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Equity Market Performance Review

February 10, 2018

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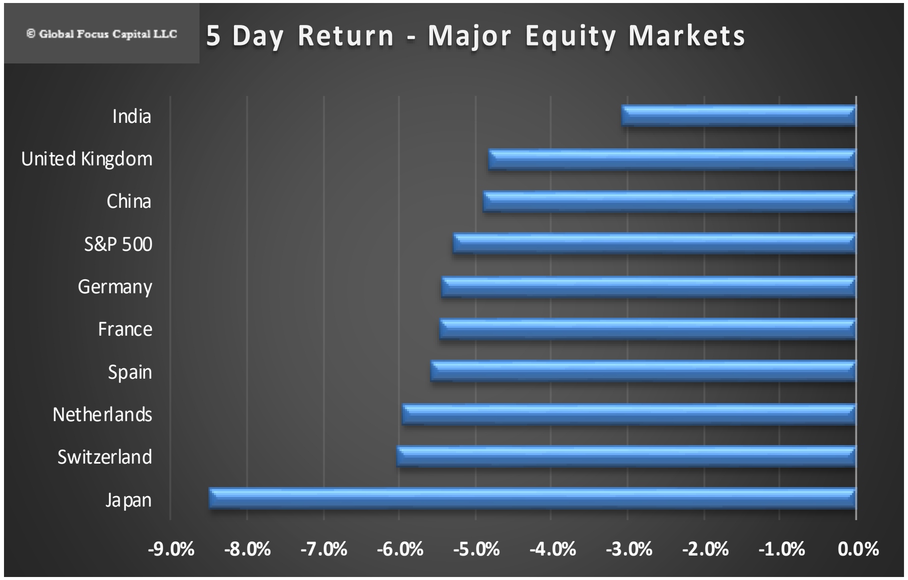
Major Global Equity Markets Tank

- Global equity markets had a very rough last week
- Japan dropped the most among the major markets
- International developed markets had the biggest losses closely followed by Emerging Markets
- In the US the biggest hit was experienced by large cap stocks



MAJOR EQUITY MARKETS	TECHNICAL STAGE
US	DETERIORATING
United Kingdom	BREAK DOWN
Switzerland	BREAK DOWN
Spain	DOWN TREND
Netherlands	BREAK DOWN
Japan	DETERIORATING
India	DETERIORATING
Germany	BREAK DOWN
France	BREAK DOWN
China	BREAK DOWN

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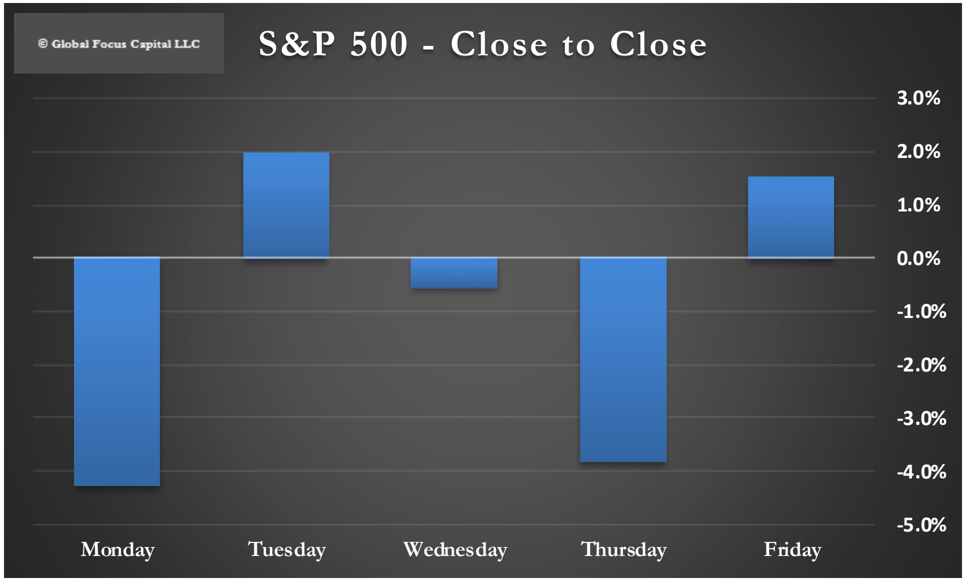
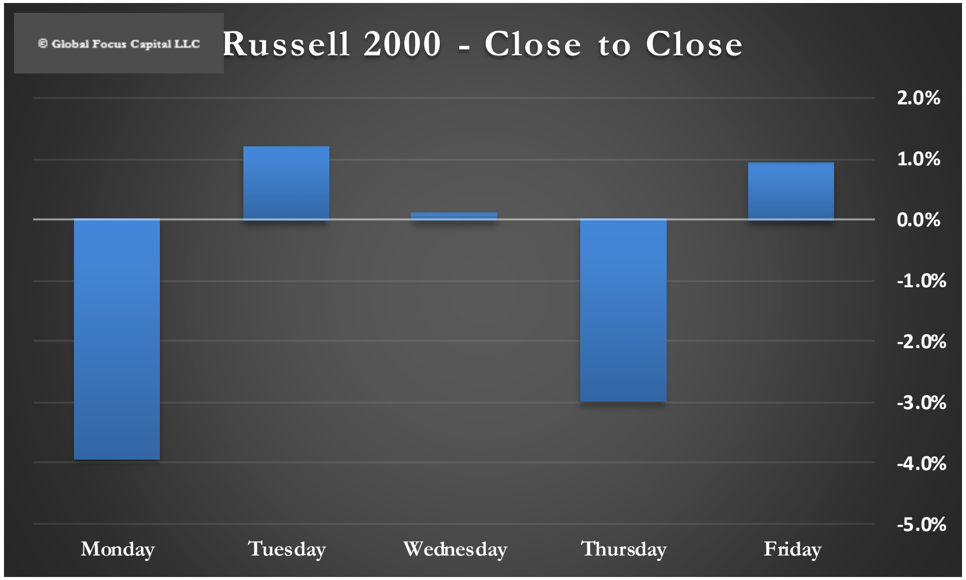
The Daily View – two really bad days with a bit of relief

