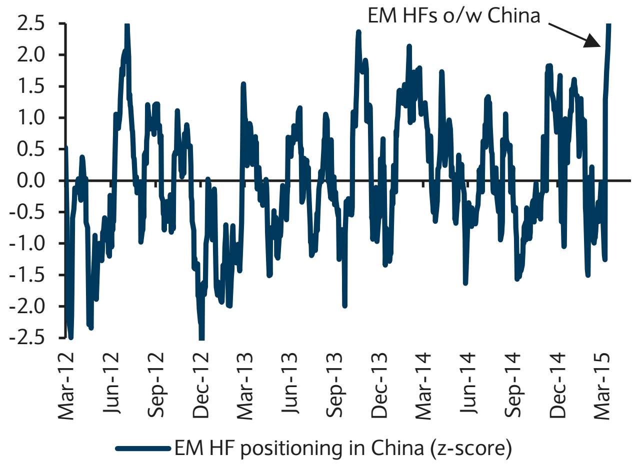
Southbound net trading flows to H-shares have been considerable in April



Source: SSE/SEHK, Bloomberg, Barclays Research

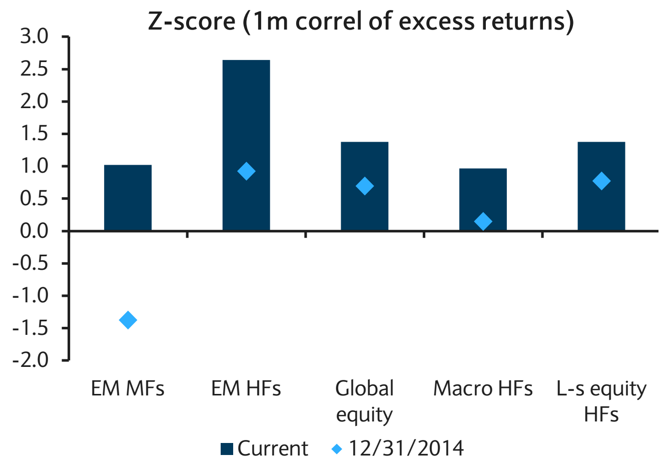
EM equity MFs and HFs are overweight China equities. Based on the correlation of excess returns, we find that EM MFs are overweight China equities. EM MF exposure has been fairly elevated since February when the PBOC reduced rates. As we pointed out in *Spring cleaning* (March 30, 2015), elevated China positioning is likely due in part to less USD exposure. A pause in the dollar cycle has seen other EM markets participate in the rally as well. Additionally, EM dedicated hedge fund positioning in Chinese equities appears to be at an

FIGURE 7
EM hedge fund positioning in China equities is very high



Source: Bloomberg, MSCI, Barclays Research

FIGURE 8
All investor types are seemingly overweight China



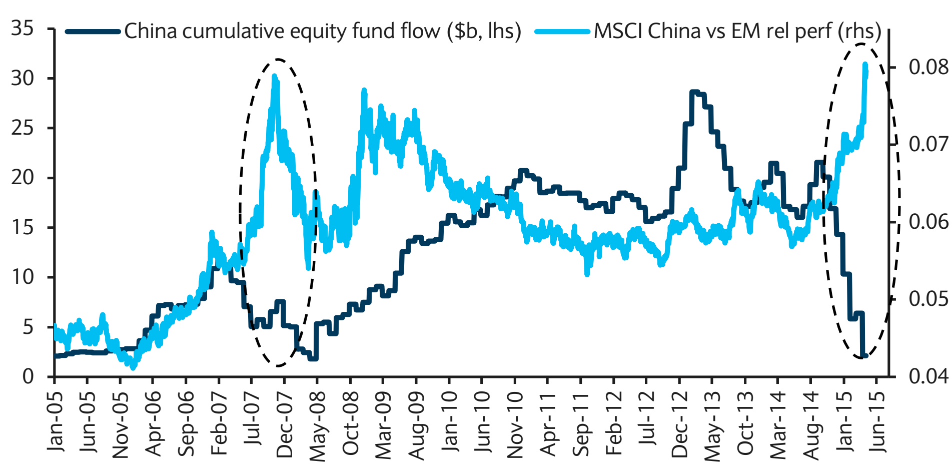
Source: Bloomberg, Barclays Research

extreme (Figure 7). EM HFs appeared to be long China going into the February rate cut, pared exposure after the cut, and went long again in March.

Other diversified global MFs and HFs appear to be overweight China as well. Using similar methodology, we also find that China exposure is well above average at global equity funds, macro hedge funds and long-short equity HFs (Figure 8). The notion that all the investor types we analyzed are now overweight China suggests that the trade is due for a breather, if not a sizeable pullback. Simple rebalancing after such an absolute and relative move is likely to slow the momentum of the China equity trade. In our view, the risk of a pullback could be exacerbated by the consensus overweight positioning.

Disconnect between big outflows from China equity funds and the surge in stocks. The relative ratio of China to EM equities has surged to peak levels, while investors have pulled nearly $20bn from China equity funds since December. The China outflows likely reflect some rebalancing effects, but also suggest end investors are reluctant to chase the China rally. China equities also surged amid sizeable outflows in 2007 before the correction.

FIGURE 9
Chinese equities have outperformed despite massive outflows from China equity funds



Source: Bloomberg, MSCI, EPFR, Barclays Research

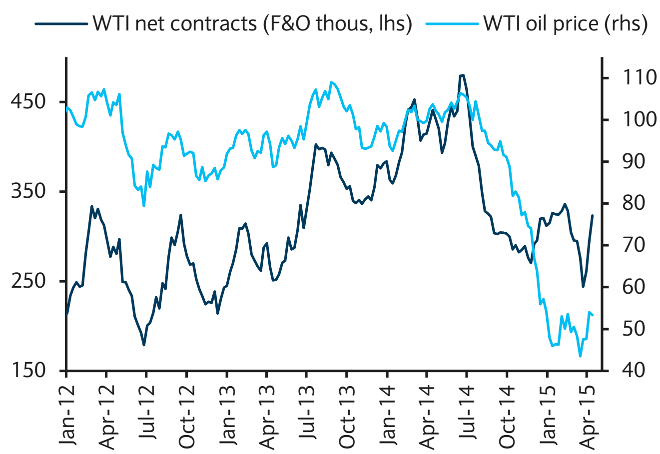
Energy sector underweight is mildly supportive

Speculative positioning in WTI oil futures rose back toward the post-November highs (Figure 10). Thus the positioning-related move in oil is likely to lose some momentum, although oil demand-supply dynamics have improved faster than expected (see *Blue Drum*).

Energy sector positioning by equity MFs (US and global) and long-short HFs, on the other hand, is still considerably underweight. As energy stocks have rallied, our positioning proxy suggests that energy stock exposure is near the historical lows (Figure 11). That said, our mutual fund sample has performed in line with their benchmarks on an AUM-weighted basis since the energy rally began in mid-March; this suggests that the size of the underweight may be less than our proxy implies (Figure 12). Additionally, long-short equity HFs are up about 2% since mid-March, also suggesting that energy underweights are not eating too much into performance. Finally, short interest in energy stocks is still elevated and was reduced modestly in March (Figure 13). We view underweight energy stock positioning as mildly supportive, all else equal.

FIGURE 10

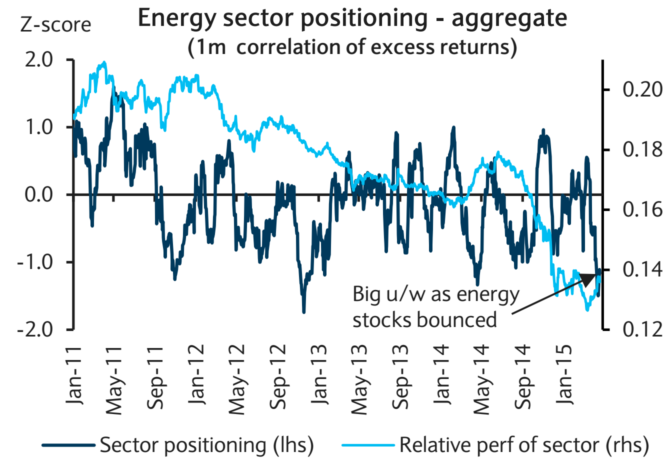
Speculative positioning in oil futures increased recently



Source: CFTC, Haver, Barclays Research

FIGURE 11

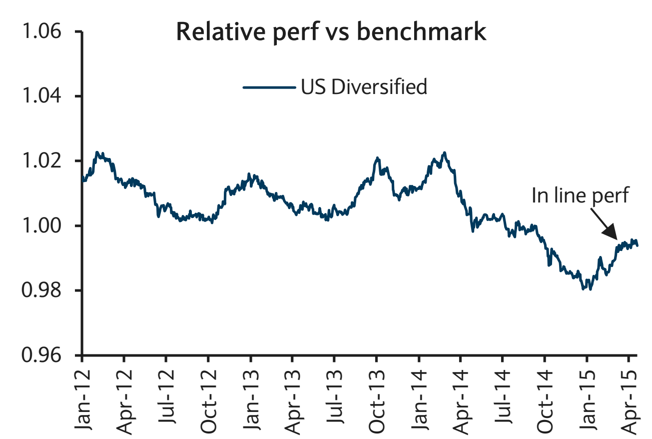
MFs and HFs are still notably underweight energy stocks



Source: Bloomberg, Barclays Research

FIGURE 12

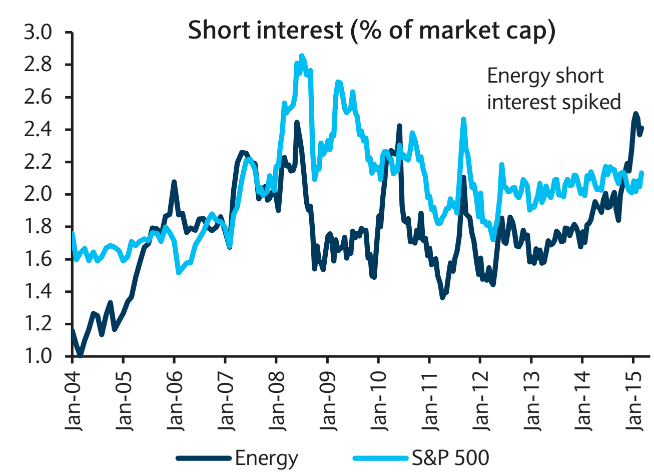
MF performance has been in line despite Energy u/w



