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INSIGHT THAT MATTERS

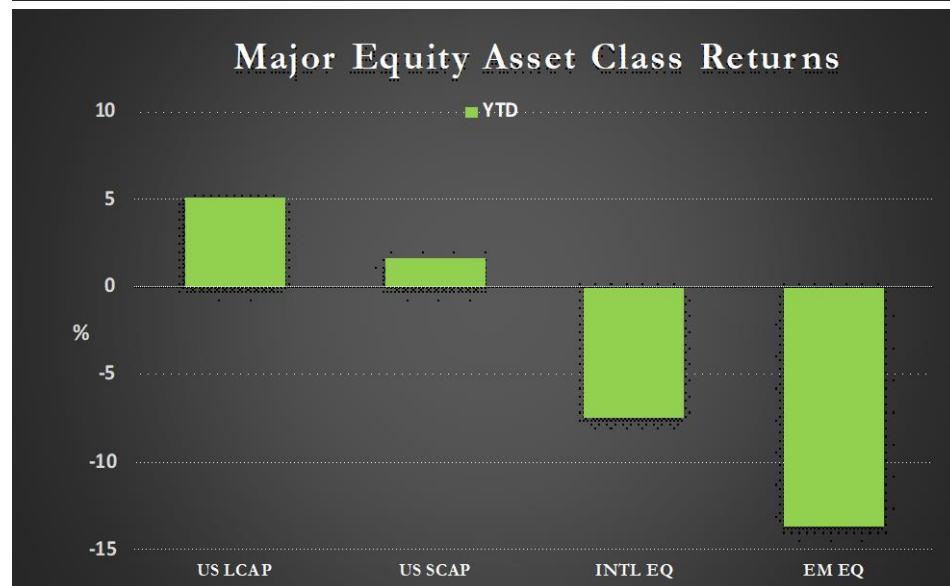
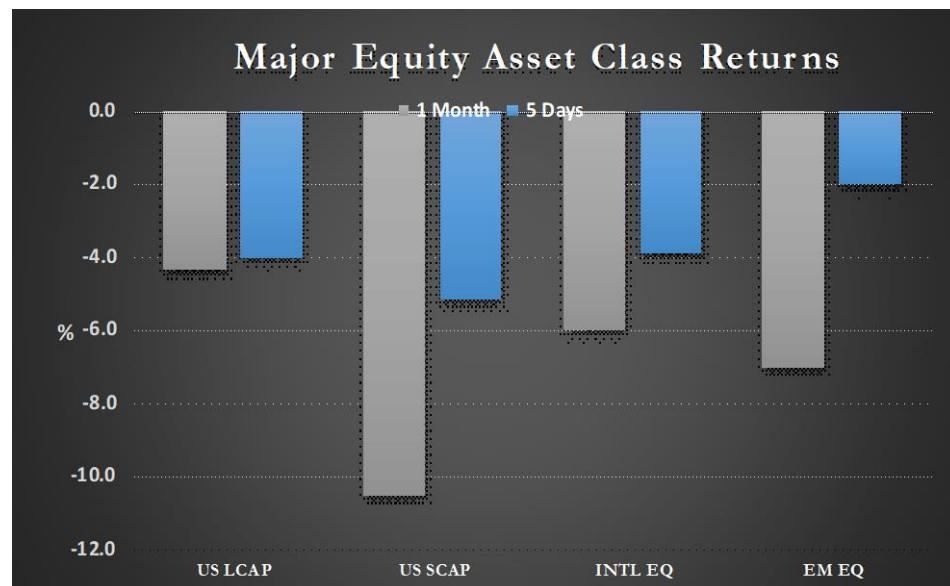
The Equity Observer

Weekly Review – October 13, 2018

Eric J. Weigel

Equity markets get slammed with small caps taking the biggest hit

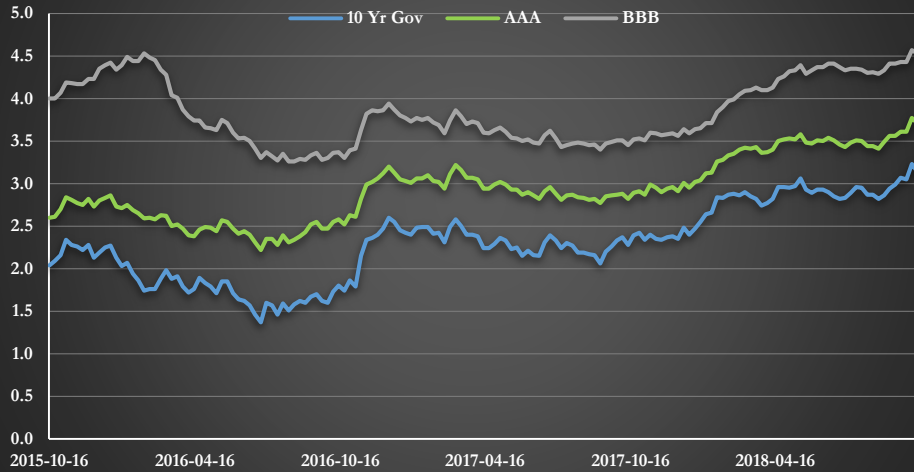
- ▶ A brutal week for risk taking - all major equity asset classes lost money last week
 - ▶ Higher rates contributed to this as well as slower expected global growth
- ▶ EM Equities lost the least last week (-2%) but continue being the worst performing equity class YTD (-13.6%)
- ▶ YTD US Large Cap has leapfrogged small caps
 - ▶ Small caps are down 10% in the last month



Big Jump in Vol but Macro Picture Remains Benign

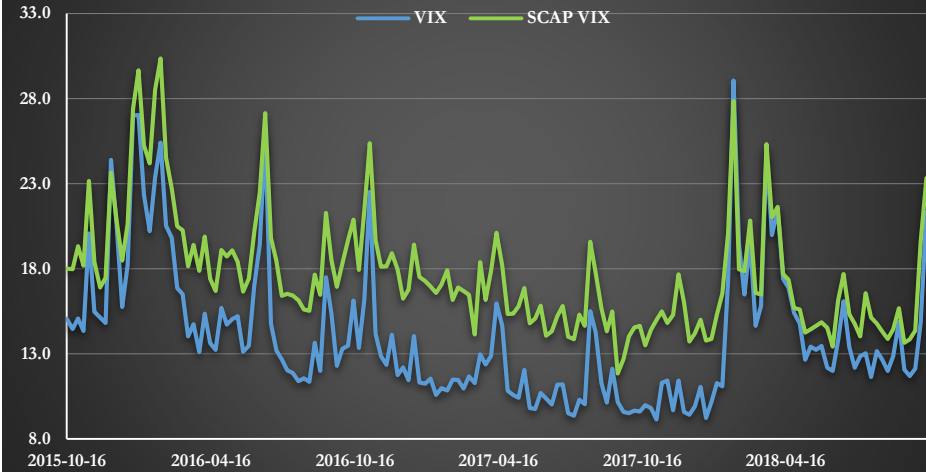
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US Interest Rates