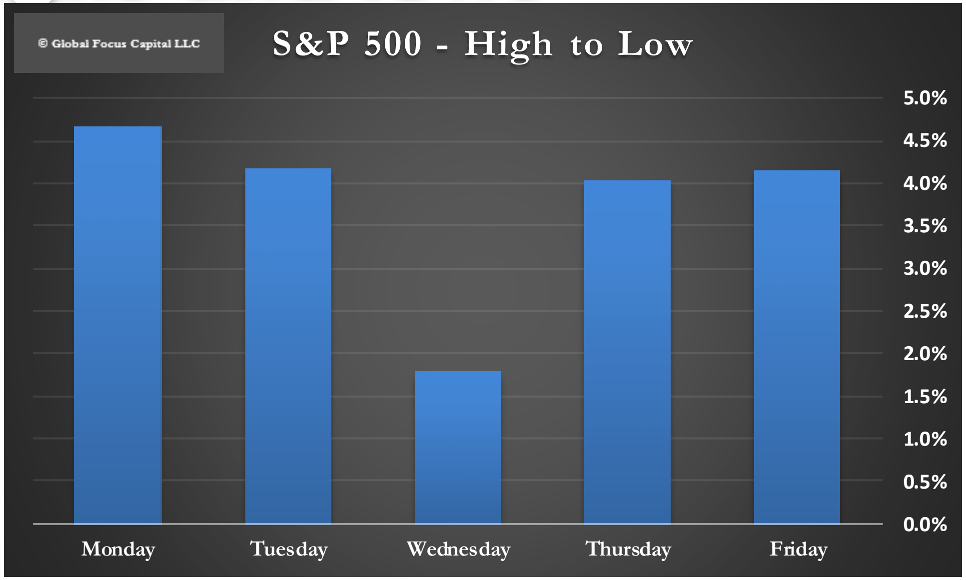
- Monday and Thursday were particularly bad for US stocks
- After a long stretch of not suffering hardly any losses, US investors got a rude awakening to other side of the return coin – i.e. risk
- The returns on the Russell 2000 were more muted both on the downside as well as the upside compared to the S&P 500

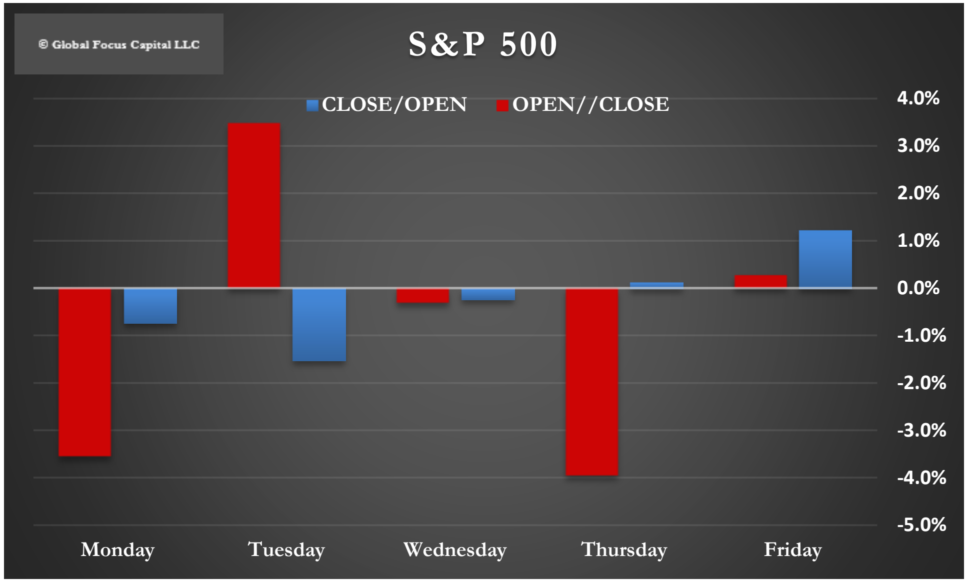




The Intraday View – massive gaps between the daily highs and lows

- The range of intraday price action was incredible wide last week
- Except for Wednesday the intraday difference between the daily high and low was greater than 4%
- The biggest portion of returns happened from the <u>open to the close</u>
- Overnight activity was somewhat muted pointing to the US equity market as the center of the storm





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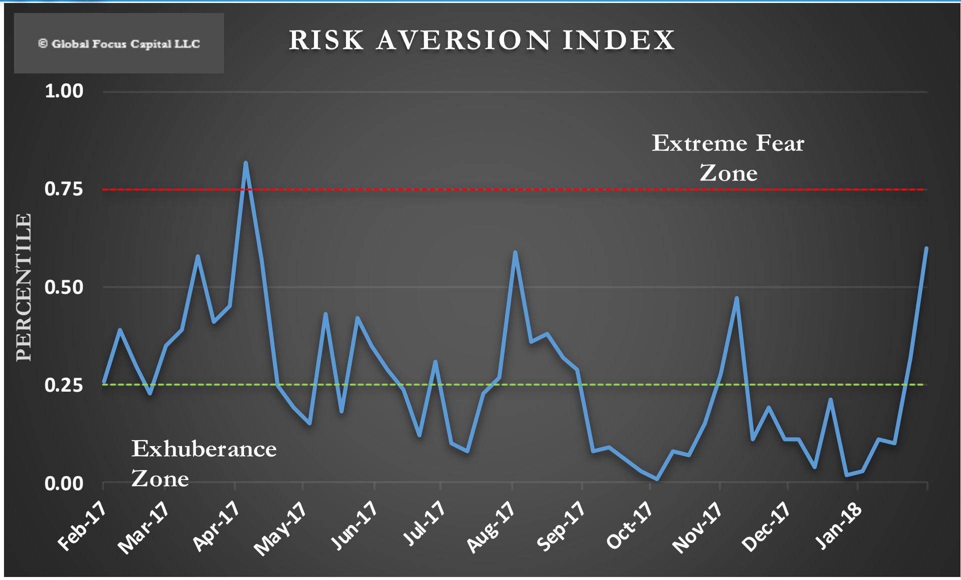
Investor Risk Aversion Spikes UP – we are now in the Normal Zone