Source: Bloomberg, Barclays Research

FIGURE 13

Energy short interest fell modestly in March from peak levels



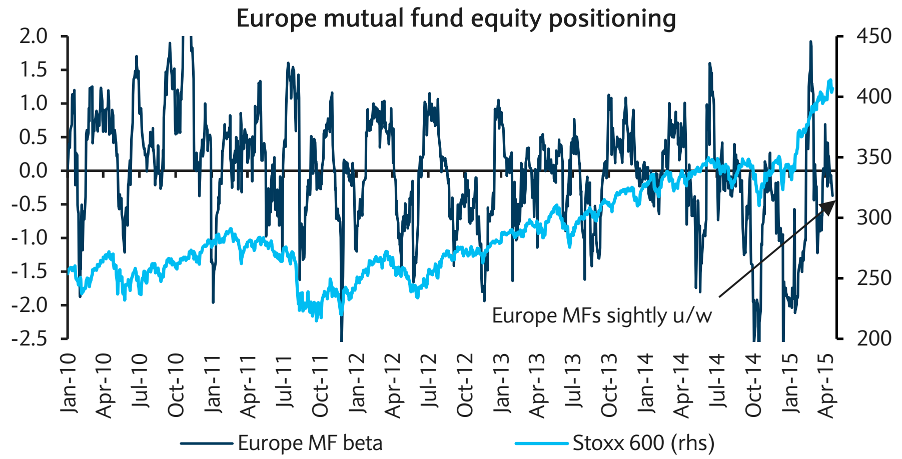
Source: Factset, Barclays Research

Europe positioning is neutral amid Greek risks

Euro area assets have been remarkably resilient thus far in April despite continued Greek headline risks. Euro area equities are basically flat for the month after giving back some gains. Given increasingly bullish sentiment for euro area equities but rising headline risks, we find that positioning is fairly neutral amid still solid economic and earnings data. Europe-dedicated MF beta is slightly below average as inflows have likely meant higher cash balances take time to put to work. Global equity funds are neutral euro area equities as well. Finally, net inflows to European equities since June have only been $16bn, compared with $60bn for European bond funds, so inflows have further to run if fundamentals remain solid.

FIGURE 14

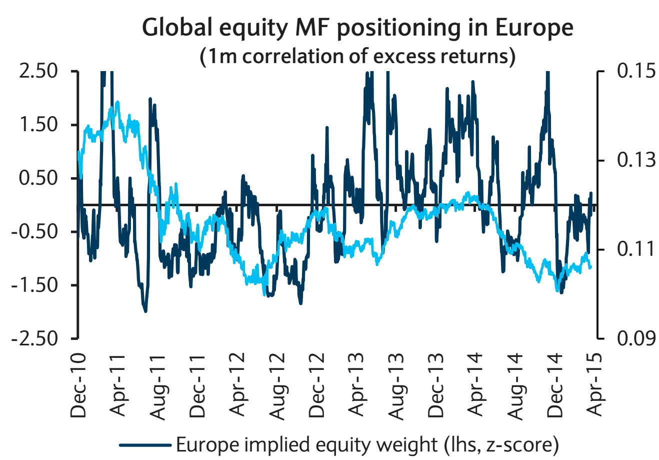
Dedicated European equity mutual beta exposure is slightly below average



Source: Bloomberg, Barclays Research

FIGURE 15

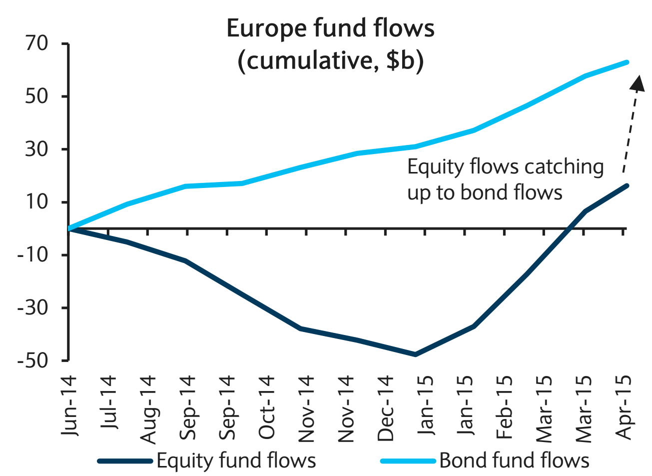
Global equity funds are still neutral euro area equities



Source: Bloomberg, Barclays Research

FIGURE 16

Europe equity inflows likely have further to run



Source: EPFR, Haver, Barclays Research

UK election positioning is short GBP but not u/w UK equities

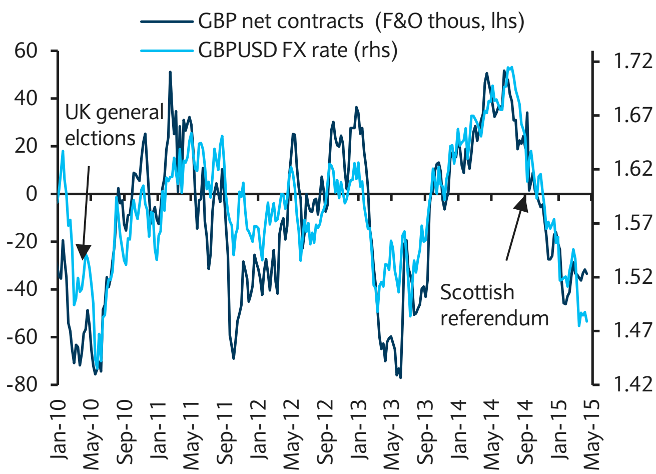
GBP positioning is the most net short since 2013 as investors increasingly focus on the May 7 UK elections (Figure 17). Our strategists expect elevated GBP volatility before and after the election, given the potential for a hung parliament (see *UK election series*).

Positioning in UK equities is not underweight, however, despite the risks. Dedicated UK equity MF beta exposure is 0.6 std above average going into the elections (Figure 18). Hedge funds and global equity MFs appear to be underweight UK equities, while pan-European MFs are overweight UK equities (Figure 19).

UK equity outflows were larger before the Scottish referendum. Outflows from UK equity funds have been $3.3bn the past three months, compared to over $5bn leading up to the Scottish referendum. So there is seemingly some further scope for capital outflows.

FIGURE 17

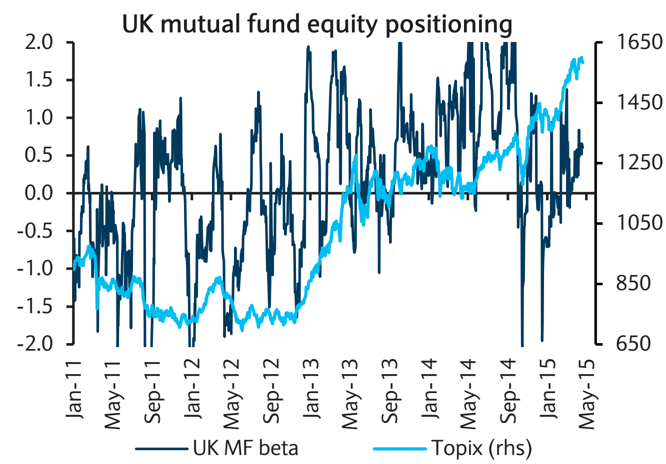
Investors are notably underweight GBP



Source: CFTC, Haver, Barclays Research

FIGURE 18

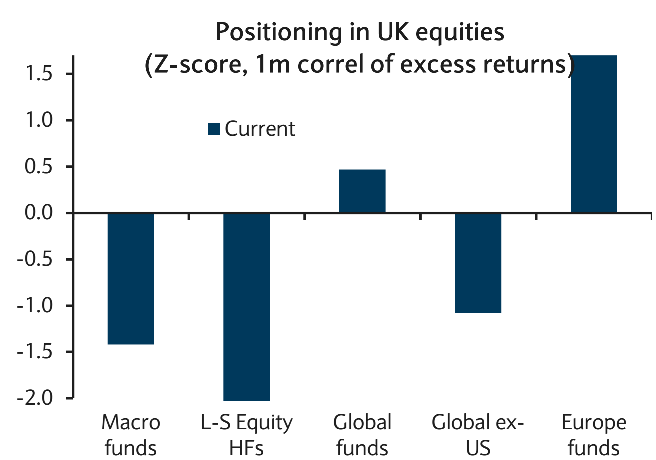
UK equity MF positioning is moderately above average



Source: Bloomberg, Barclays Research

FIGURE 19

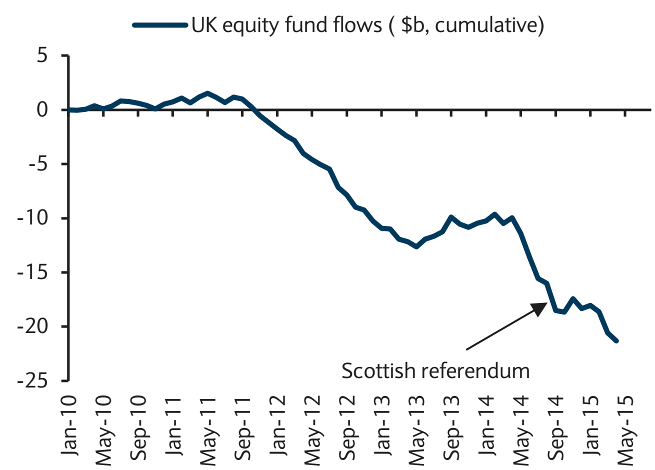
Europe funds are o/w UK, but other funds are not