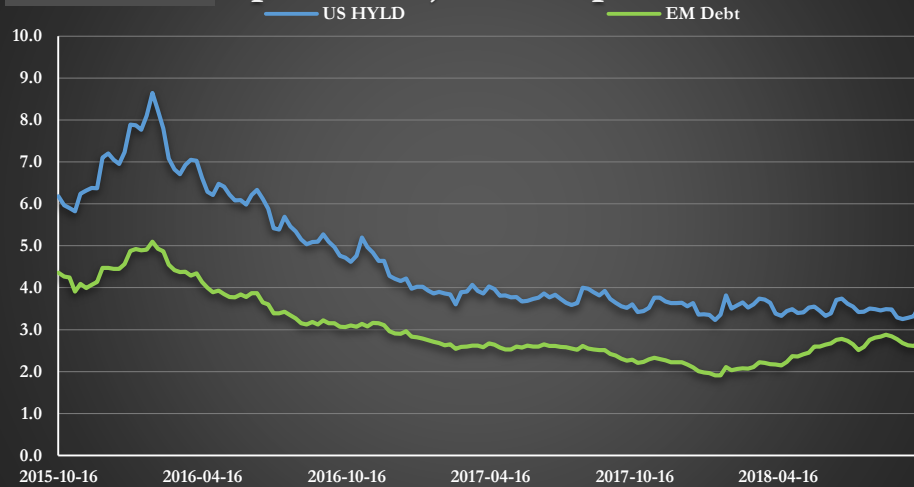
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Stock Index Implied Volatility



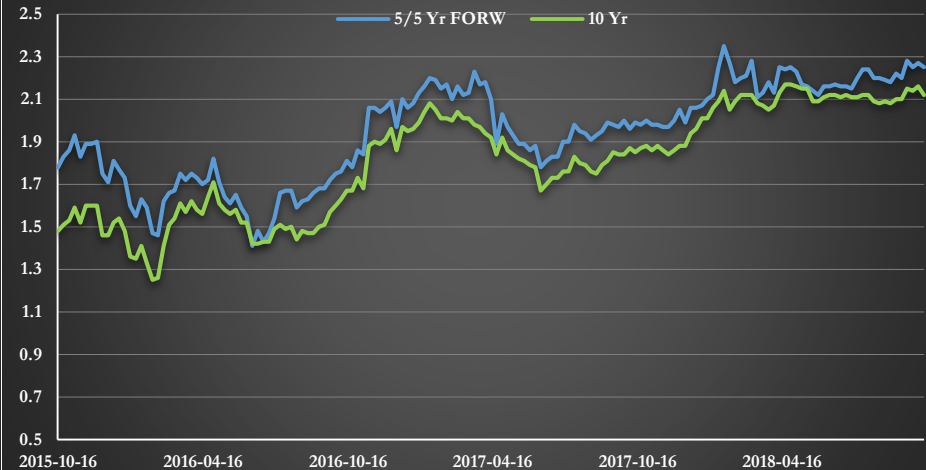
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Option Adjusted Spreads



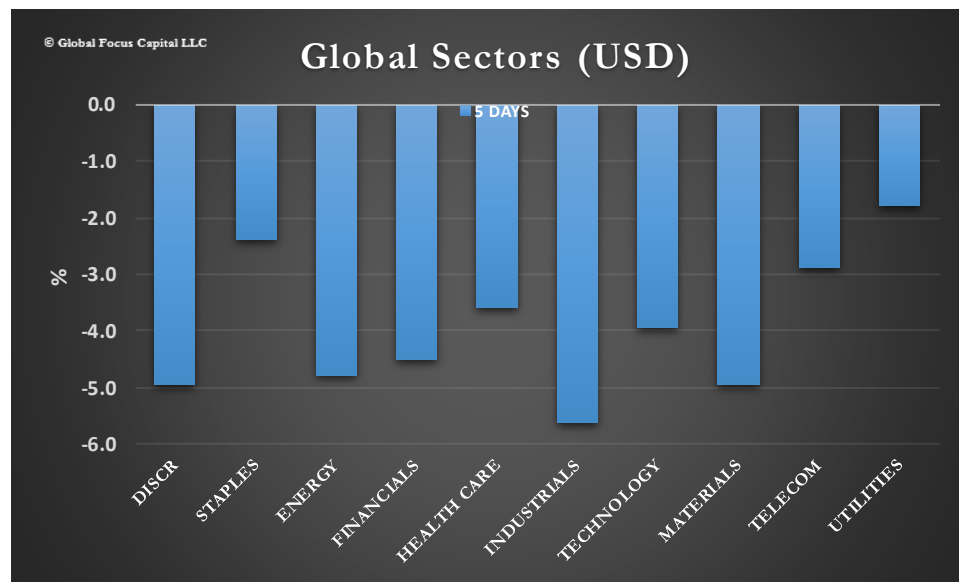
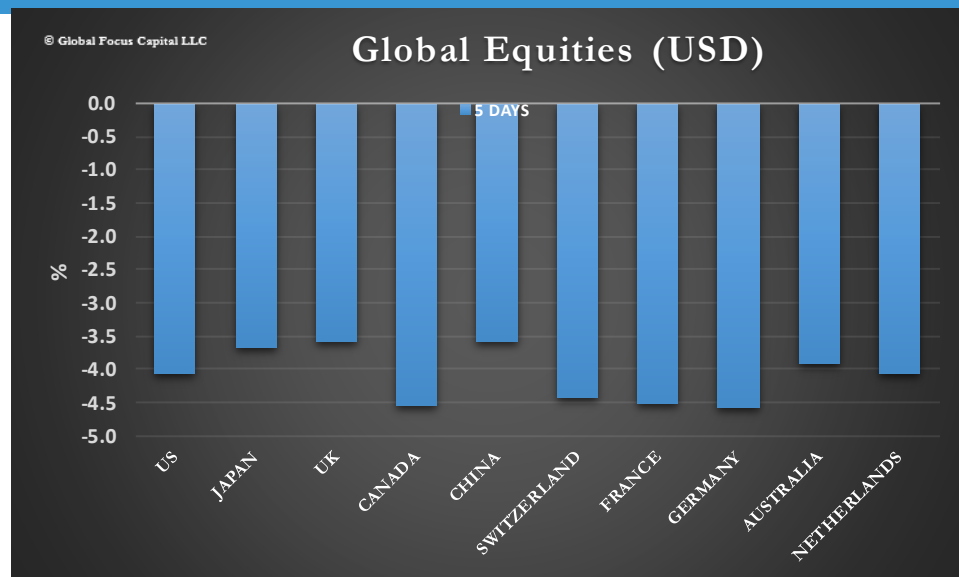
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US Inflationary Expectations



