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INSIGHT THAT MATTERS

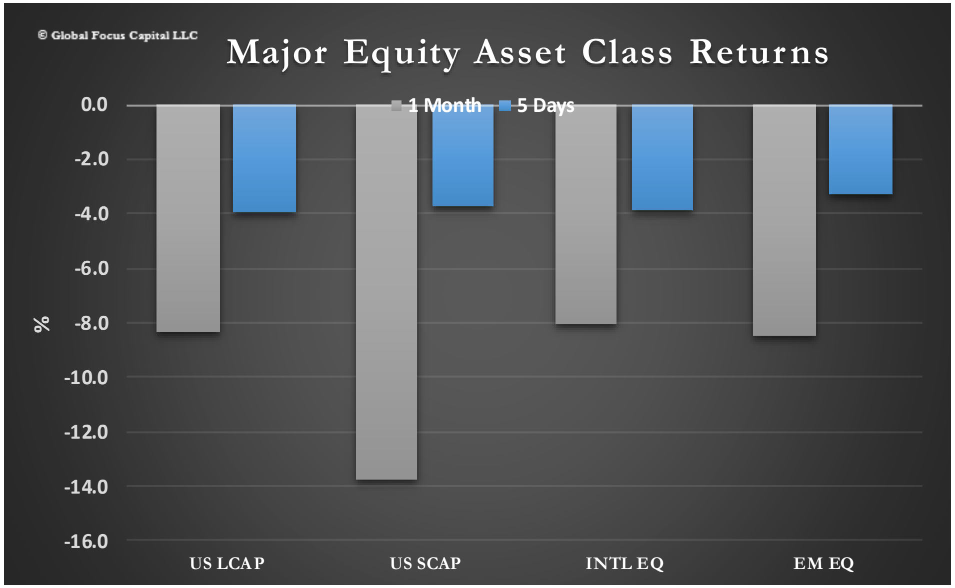
The Equity Observer

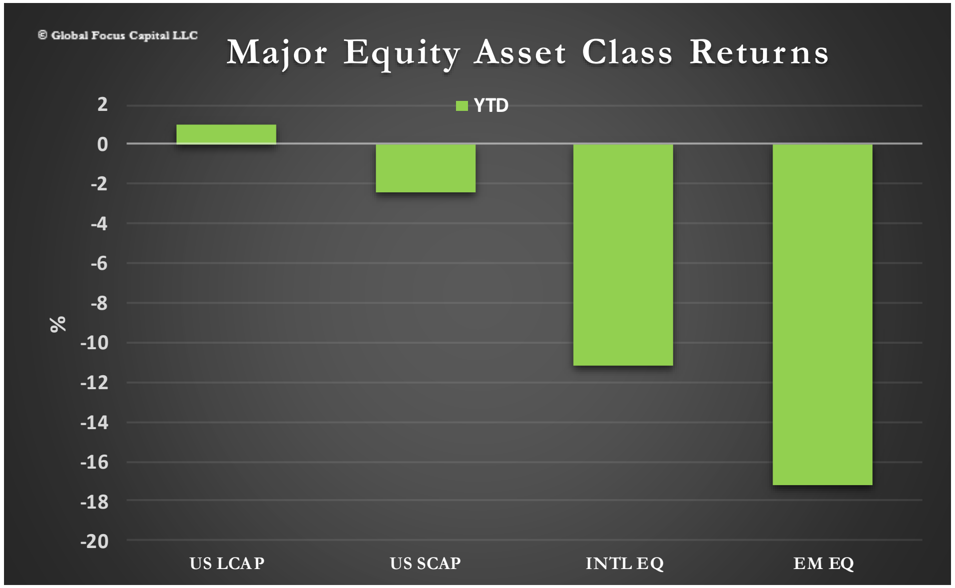
Weekly Review – October 28, 2018

Eric J. Weigel

Equity markets get slammed across the board

- 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 due to an escalation of tariffs
- EM Equities have taken a real beating this year down over 17%
- YTD only US Large Cap are in positive territory
  - The S&P 500 is up 1% for the year