Source: Bloomberg, Barclays Research

FIGURE 20

UK outflows were larger around the Scottish referendum

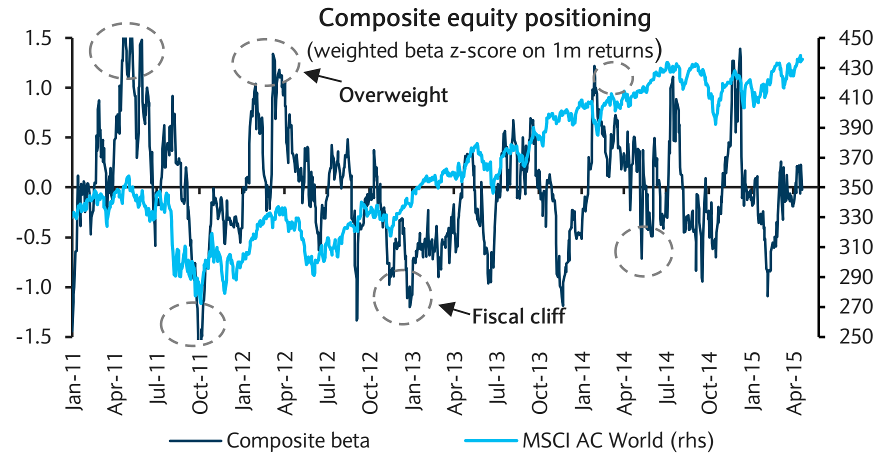


Source: EPFR, Haver, Barclays Research

Equity MF and HF positioning summary

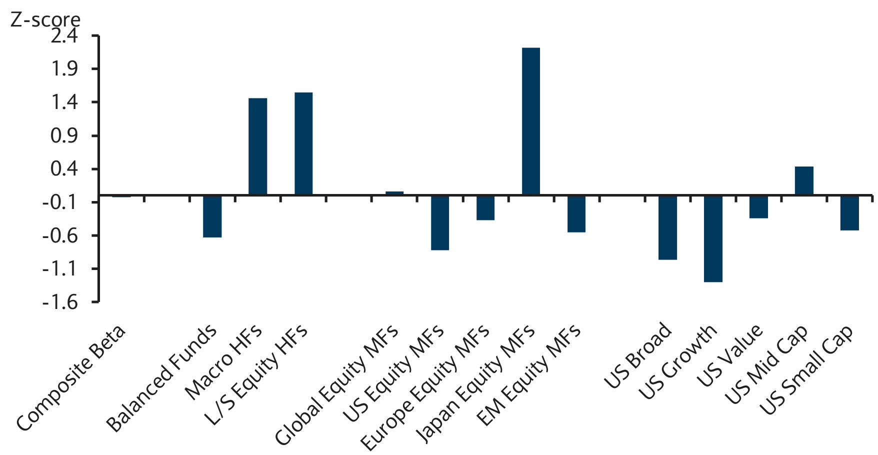
- Aggregate equity positioning has remained close to average
- Balanced funds reduced exposure to 0.6 std below average last week
- Macro hedge fund exposure has risen notably (1.5 std above average)
- Long-short equity HF beta is also 1.5 std above average, rising in April
- Global fund positioning is at average levels
- US mutual funds have stayed moderately underweight much of this year
- Europe mutual fund exposure is slightly below average
- Japan MF positioning has remained well above average the past month
- EM funds have reduced beta exposure recently
- Across sectors, overweights are in financials, consumer discretionary and healthcare; the biggest underweights are in energy, materials, utilities and industrials
- Across styles, growth fund exposure is 1.3 std below average while value and small cap fund positioning is modestly below average

FIGURE 21
Composite equity beta



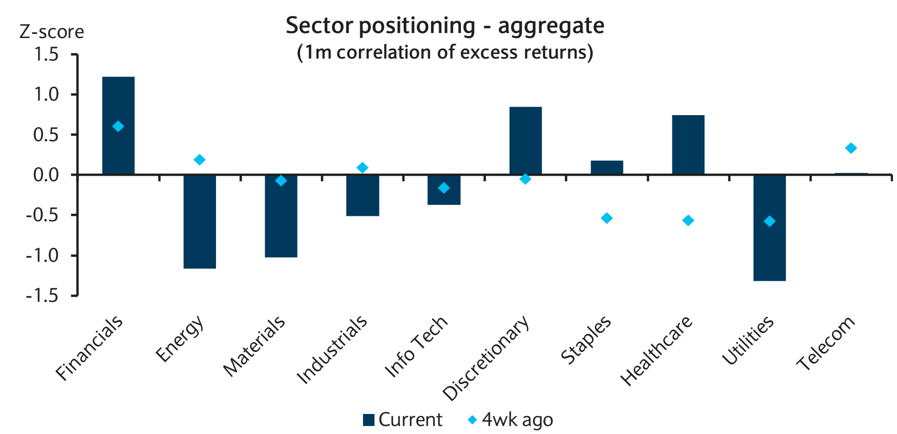
Source: Bloomberg, Barclays Research

FIGURE 22
Equity positioning across fund types



Source: Bloomberg, Barclays Research

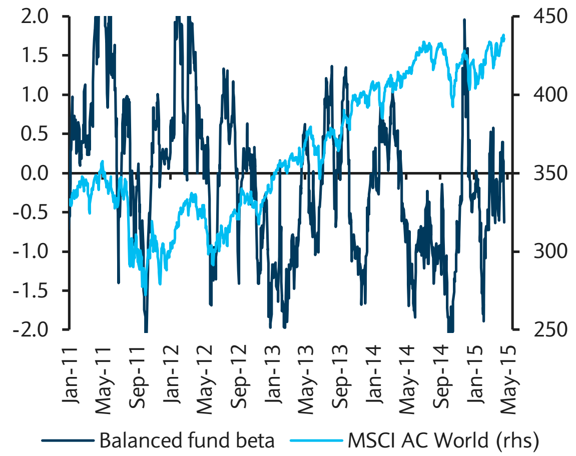
FIGURE 23
Sector positioning – Current versus four weeks ago



Source: Bloomberg, Barclays Research

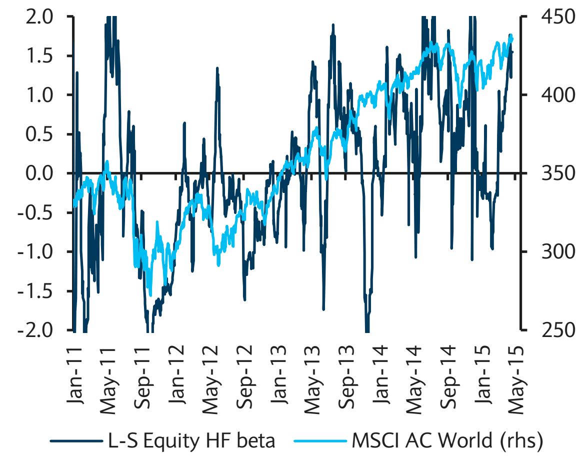
Equity positioning by fund type (beta is z-score based on 1m returns)

FIGURE 24
Balanced funds



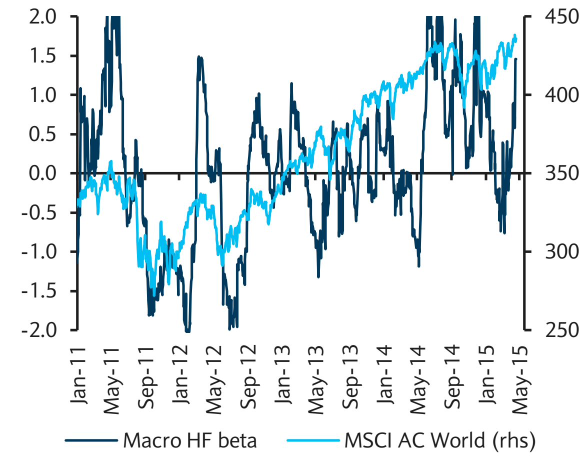
Source: Bloomberg, Barclays Research

FIGURE 25
Long-short equity hedge funds



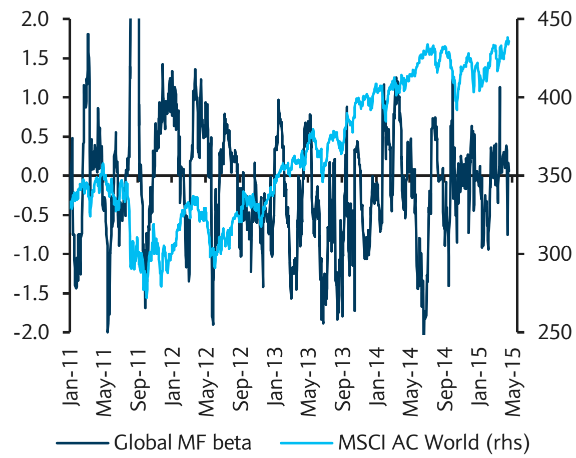
Source: Bloomberg, Barclays Research

FIGURE 26
Macro hedge funds



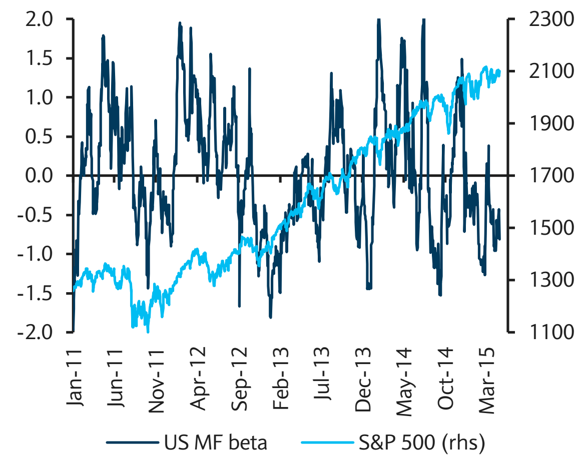
Source: Bloomberg, Barclays Research

FIGURE 27
Global equity funds



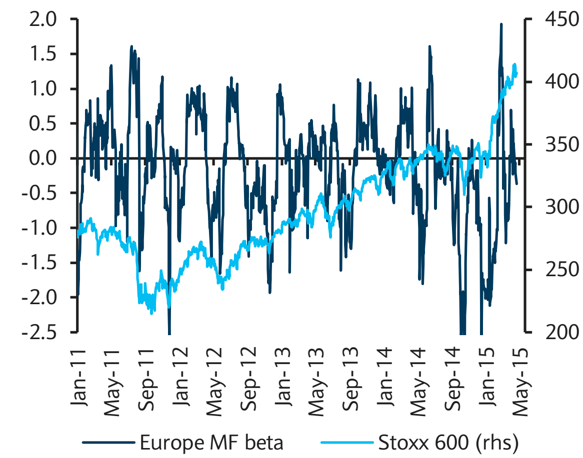
Source: Bloomberg, Barclays Research

FIGURE 28
US mutual funds



Source: Bloomberg, Barclays Research

FIGURE 29
Europe mutual funds

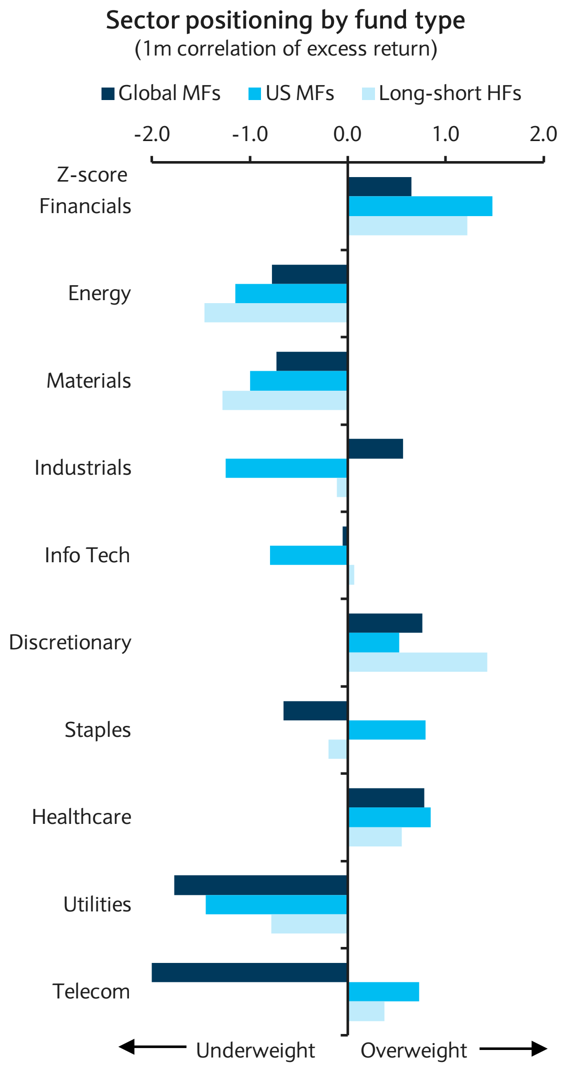


Source: Bloomberg, Barclays Research

Equity positioning by sector and style (z-score based on 1m returns)