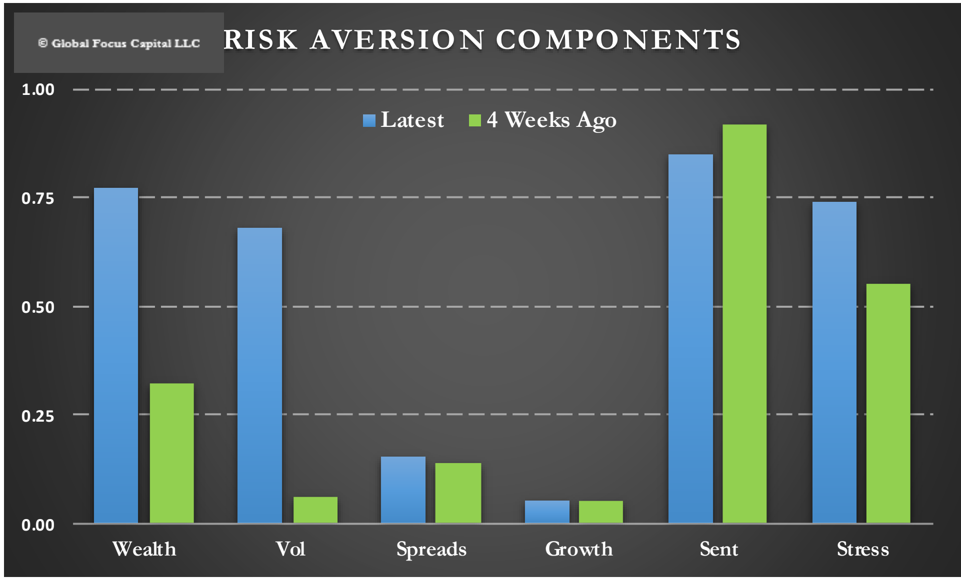
- Our proprietary Risk Aversion Index had been sitting in the Exuberance Zone until about week ago

- We are now sitting at about the 60th percentile (Normal Zone)

- Default spreads and measures of economic growth remain below average denoting a lack of fear

- The "fear" we see among investors is confined to equities, not bonds





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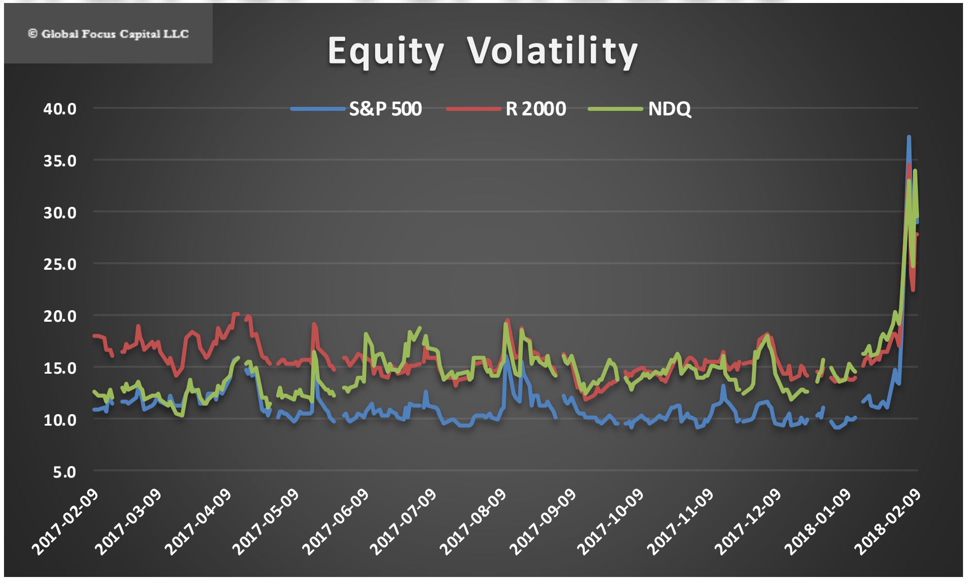
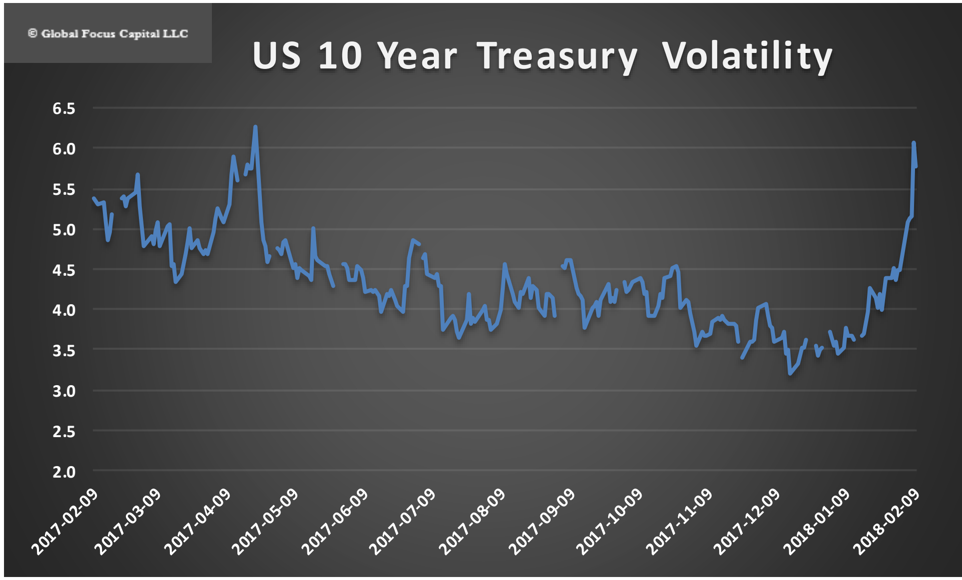
Stock & Bond Volatility Show Some Mean Reversion – a Black Swan for Vol Traders