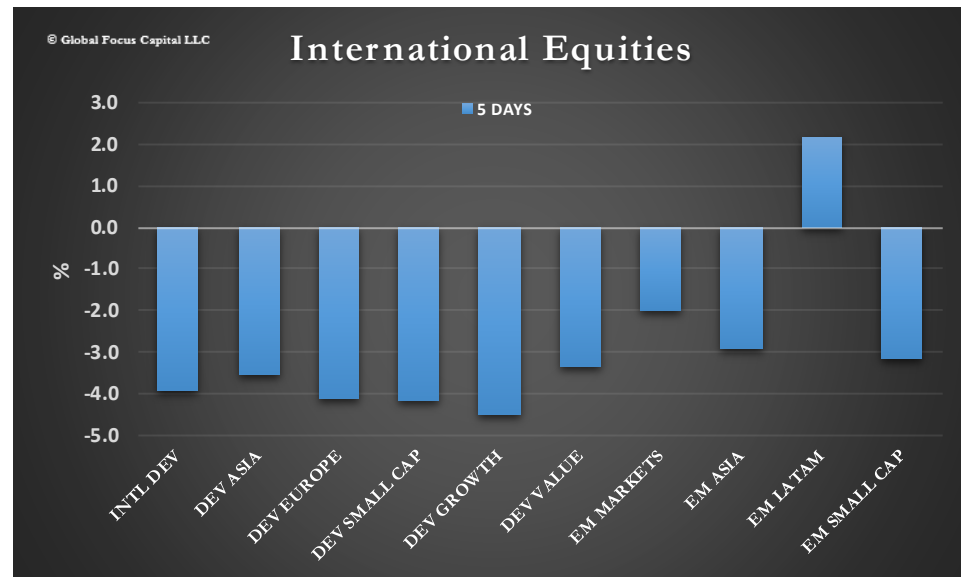
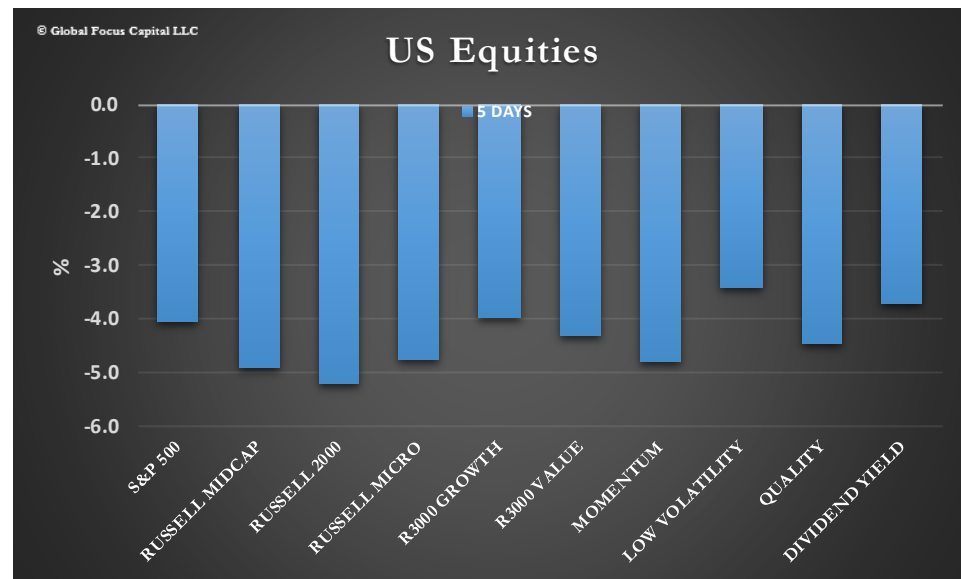
Global Equities

- ▶ Carnage all over the place – a global retreat from risky assets
- ▶ Equities vastly under-performed bonds last week despite generally higher global interest rates
- ▶ In the US Growth out-performed Value over the last 5 trading days but in the rest of the world Value outperformed
- ▶ Traditional Value sectors such as Industrials, Materials and Financials got hit hardest
- ▶ Utilities and Staples, two traditional low beta sectors lost the least



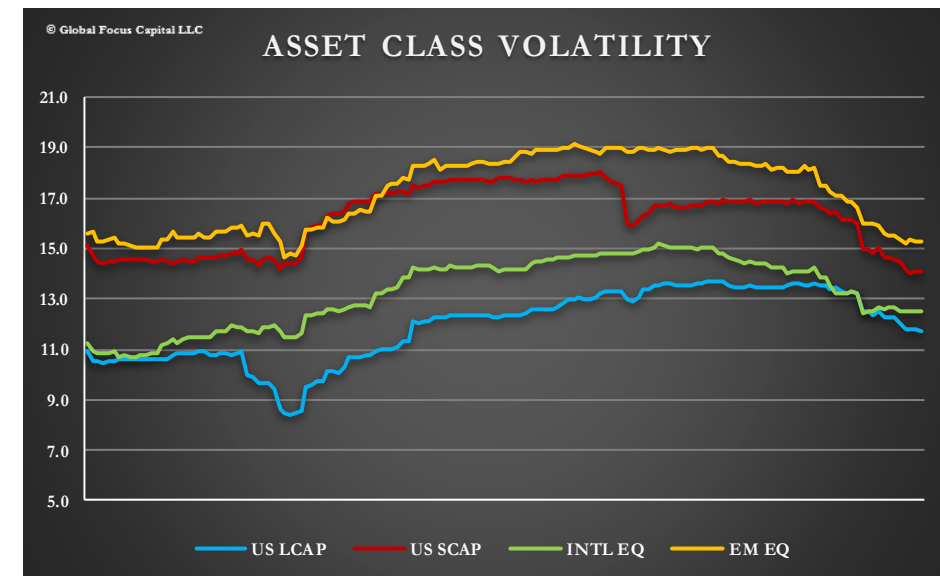
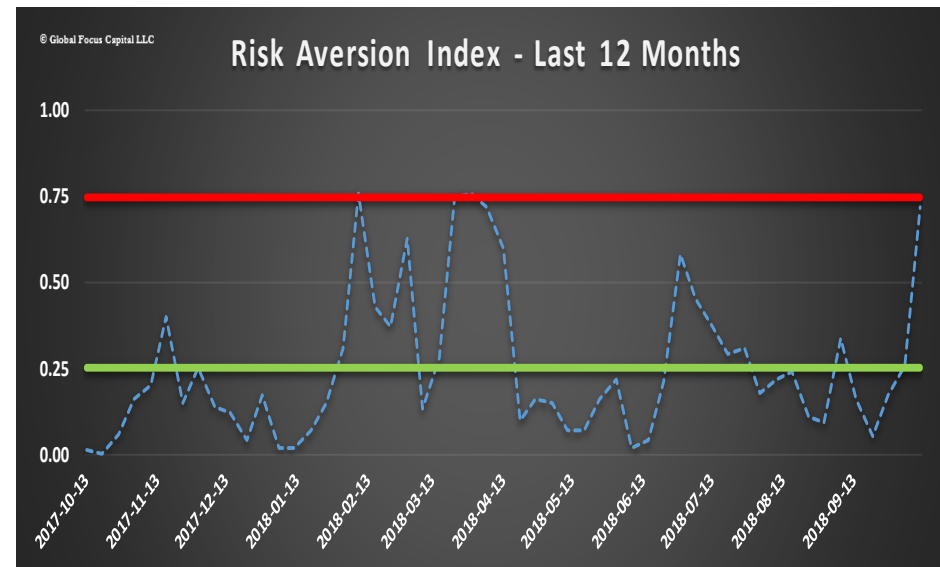
Style and Geography