FIGURE 30

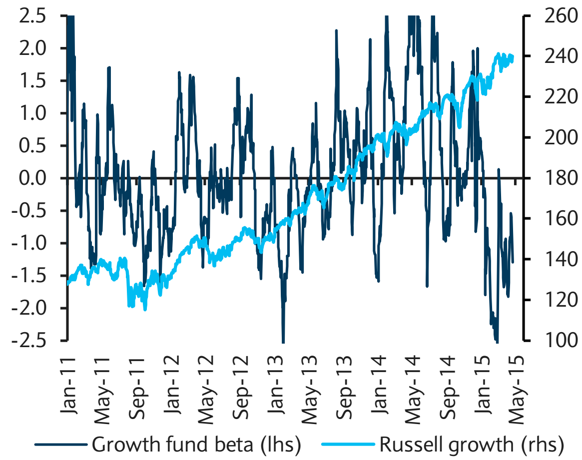
Sector positioning for global, US, and long-short funds



Source: Bloomberg, Barclays Research

FIGURE 31

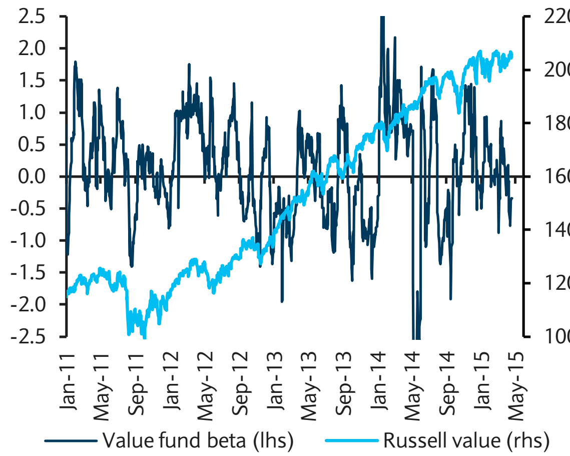
US growth funds



Source: Bloomberg, Barclays Research

FIGURE 32

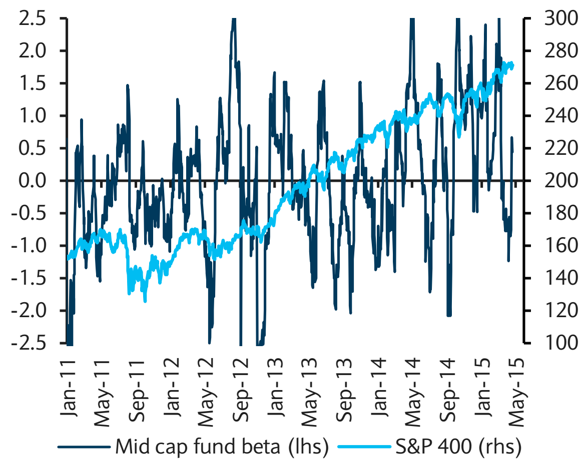
US value funds



Source: Bloomberg, Barclays Research

FIGURE 33

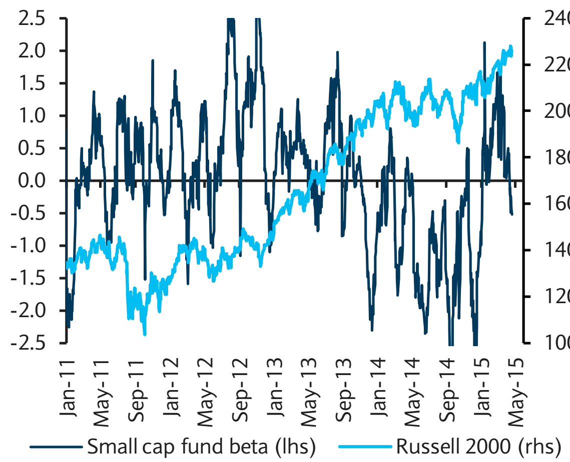
Mid cap funds



Source: Bloomberg, Barclays Research

FIGURE 34

Small cap funds

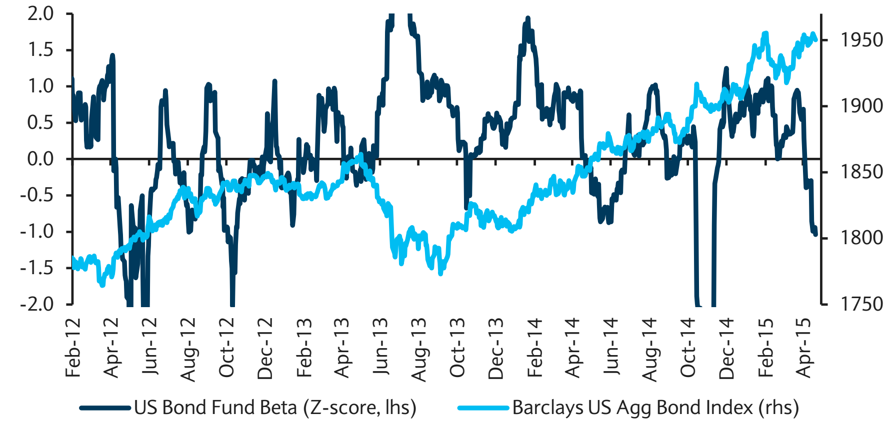


Source: Bloomberg, Barclays Research

US bond fund positioning summary

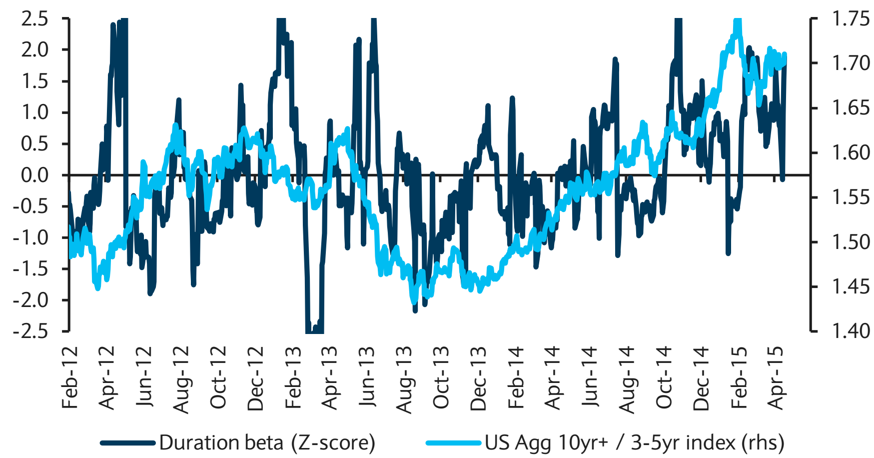
- US bond fund beta has declined to 1.0 std below average as inflows to bond funds have continued at a strong pace
- Duration beta at diversified bond funds remains fairly elevated relative to post-crisis levels as the yield curve has steepened recently
- Credit beta has risen back toward elevated levels as credit has modestly outperformed recently
- Balanced fund beta exposure to bonds has fallen toward average levels

FIGURE 35
US diversified bond fund beta



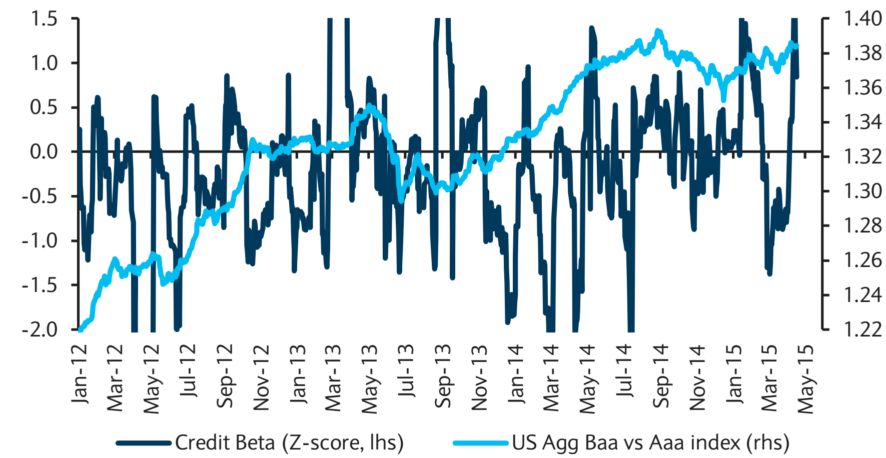
Source: Bloomberg, Barclays Research

FIGURE 36
Duration beta



Source: Bloomberg, Barclays Research

FIGURE 37
Credit beta



Source: Bloomberg, Barclays Research

CFTC positioning summary: rates, FX, commodities and equities

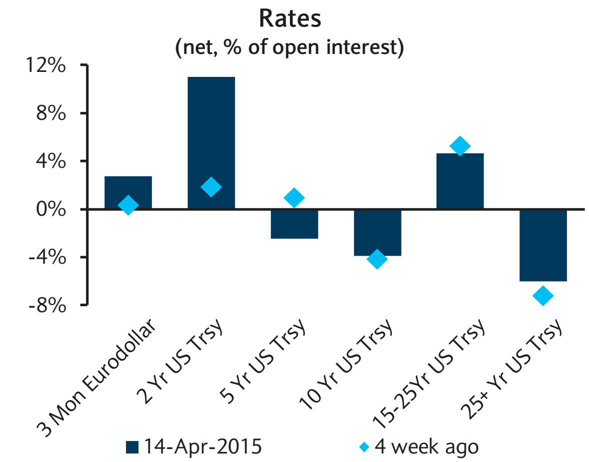
- USD longs were pared from record levels
- EUR shorts were trimmed from near peak levels
- GBP shorts have stayed flat at sizeable levels
- JPY shorts have been cut YTD from -34% to 10% of open interest
- NZD long positions continue to rise while AUD and CAD net shorts were added