- Stock and bond volatility are components of our Risk Aversion Index so it is not surprising that both experienced large jumps

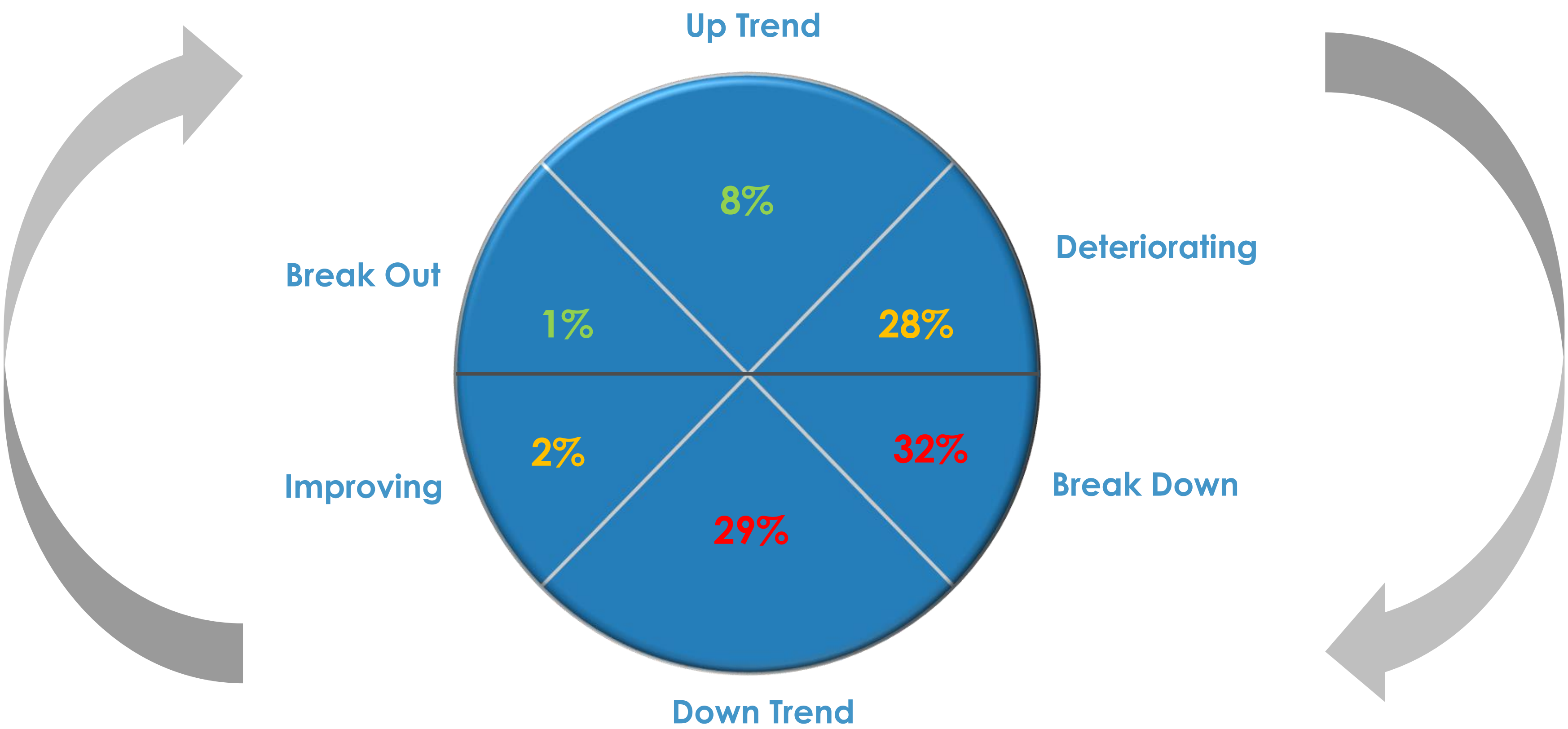
- Last week brought on some of the largest ever jumps in equity market volatility

- Short volatility strategies finally experienced a Black Swan event after many months of quiet (and profit making)





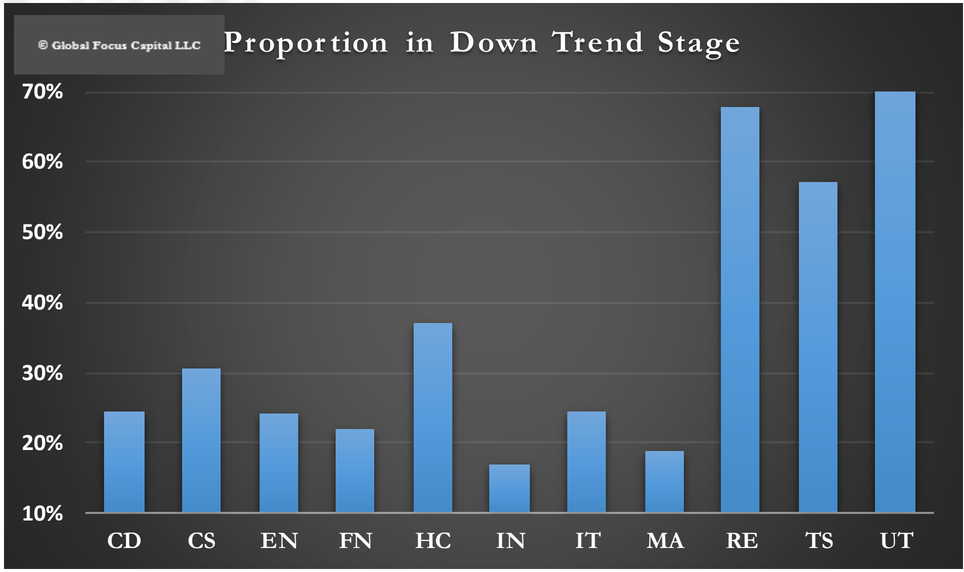
Market Internals - the current Technical Picture for US stocks has deteriorated significantly