- ▶ In the US, mega-caps outperformed (lost less unfortunately)
- ▶ Value once again underperformed Growth –mainly due to losses in the Industrials, Materials and Finance sectors
- ▶ Growth and Momentum keep dominating YTD among US stocks
- ▶ Developed international markets slightly outperformed the US but remain in the red for the year
- ▶ EM LATAM recovered last week driven by Brazilian election results favoring a pro-business candidate



Investor Risk Aversion jumped last week to the top of the Normal Zone

- ▶ Investors woke up to capital market risk last week
- ▶ Our risk aversion index jumped from the Exuberant Zone to close to the top of the Normal Zone
- ▶ Asset class volatility has risen from the lows of last year but remains lower than expected
- ▶ We see a huge disconnect between volatility, valuations and economic conditions
 - ▶ Global growth is good but leveling off, valuations are high and economic policy is uncertain



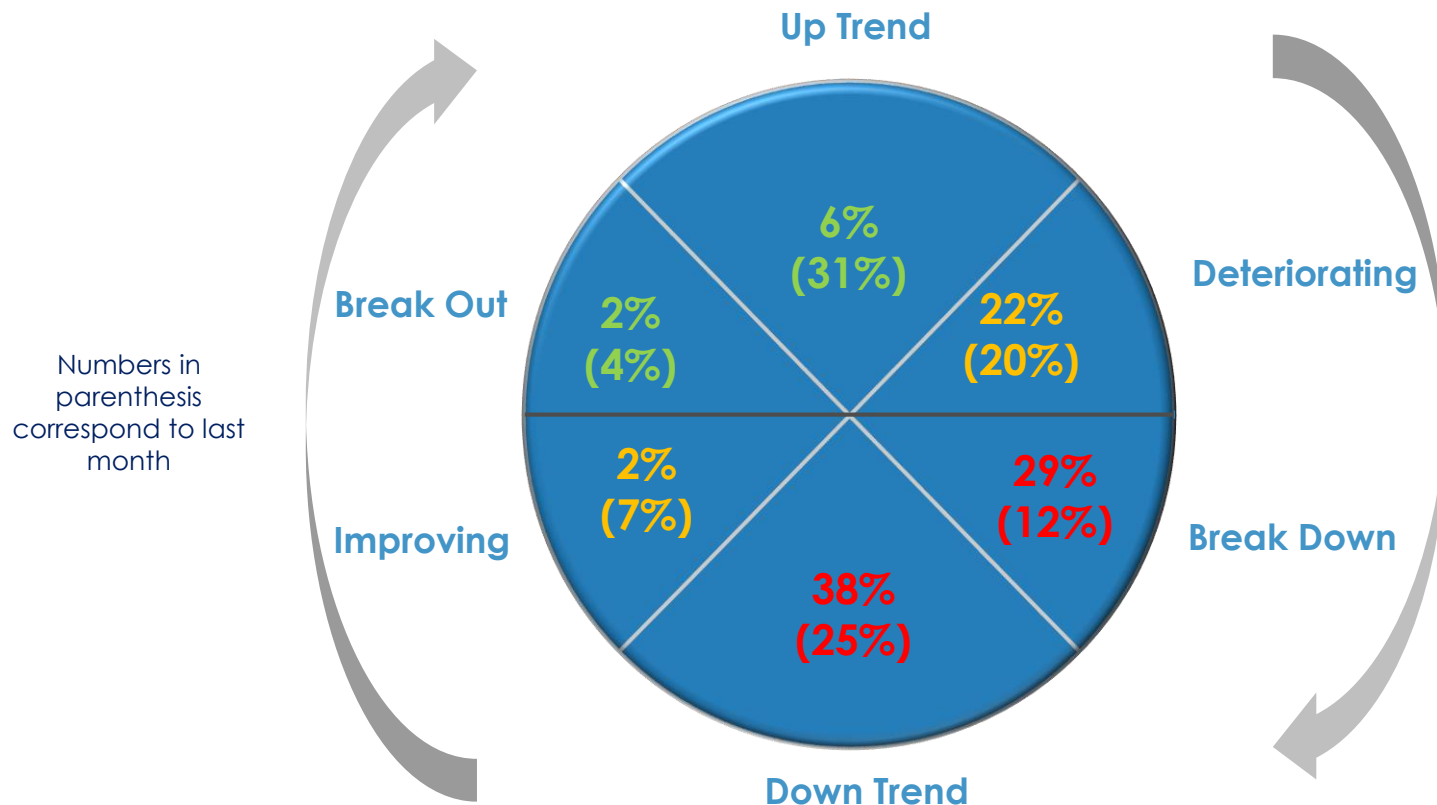


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US Equities

Weekly Performance

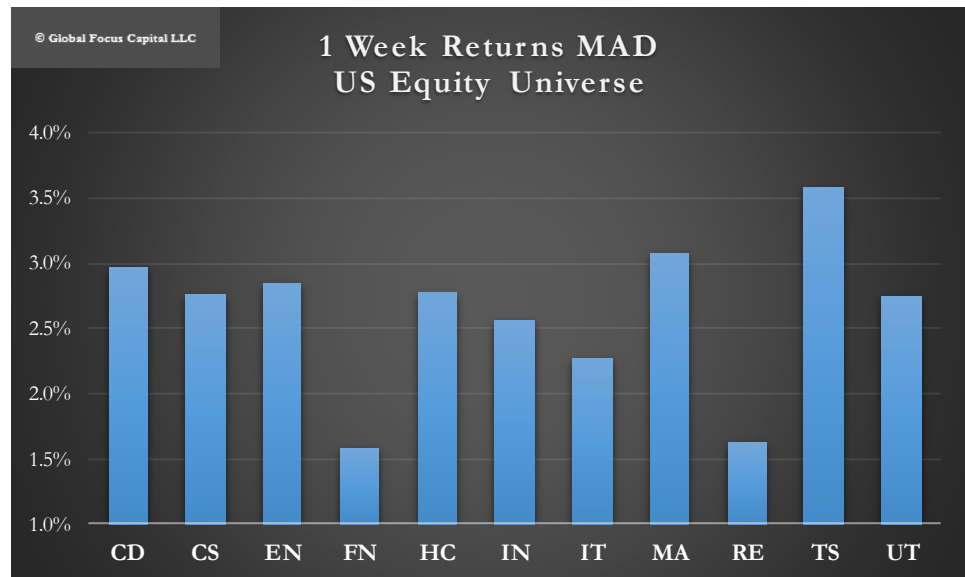
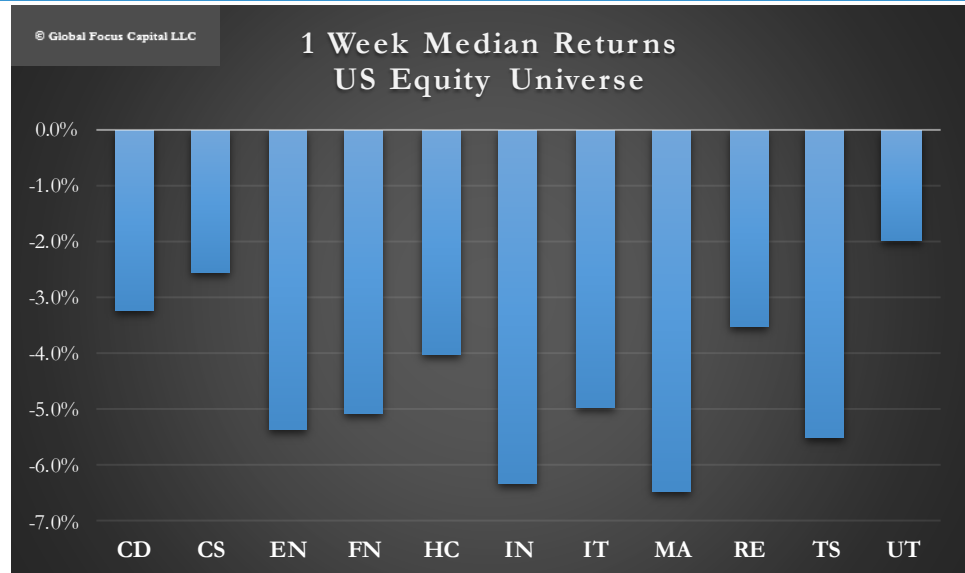
Sure looks like a serious correction and possible the start of a Bear Market – huge deterioration in technicals in the last week



GF CAP US All Equity Universe

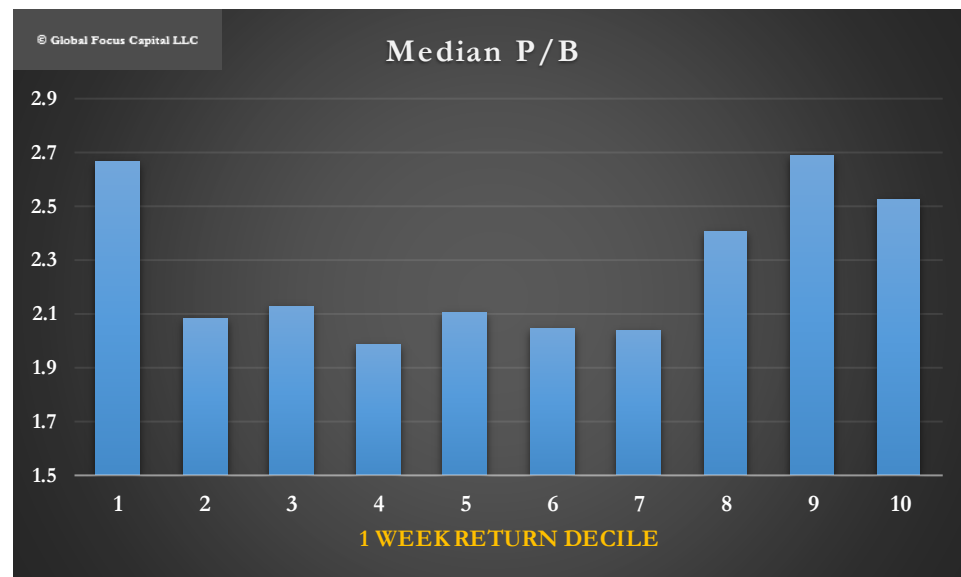
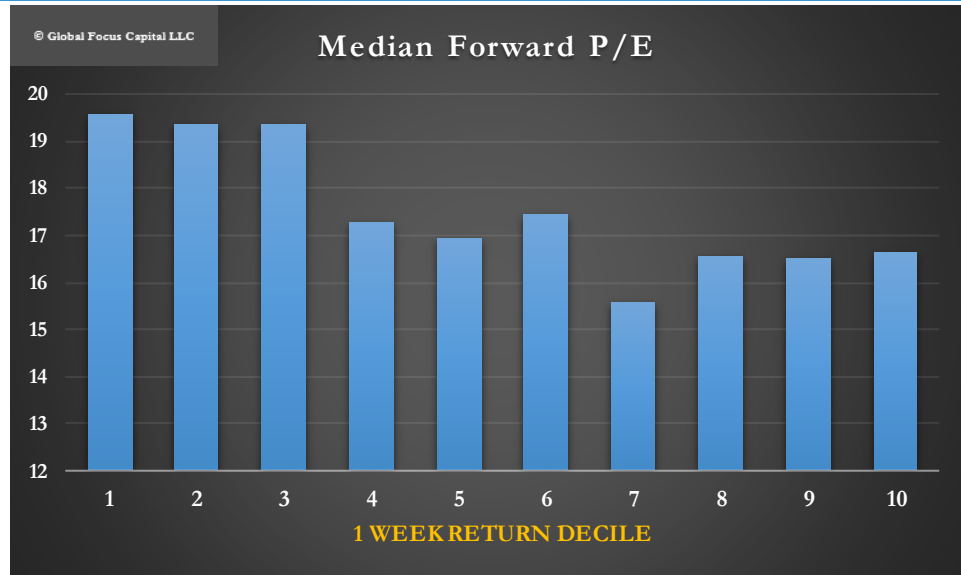
The Sector Look – median performance and dispersion

- ▶ The median stock in our universe fell 4.7% over the last 5 trading days
- ▶ The smallest losses were seen among utilities and consumer staples
- ▶ Industrials and Material stocks took the biggest hits last week
- ▶ The widest variability in performance was seen in the Telecom sector – good for stock picking
- ▶ Financials showed the most homogeneity in stock price action
- ▶ We use the median absolute deviation as a robust measure of within sector variability