- WTI net long positions increased to the highest level since January
- Copper net shorts are the smallest since September
- Gold net longs are well below recent peaks while silver positioning is still elevated
- Corn net longs have been cut toward neutral while net shorts in wheat are near extreme levels

- Eurodollar net long positioning is at the highest level since May 2013, as is 2yr positioning
- 5yr & 10yr trimmed shorts, after big addition to short positions last week

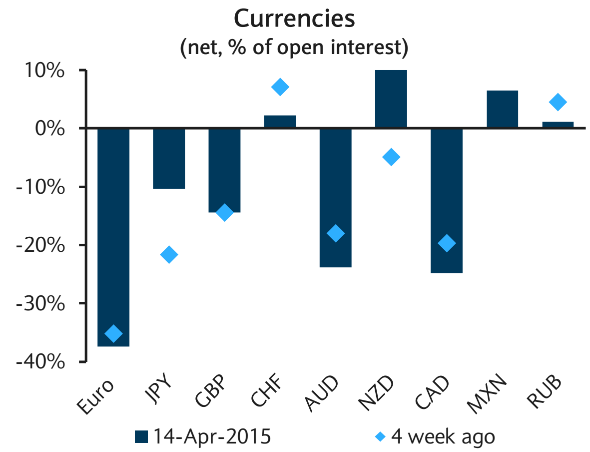
- S&P 500 net positioning has stayed close to neutral while Russell 2000 net shorts have been cut
- VIX positions went further net short

FIGURE 38
Rates positioning



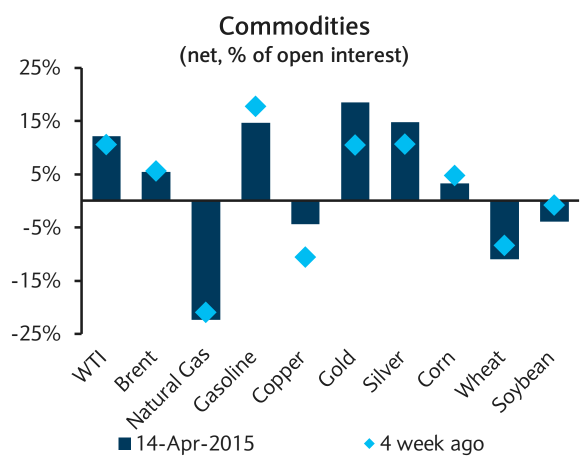
Source: CFTC, Haver Analytics, Barclays Research

FIGURE 39
Currency positioning



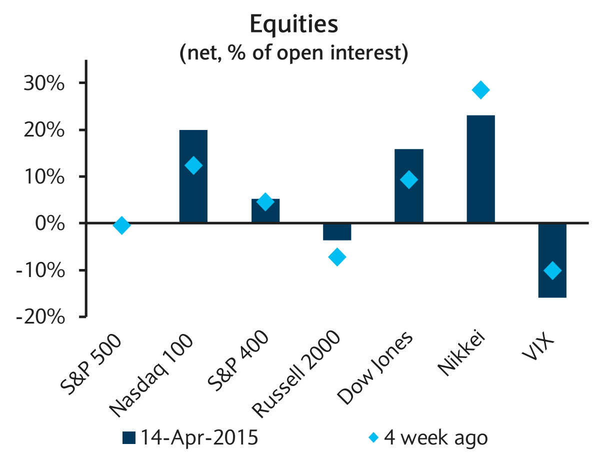
Source: CFTC, Haver Analytics, Barclays Research

FIGURE 40
Commodities positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 41
Equity positioning

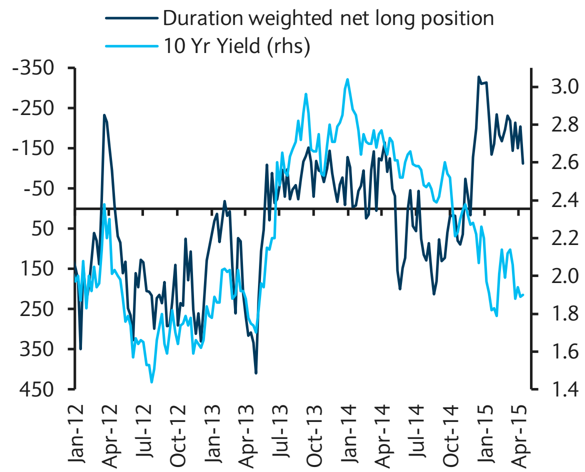


Source: CFTC, Haver Analytics, Barclays Research

Rates net speculative futures and options positions

FIGURE 42

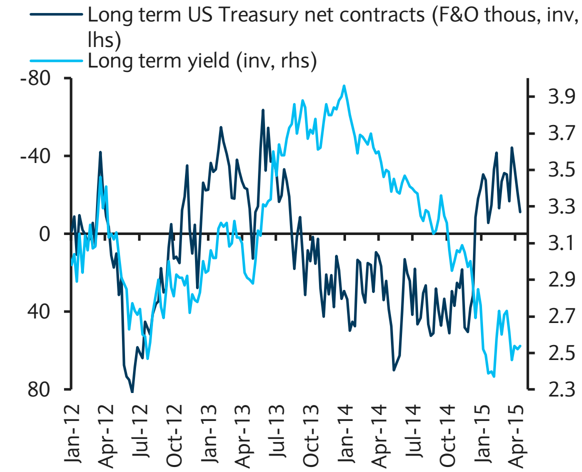
Duration weighted rates positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 43

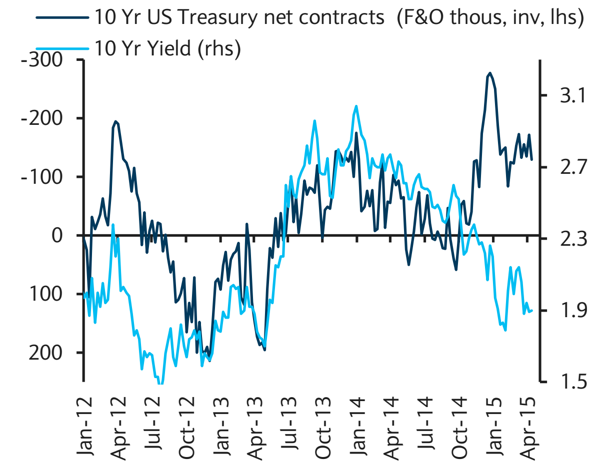
Long-term rate positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 44

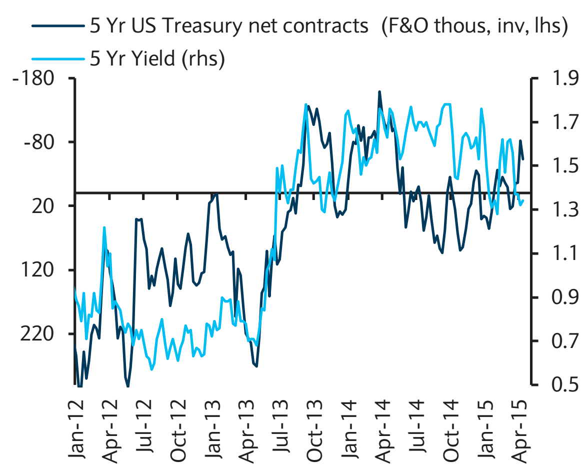
10y rate positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 45

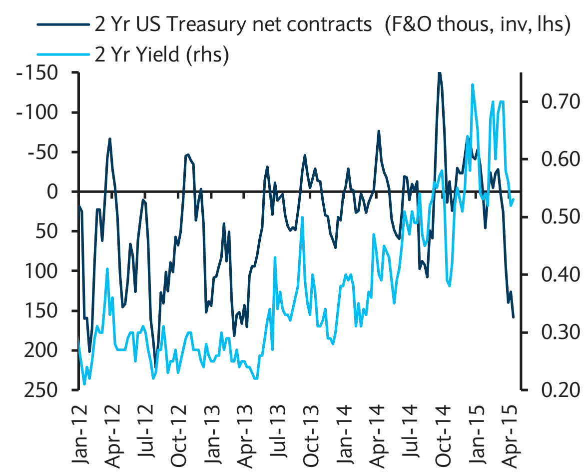
5y rate positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 46

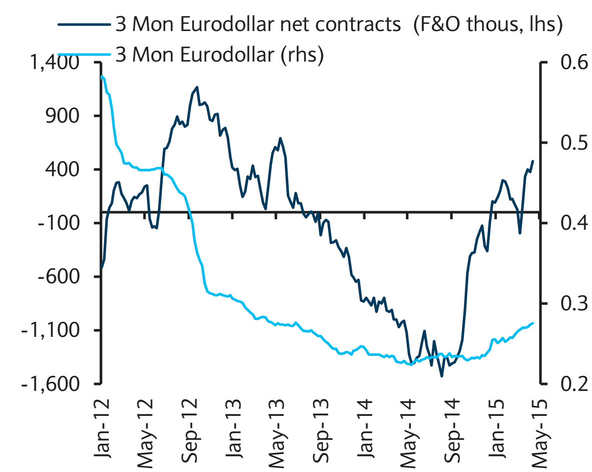
2y positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 47

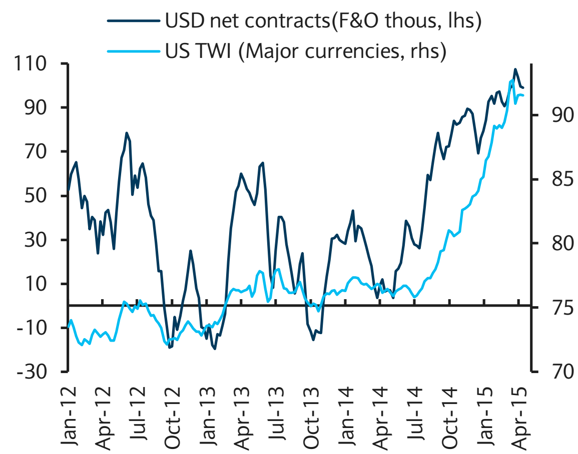
3m eurodollar positioning



Source: CFTC, Haver Analytics, Barclays Research

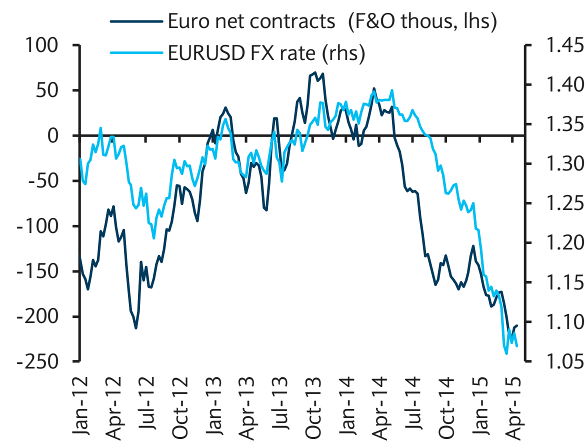
Currencies net speculative futures and options positions