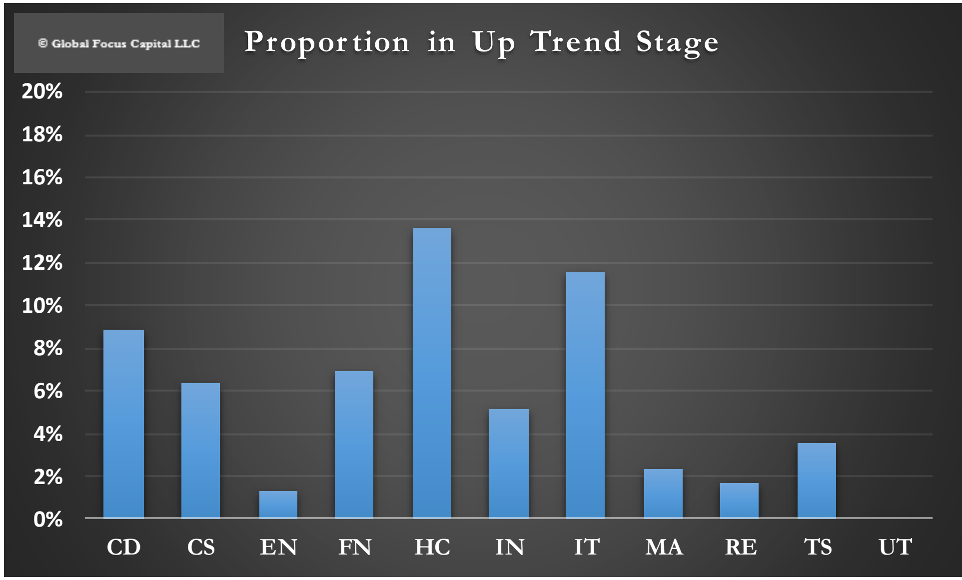


Russell 3000 Universe

The Sector Look – interest sensitive sectors have deteriorated the most

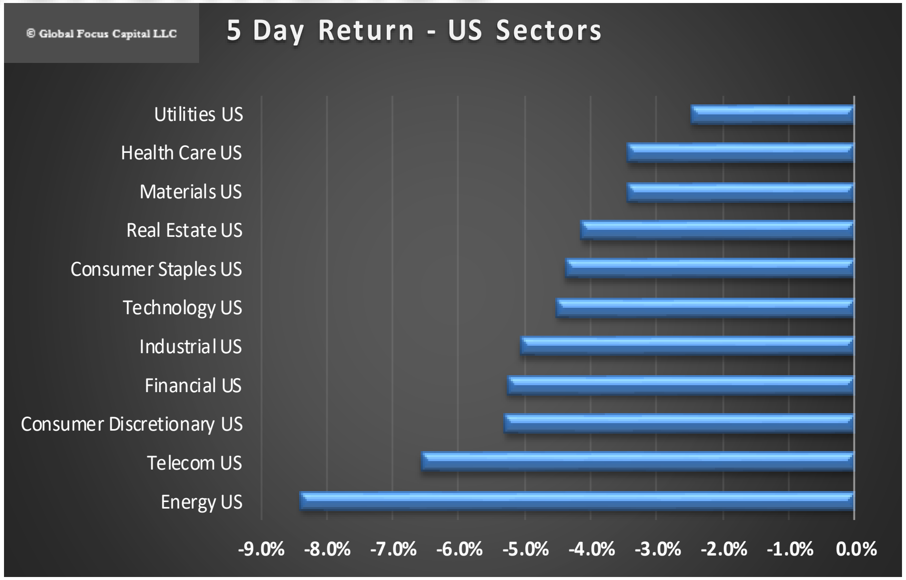
- Stocks in the real estate, telecom and utility sectors have deteriorated the most
  - These sectors are all very interest rate sensitive
  - About 70% of utilities in the R3000 are in the Down Trend Stage
- After a great start to 2018 we are now left with only a handful of stocks in the Up Trend Stage
  - Health Care and Tech have the most "survivors" in the momentum trade





US Equity Sectors – last week we saw large differences in performance

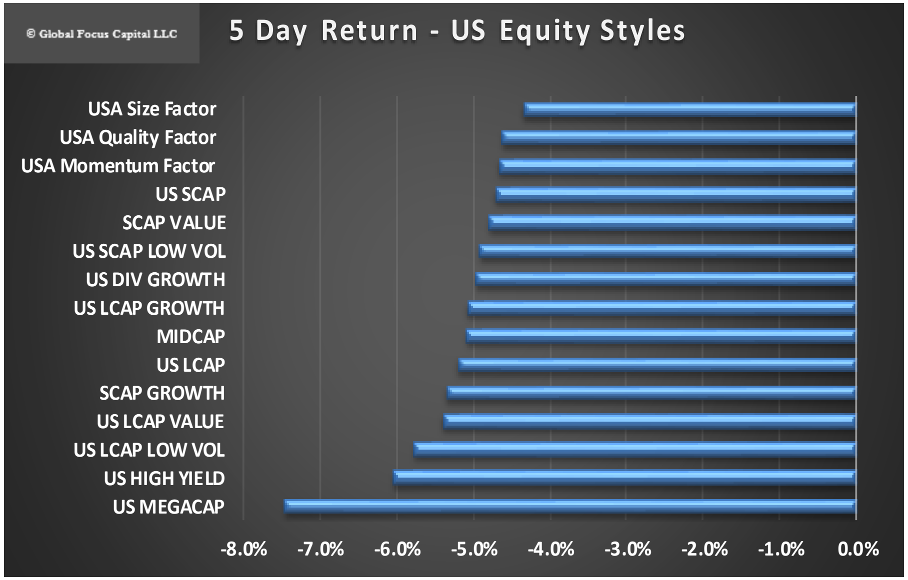
- All major US equity sectors saw large losses last week
- Utilities while under stress all year exhibited the smallest losses
- Energy stocks significantly under-performed
  - Oil and natural gas prices dropped the most within the commodity space
- Utilities and Telecom are currently in the Down Trend Technical Stage