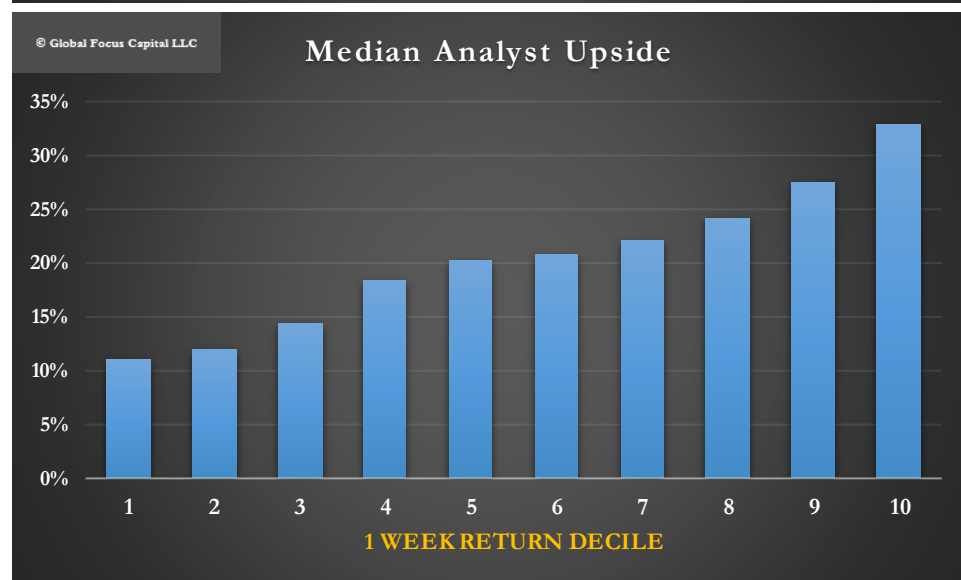
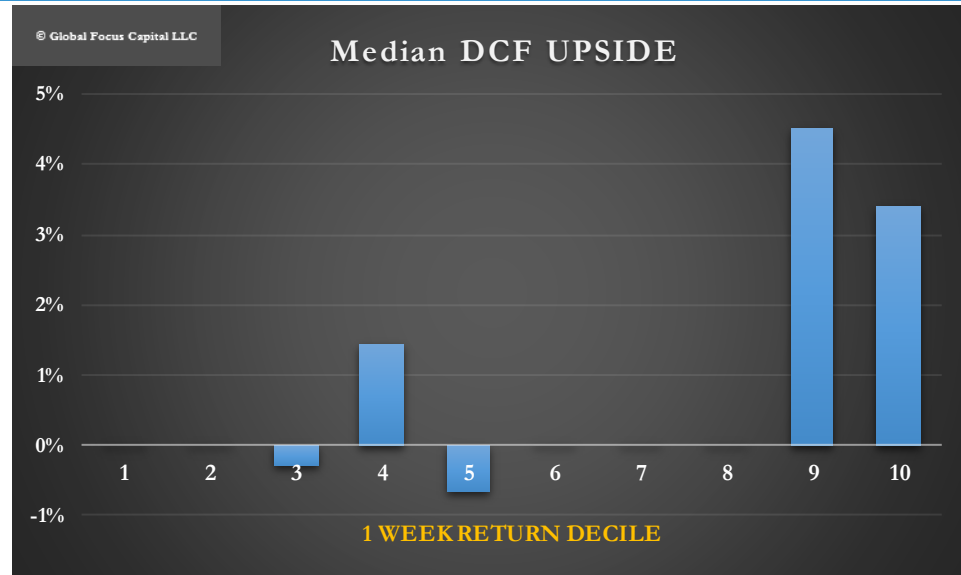
What did the markets reward last week: Valuation Multiples

- ▶ Valuation as a factor had a poor week especially when looking at P/E ratios
- ▶ The best performers over the last 5 days had the highest median P/E
- ▶ We saw a slightly different pattern for P/B – better performers had lower P/B ratios except for Decile 1
- ▶ More expensive stocks continue to do better YTD



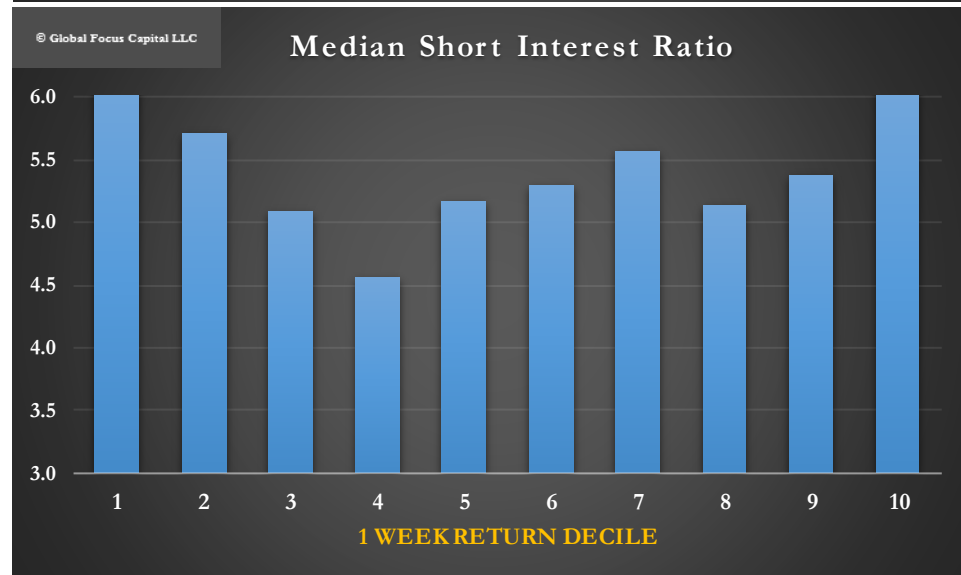
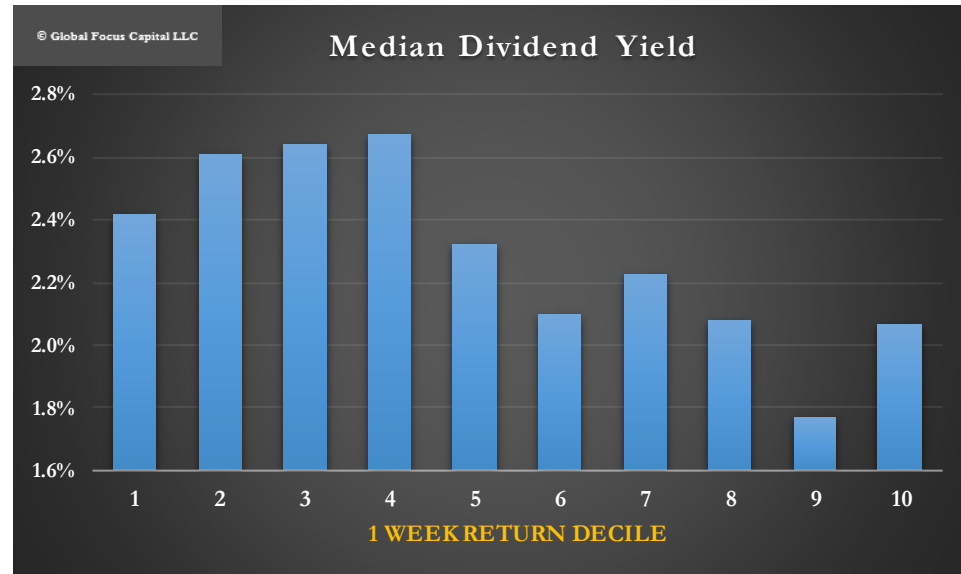
What did the markets reward last week: Valuation Models