FIGURE 48
USD positioning



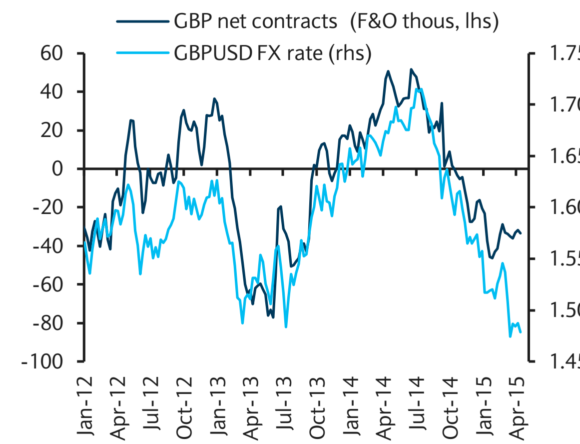
Source: CFTC, Haver Analytics, Barclays Research

FIGURE 49
EUR positioning



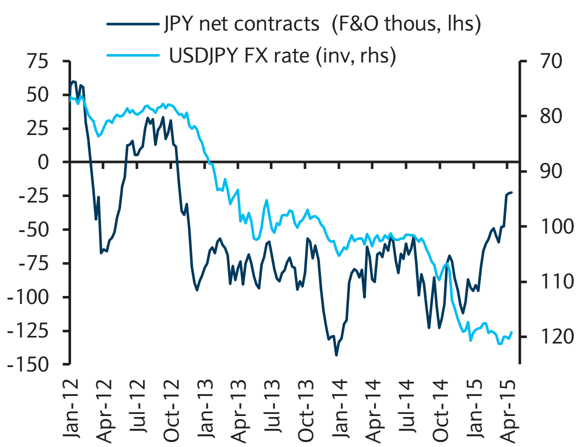
Source: CFTC, Haver Analytics, Barclays Research

FIGURE 50
GBP positioning



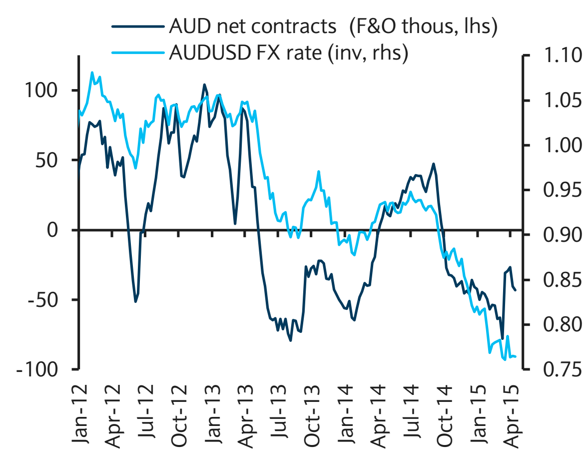
Source: CFTC, Haver Analytics, Barclays Research

FIGURE 51
JPY positioning



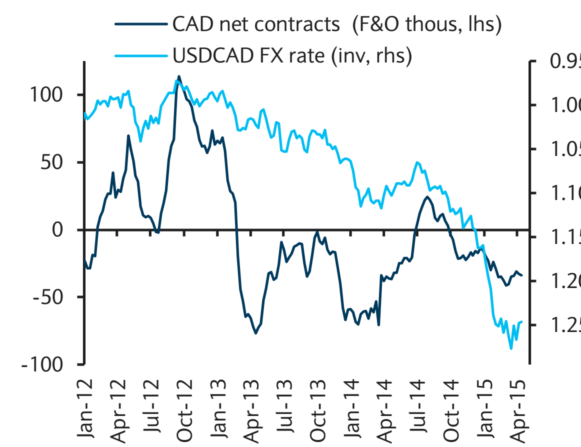
Source: CFTC, Haver Analytics, Barclays Research

FIGURE 52
AUD positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 53
CAD positioning

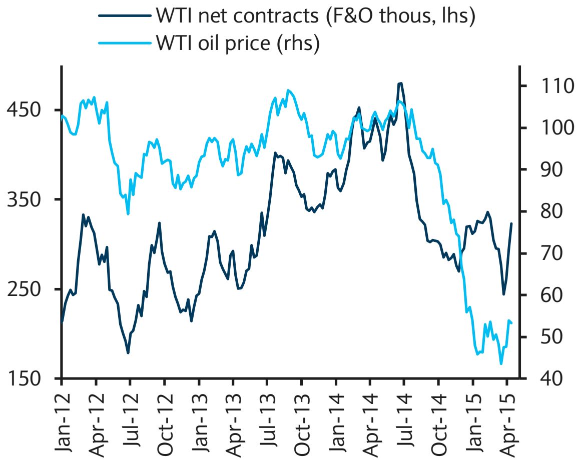


Source: CFTC, Haver Analytics, Barclays Research

Commodities net speculative futures and options positions

FIGURE 54

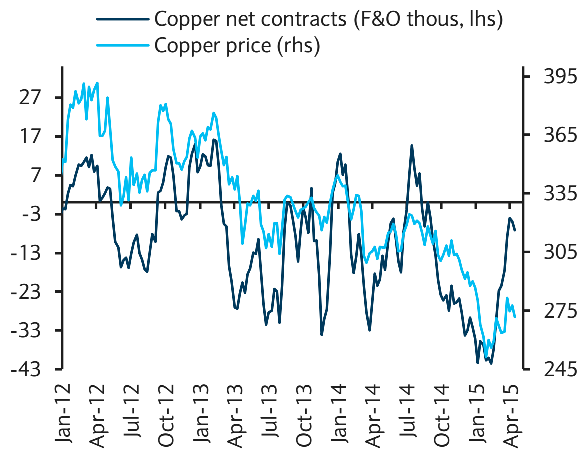
WTI crude positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 55

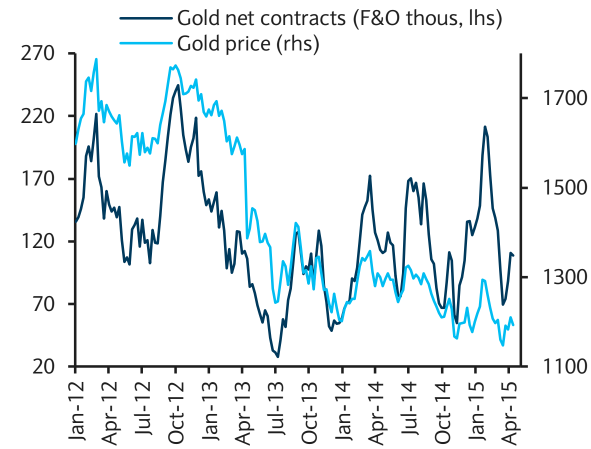
Copper positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 56

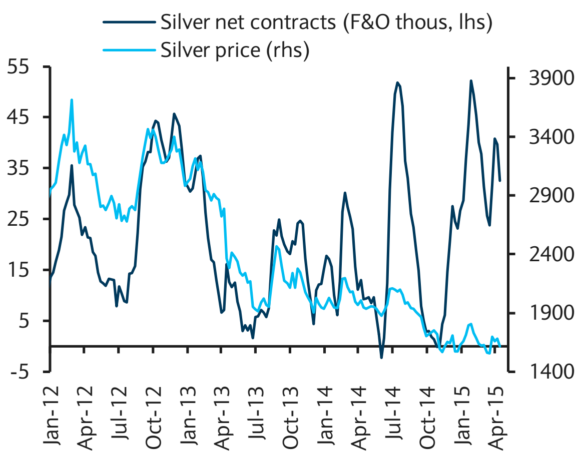
Gold positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 57

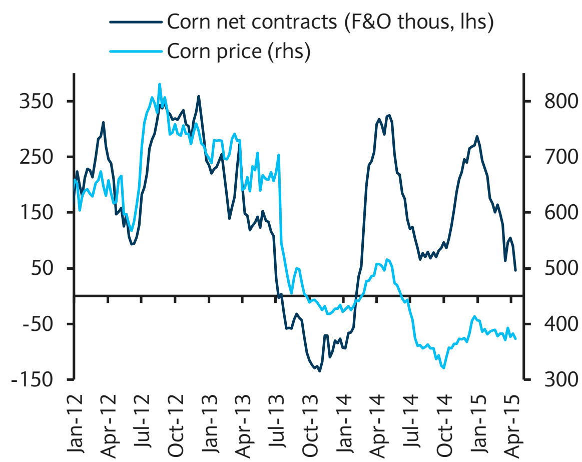
Silver positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 58