US EQUITY SECTOR	TECHNICAL STAGE
Materials US	DETERIORATING
Energy US	BREAK DOWN
Financial US	DETERIORATING
Industrial US	DETERIORATING
Technology US	DETERIORATING
Consumer Staples US	BREAK DOWN
Utilities US	DOWN TREND
Health Care US	DETERIORATING
Consumer Discretionary US	DETERIORATING
Telecom US	DOWN TREND
Real Estate US	BREAK DOWN

US Equity Style Performance

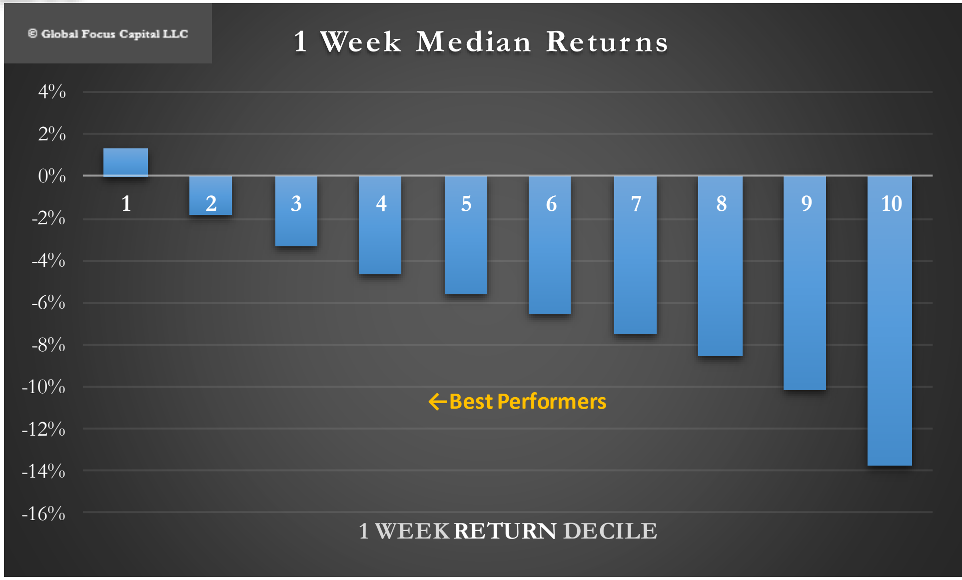
- Similar to the sector view, all equity styles took a hit last week
- Some traditional "defensive" styles such as low "vol" did not offer any enhanced protection
- Mega caps suffered the largest losses last week
  - In a stressed market, investors will almost always sell the most liquid investments first
- We do not see much rhyme or reason behind last week's relative style performance

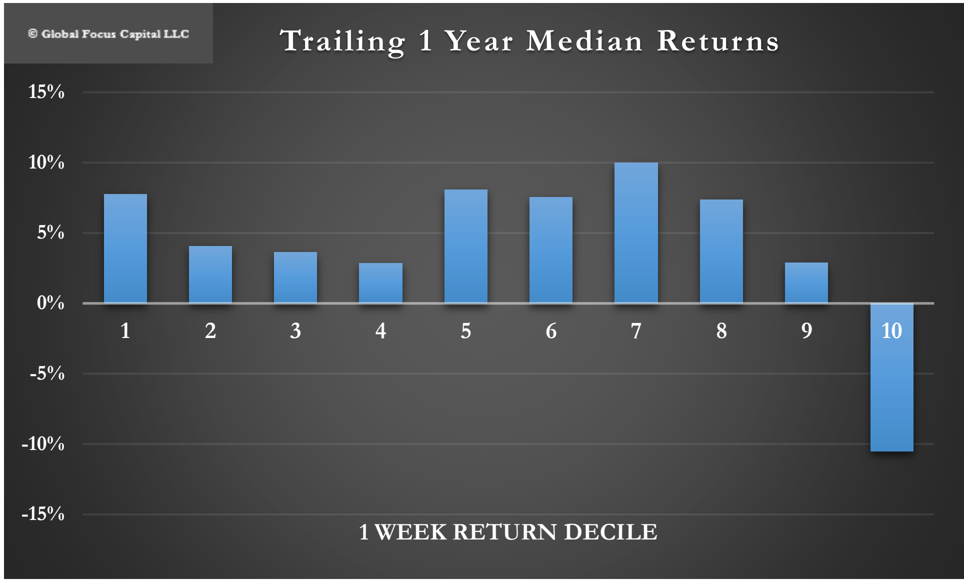


US EQUITY STYLES	TECHNICAL STAGE
USA SCAP MV Factor	BREAK DOWN
USA LCAP MV Factor	DETERIORATING
USA Quality Factor	DETERIORATING
USA Momentum Factor	DETERIORATING
USA Value Factor	DETERIORATING
USA Size Factor	DETERIORATING
US MEGACAP	DETERIORATING
US HIGH YIELD	BREAK DOWN
US DIV GROWTH	DETERIORATING
US LCAP GROWTH	DETERIORATING
US LCAP VALUE	DETERIORATING
SCAP VALUE	BREAK DOWN
SCAP GROWTH	DETERIORATING
MICROCAP	DETERIORATING
MIDCAP	DETERIORATING