- ▶ The median stock in our universe is 2% under-valued according to a DCF valuation
- ▶ The worst performing stocks last week (Decile 10) appeared most under-valued
- ▶ In terms of analyst price targets, there was a perverse relationship
 - ▶ Stocks doing the best had the lowest price targets



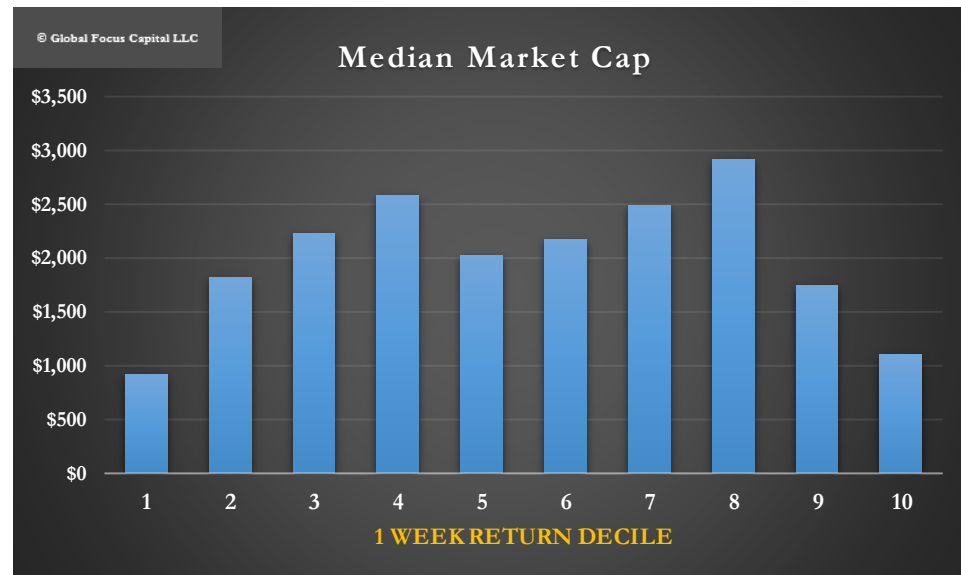
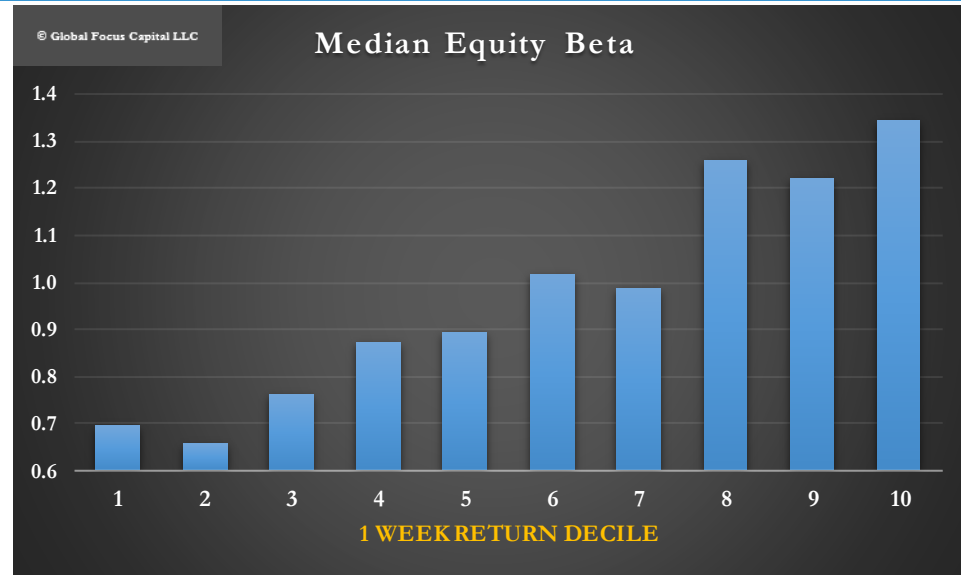
What did the markets reward last week: Yield and Sentiment

- ▶ On an equally weighted basis, dividend yield had a good week
- ▶ The best performing stocks (Deciles 1-4) had above market average yields
- ▶ Short interest, a measure of sentiment, showed a “U” shaped pattern of returns



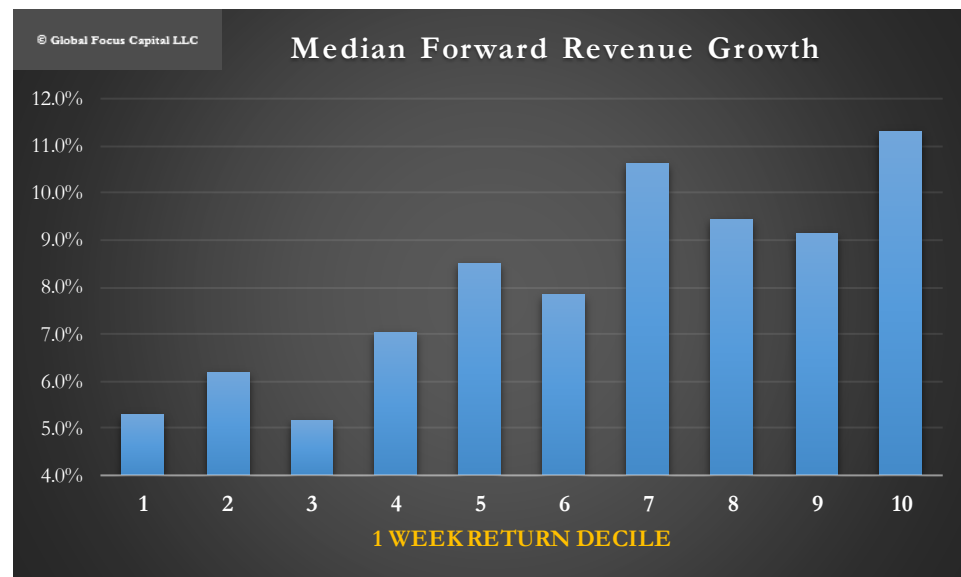
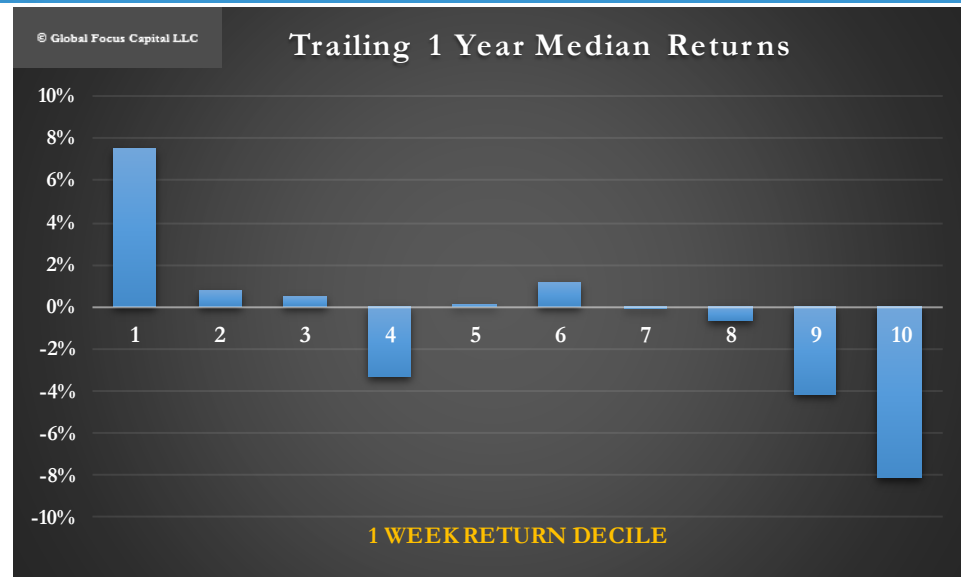
What did the markets reward last week: Beta and Size