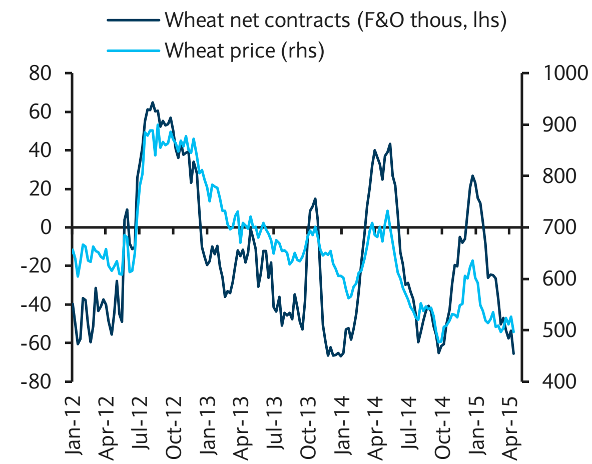
Corn positioning



Source: CFTC, Haver Analytics, Barclays Research

FIGURE 59

Wheat positioning



Source: CFTC, Haver Analytics, Barclays Research

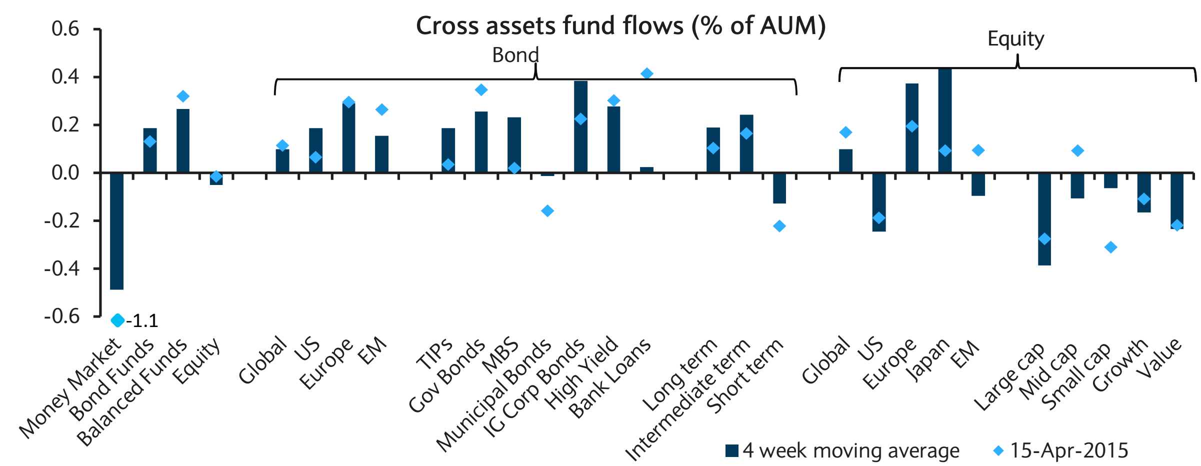
Fund flow summary

Note: EPFR fund flow data as of April 15, 2015

- Money markets had big outflows for a net outflow of -$77bn this month
- Bond fund inflows continue at a strong pace, with $117bn YTD
- Balanced funds are getting steady inflows totalling $41.5bn YTD
- Equity outflows have been -$10bn this month, versus inflows of $60.5bn the past two months
- US bonds continue to have steady inflows ($1.3bn), summing to $61bn YTD; Europe bond inflows have stayed solid, with $32bn YTD
- Government bonds have had inflows for six straight weeks (total $4.9bn), while MBS funds also continue to get steady inflows ($5.4bn YTD)
- IG corp bonds' strong inflows ($0.7bn) take the total to $22bn in the past 15 weeks; HY had inflows of $1.4bn, summing to $21bn YTD
- EM bond funds have had modest inflows for four straight weeks (total $1.5bn)
- Intermediate-term bond funds continue to get steady inflows ($46bn YTD), while long- and short-term bond flows have been flat
- Global equity funds continue to get strong inflows, with $39bn YTD
- US equity funds' large outflows resumed, bringing total outflows to -$54bn YTD
- Europe equity inflows continued at a strong pace. bringing inflows to $56bn YTD
- Japan flows slowed, but inflows were $9bn over eight weeks
- EM equities had their first inflow last week ($0.8bn) after -$10.5bn of outflows in the past five weeks
- Inflows to EM equities are going to diversified GEM funds, while Asia funds have surprisingly had outflows of -$7bn the past six weeks
- Across sectors, energy and healthcare funds continue to get inflows, while almost all other sector flows have been relatively muted
- Across styles, large cap funds have had considerable outflows the past few weeks, while outflows from growth and value funds have continued
- Mutual fund outflows resumed in April (-$10.5bn) after flat flows from January to March; ETF inflows have slowed of late

FIGURE 60

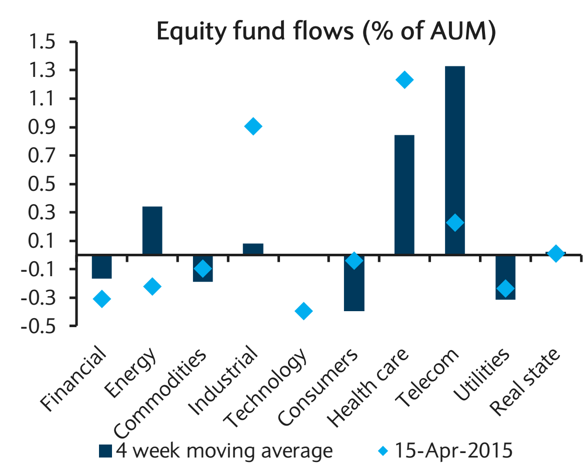
Fund flows across assets – Four-week average and latest week



Source: EPFR, Haver Analytics, Barclays Research

FIGURE 61

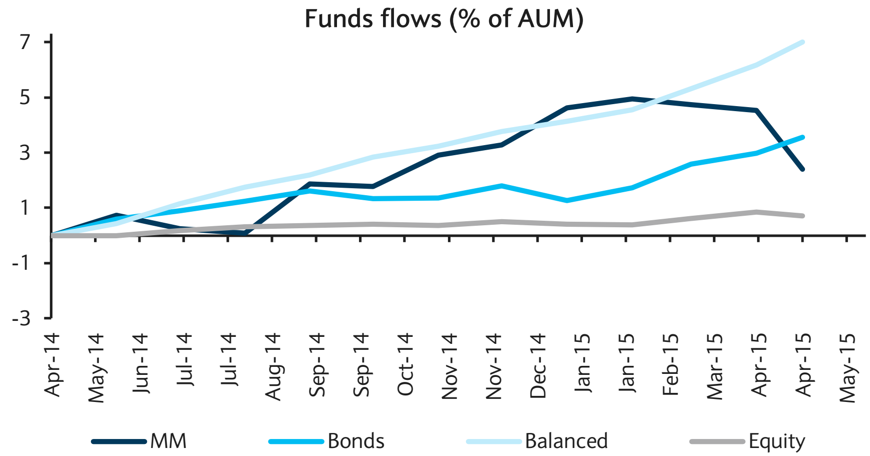
Sector fund flows– Four week average and latest week



Source: EPFR, Haver Analytics, Barclays Research

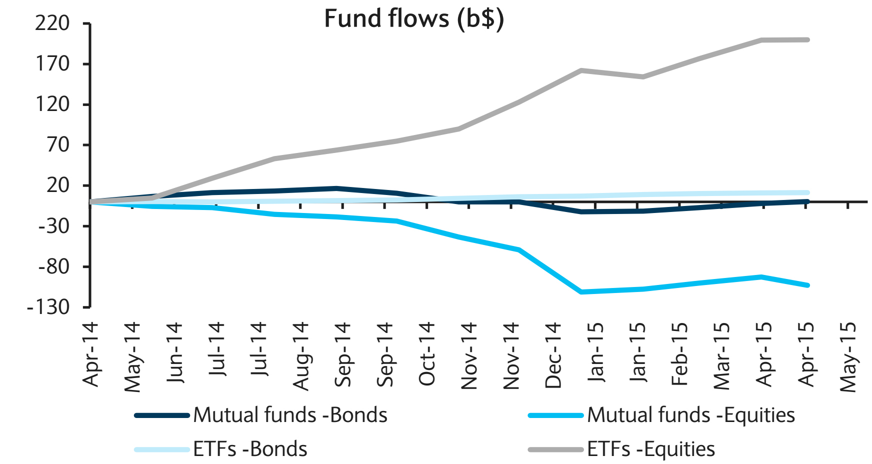
Cross-asset fund flows

FIGURE 62
Cross-asset fund flows over the past 12 months



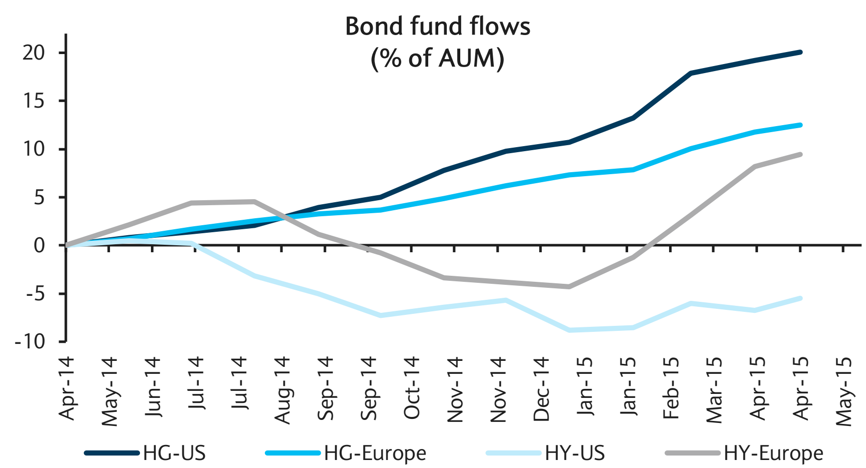
Source: EPFR, Haver Analytics, Barclays Research

FIGURE 63
Mutual fund versus ETF fund flows over the past 12 months



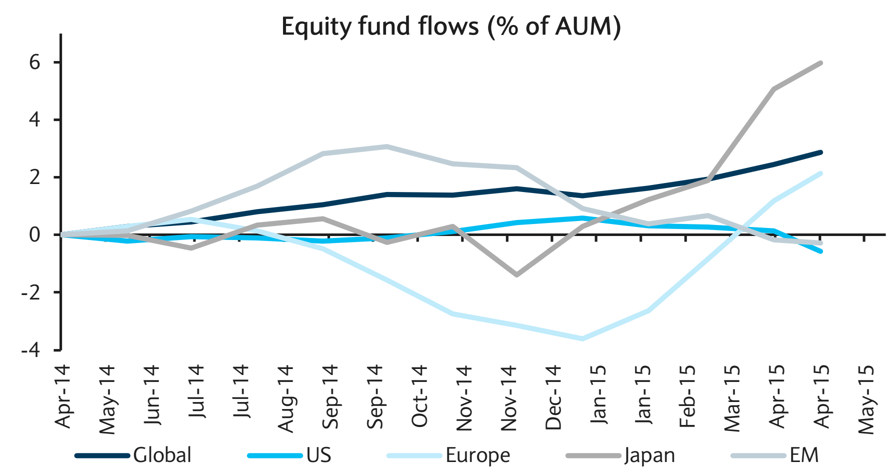
Source: EPFR, Haver Analytics, Barclays Research

FIGURE 64
Bond flows over the past 12 months



Source: EPFR, Haver Analytics, Barclays Research

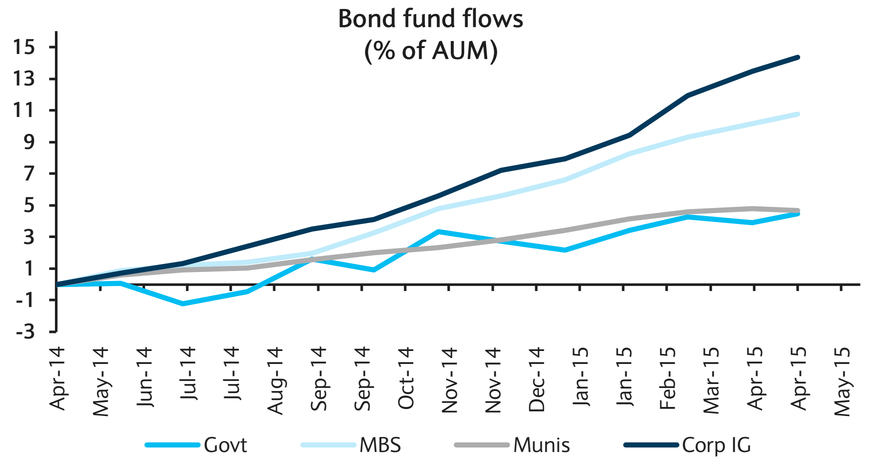
FIGURE 65
Equity flows over the past 12 months