US Broad Equity Universe – a bad week was had by virtually all

- When ranked by last week's performance, only Decile 1 squeezed out a positive return
- Decile 10 stocks (our worst performers) had a median return last week of -14%
- Needless to say there were very few bright spots last week
- Comparing last week's performance to the trailing 1 year returns does not reveal any real patterns
  - The only noteworthy comment regards the continued losing streak of the 1 year worst performers





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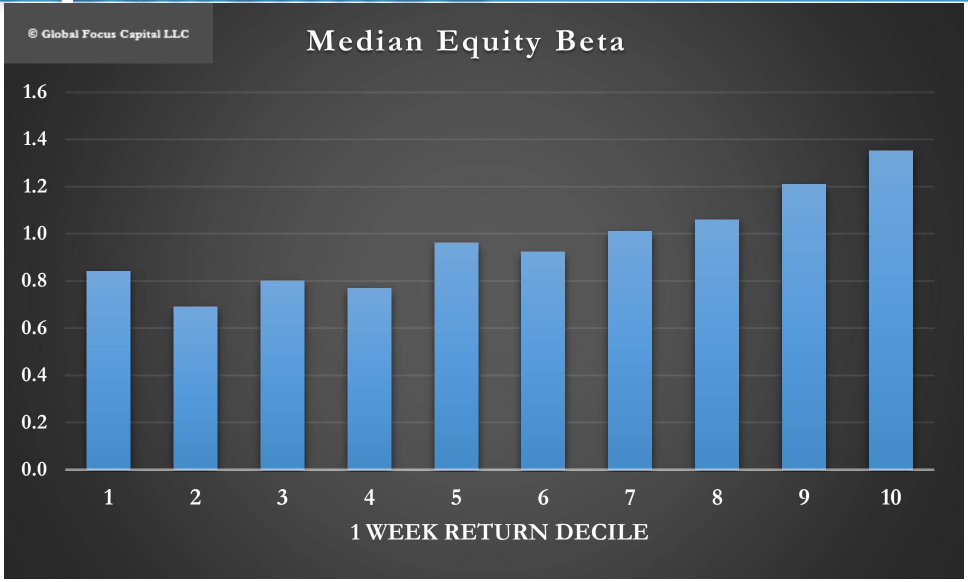
Lower beta had the smallest losses while smaller caps also out-performed

- In a period of turmoil, we would expect lower beta stocks do loose less
  - The highest beta stocks lost the most last week
  - The effect was fairly linear in magnitude
- The smallest stocks by market capitalization had the smallest losses last week
  - The reluctance of investors to trade the most illiquid stocks during a crisis explains this effect
  - The first stocks to feel a crisis are usually mid and large caps where the bid-ask spreads are more compressed



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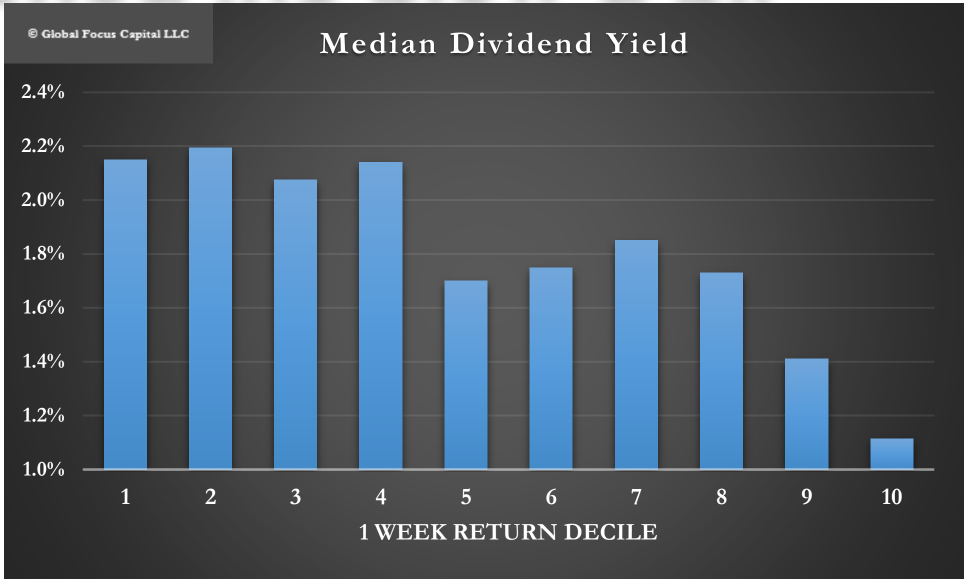
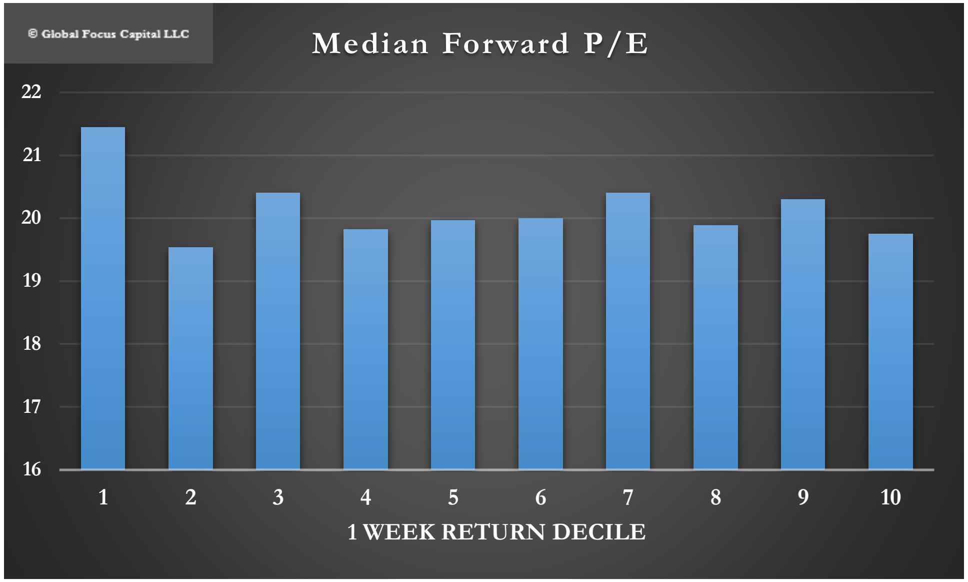
Value offered no safety last week, dividend yield cushioned the blow a bit