- ▶ Beta worked extremely well last week.
- ▶ The lower the beta the better (smaller losses)
- ▶ In terms of market cap over the last week we have seen an inverted V pattern – repeat from previous weeks
- ▶ The Russell 2000 index underperformed the S&P 500 by 1.1% over the last 5 trading days
 - ▶ Over the last 3 months large caps have been soundly beating small caps



What did the markets reward last week: Momentum and Growth

- ▶ The 1 year momentum effect worked last week in a relative sense – past 1 year winners had the highest median weekly performance
- ▶ Winners keep winning, losers keep losing
- ▶ We have seen some faint industry rotation but this past week the whole just fell apart
- ▶ Revenue growth as a factor exhibited a perverse relationship to return – higher growth companies showed the worst performance



Big Movers – Last 5 Days

Down

PNC Financial Services Group	PNC	Financials
Square, Inc.	SQ	Information Technology
PPG Industries, Inc.	PPG	Materials
Continental Resources, Inc	CLR	Energy
Marathon Oil Corporation	MRO	Energy
W.W. Grainger, Inc.	GWV	Industrials
International Paper Company	IP	Materials
Transdigm Group Incorporated	TDG	Industrials
Arista Networks, Inc.	ANET	Information Technology
American Airlines Group, Inc	AAL	Industrials
Celanese Corporation	CE	Materials
Xylem Inc.	XYL	Industrials
United Rentals, Inc.	URI	Industrials
Old Dominion Freight Line	ODFL	Industrials
Westrock Company	WRK	Materials
GrubHub Inc.	GRUB	Information Technology
Huntington Ingalls Industries	HII	Industrials
Packaging Corporation of America	PKG	Materials
Invesco Plc	IVZ	Financials
Cognex Corporation	CGNX	Information Technology

Up

L Brands, Inc.	LB	Consumer Discretionary
Esterline Technologies Company	ESL	Industrials
Imperva, Inc.	IMPV	Information Technology
Revlon, Inc.	REV	Consumer Staples
Corium International, Inc.	CORI	Healthcare
GAIN Capital Holdings, Inc	GCAP	Financials
Gold Resource Corporation	GORO	Materials
Mitek Systems, Inc.	MITK	Information Technology
Axovant Sciences Ltd.	AXON	Healthcare
Calithera Biosciences, Inc.	CALA	Healthcare
IDT Corporation	IDT	Telecommunication Services
Pacific Ethanol, Inc.	PEIX	Energy
Aqua Metals, Inc.	AQMS	Industrials
Fred's, Inc.	FRED	Consumer Discretionary
Quantum Corporation	QTM	Information Technology

This Coming Week

Reporting Soon

Johnson & Johnson	JNJ	Healthcare
Bank of America Corporation	BAC	Financials
UnitedHealth Group Incorporated	UNH	Healthcare
Netflix, Inc.	NFLX	Consumer Discretionary
International Business Machines Corporation	IBM	Information Technology
Philip Morris International Inc.	PM	Consumer Staples
Abbott Laboratories	ABT	Healthcare
PayPal Holdings, Inc.	PYPL	Information Technology
American Express Company	AXP	Financials
U.S. Bancorp	USB	Financials
Goldman Sachs Group, Inc.	GS	Financials
Morgan Stanley	MS	Financials
Danaher Corporation	DHR	Healthcare
BlackRock, Inc.	BLK	Financials
The Charles Schwab Corporation	SCHW	Financials
Intuitive Surgical, Inc.	ISRG	Healthcare
CSX Corporation	CSX	Industrials
Bank Of New York Mellon	BK	Financials
Crown Castle International	CCI	Real Estate
ProLogis, Inc.	PLD	Real Estate
Progressive Corporation (Truist)	PGR	Financials
Kinder Morgan, Inc.	KMI	Energy
BB&T Corporation	BBT	Financials
The Travelers Companies, Inc.	TRV	Financials
Southern Copper Corporation	SCCO	Materials
PPG Industries, Inc.	PPG	Materials
M&T Bank Corporation	MTB	Financials
Northern Trust Corporation	NTRS	Financials
United Continental Holdings	UAL	Industrials
Lam Research Corporation	LRCX	Information Technology

- ▶ Risk Aversion should stay high and we expect choppy markets this coming week
- ▶ Technicals have deteriorated massively – sure looks like a bear market or at least a very serious correction
- ▶ The battle may not be between growth and value – feels more like momentum versus reversal
- ▶ Tariff wars are taking a bite with the IMF recently citing trade wars as the main reason for a cut in their forecast of global growth
- ▶ Small caps have massively under-performed large caps over the last 3 months – risk is being shunned at the moment
 - ▶ Our models still like small caps better
- ▶ Will EM equities recover? Seems to be all about the direction of the US dollar at the moment. Pretty beat up despite stronger fundamentals
- ▶ What form will sanctions take against Saudi Arabia?
 - ▶ Maybe they get a free pass but in any case I would expect the oil market to be materially affected.
- ▶ Q3 reporting starts in the US – looking for commentary on tariffs, slowing growth and inflationary pressures

Contact & Subscription Information

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