Source: EPFR, Haver Analytics, Barclays Research

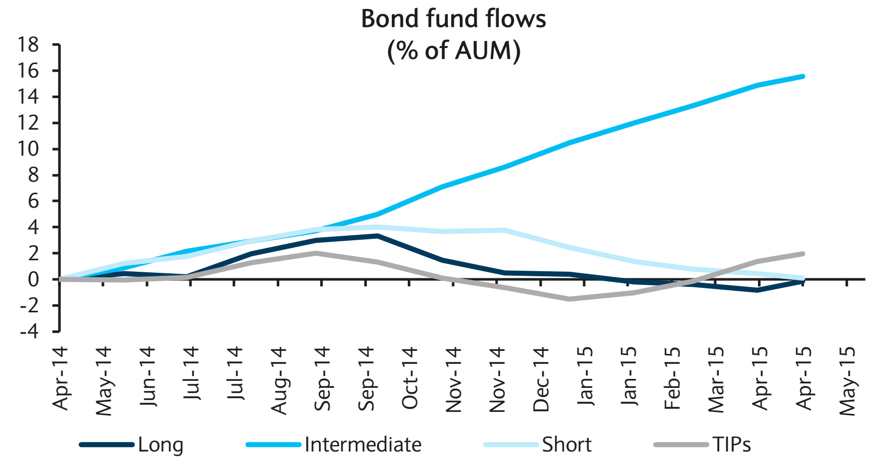
Bond fund flows

FIGURE 66
Investment grade – Bond flows over the past 12 months



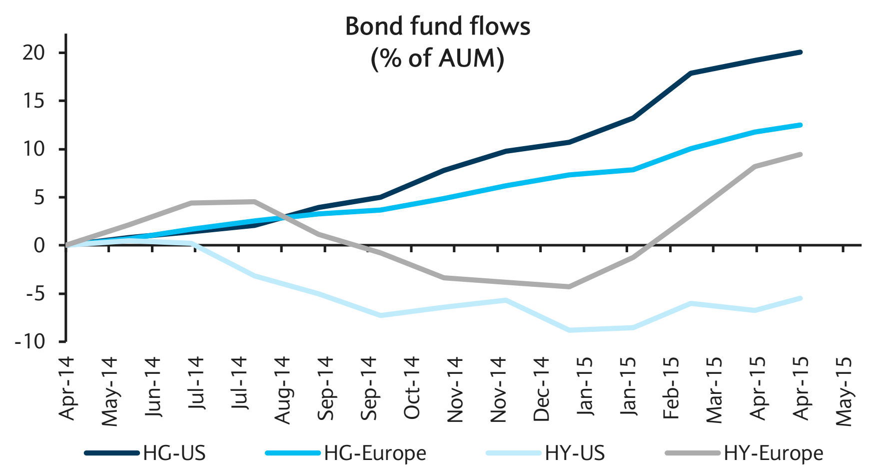
Source: EPFR, Haver Analytics, Barclays Research

FIGURE 67
Duration – Bond flows over the past 12 months



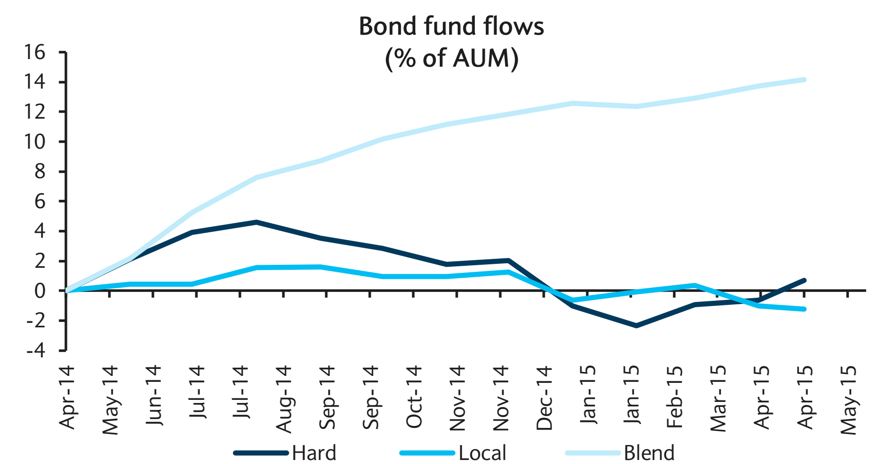
Source: EPFR, Haver Analytics, Barclays Research

FIGURE 68
Corporates – Bond flows over the past 12 months



Source: EPFR, Haver Analytics, Barclays Research

FIGURE 69
Emerging markets – Bond flows over the past 12 months

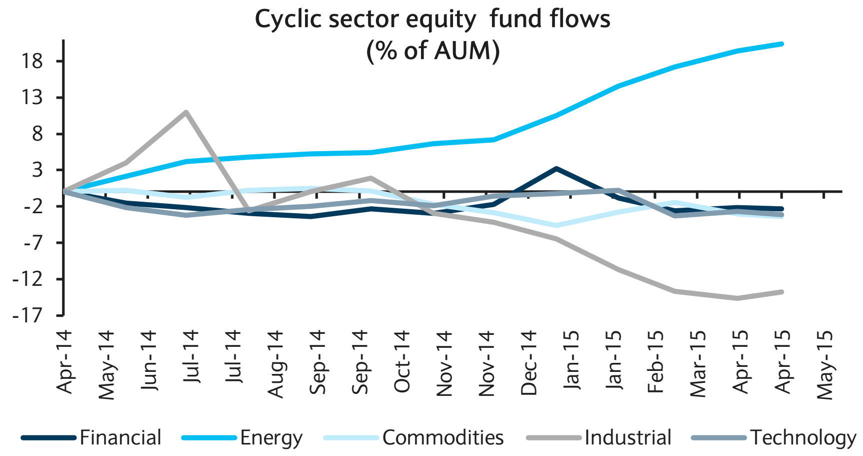


Source: EPFR, Haver Analytics, Barclays Research

Equity fund flows

FIGURE 70

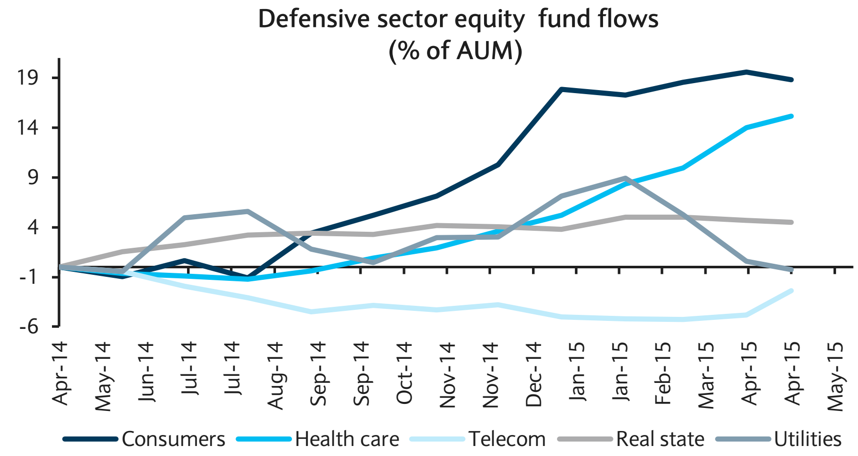
Cyclical sectors – Equity flows over the past 12 months



Source: EPFR, Haver Analytics, Barclays Research

FIGURE 71

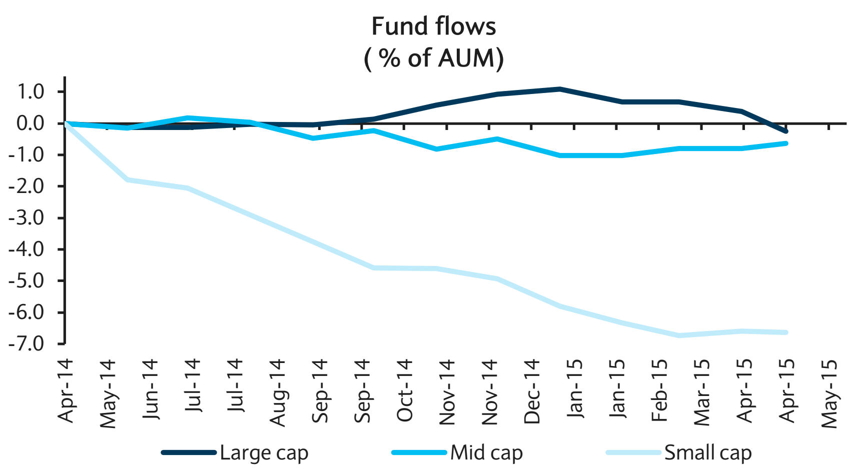
Defensive sectors – Equity flows over the past 12 month



Source: EPFR, Haver Analytics, Barclays Research

FIGURE 72

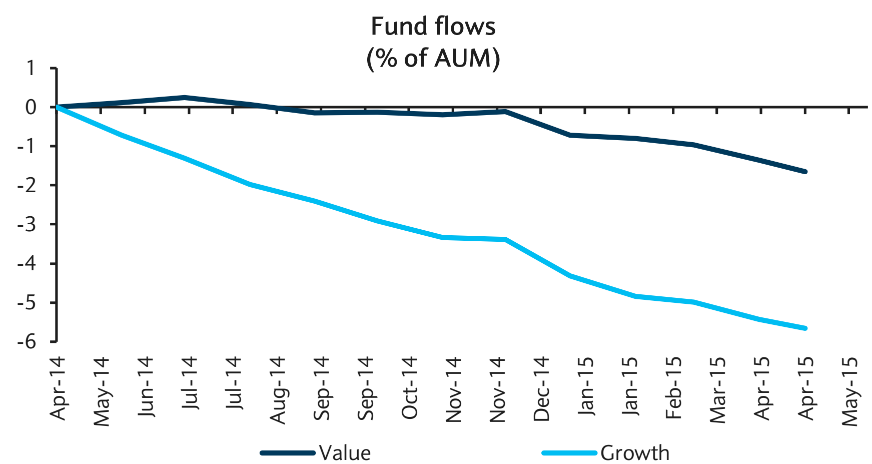
Size styles – Equity flows over the past 12 months



Source: EPFR, Haver Analytics, Barclays Research

FIGURE 73

Growth vs value – Equity flows over the past 12 months



Source: EPFR, Haver Analytics, Barclays Research

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