- Stocks with the smallest losses last week had higher than average dividend yields
  - This is a reversal from prior weeks when dividend yield stocks had under-performed
- Median forward P/E's were fairly uniform across weekly return deciles
  - In other words, cheap stocks did not do better last week
  - Valuation offered no discrimination power





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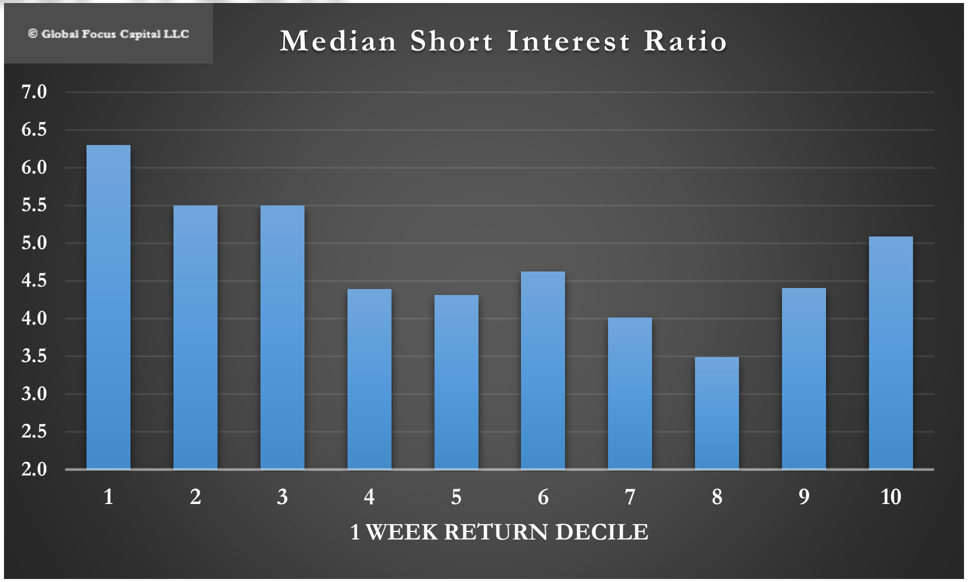
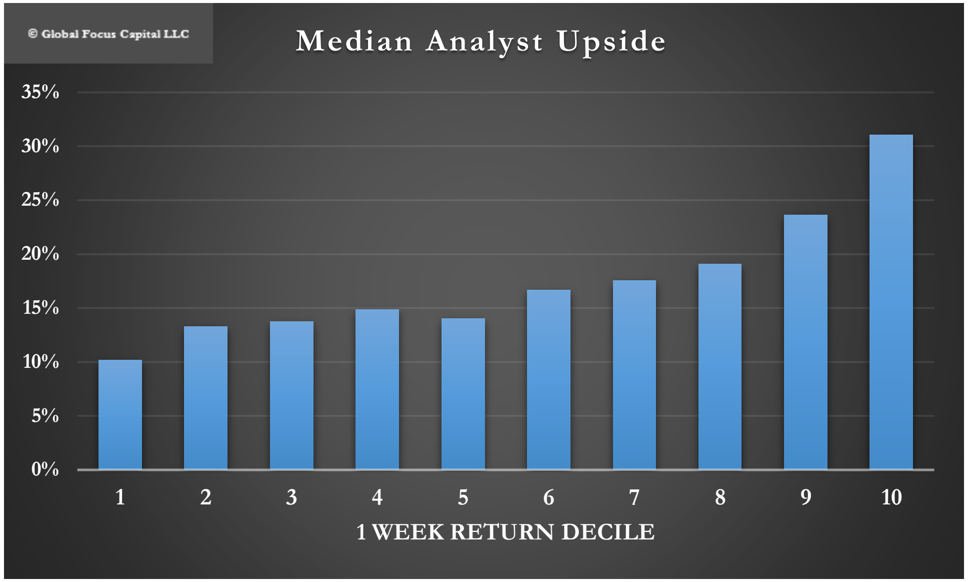
Stocks with the most favorable sell-side ratings lost the most last week

- Stocks with negative sentiment outperformed last week
- Decile 1 (stocks with the best performance last week) have the highest median short interest ratios
- Stocks deemed to have the highest rate of potential upside by sell-side analysts had the worst returns last week (Decile 10)





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This Coming Week

- The open on Monday will be an important test for how long this equity downdraft continues
- My view is that this is a <u>technical correction</u> and it will be over soon
- Investors have been conditioned by 2008, but this is different
  - The global economy is growing
  - Inflation is low and inflationary pressures are contained by plenty of slack capacity
  - Monetary policy has followed a predictable path and remains accommodative

- Earnings – CSCO, AIG, AMAT, PEP, OXY, MRO
- Risk Aversion – expect the RAI to remain in the <u>Neutral</u> Zone
- Market Internals – expected to improve this week
- Expect equity and bond volatility to subside, volatility is mean-reverting
- Look for <u>rebound candidates</u> in Health Care & Energy sectors

Contact & Subscription Information

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