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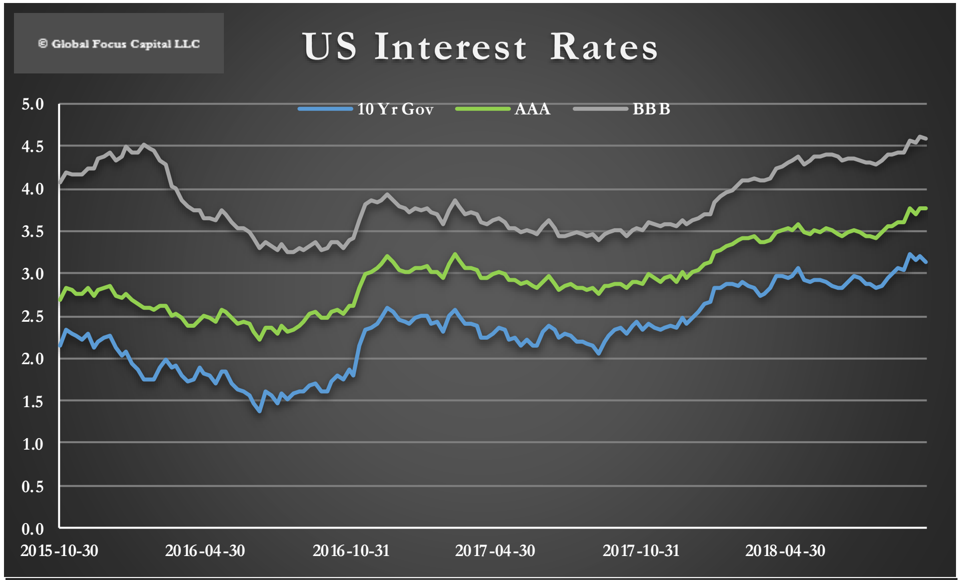
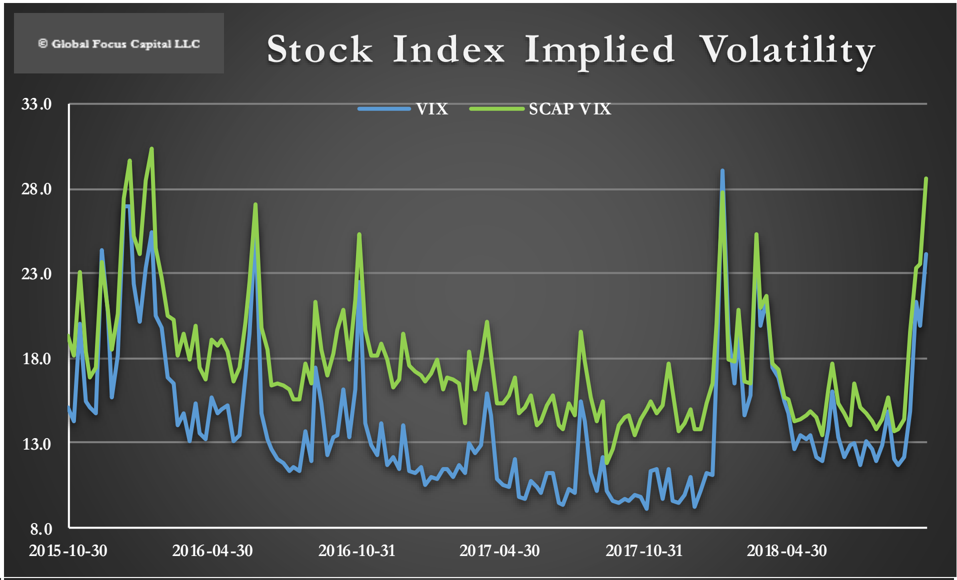
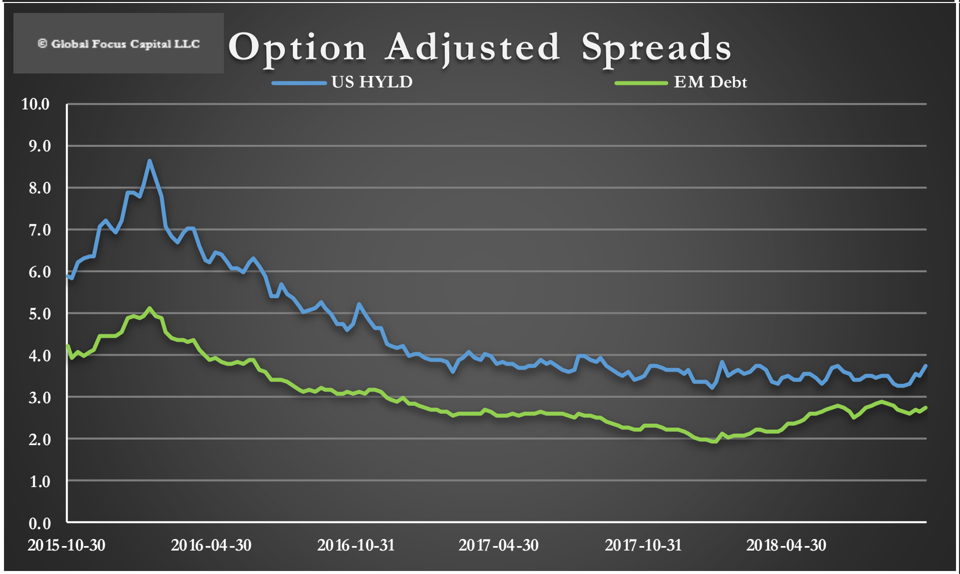
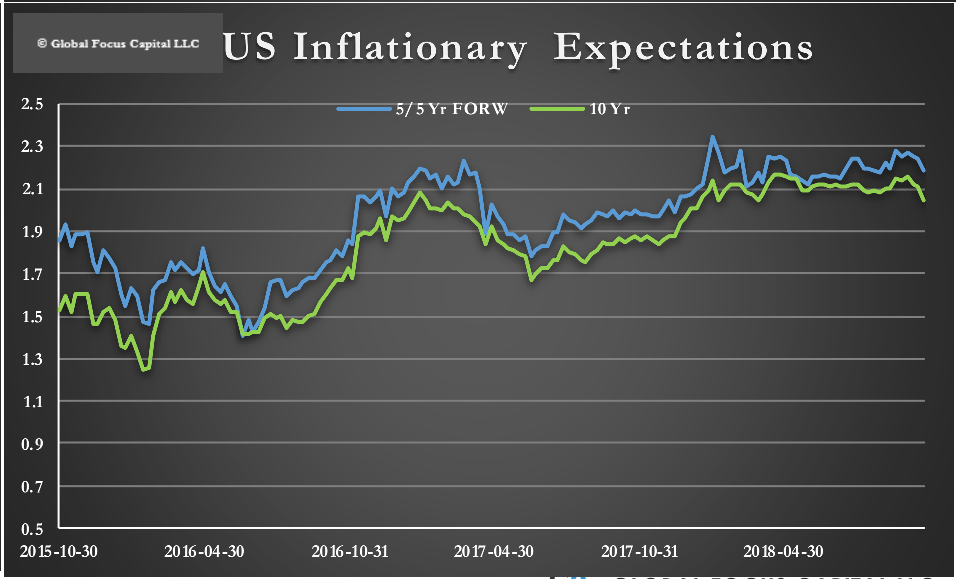
Big Jump in Vol but Macro Picture Remains Supportive but does not yet factor in the effect of tariffs



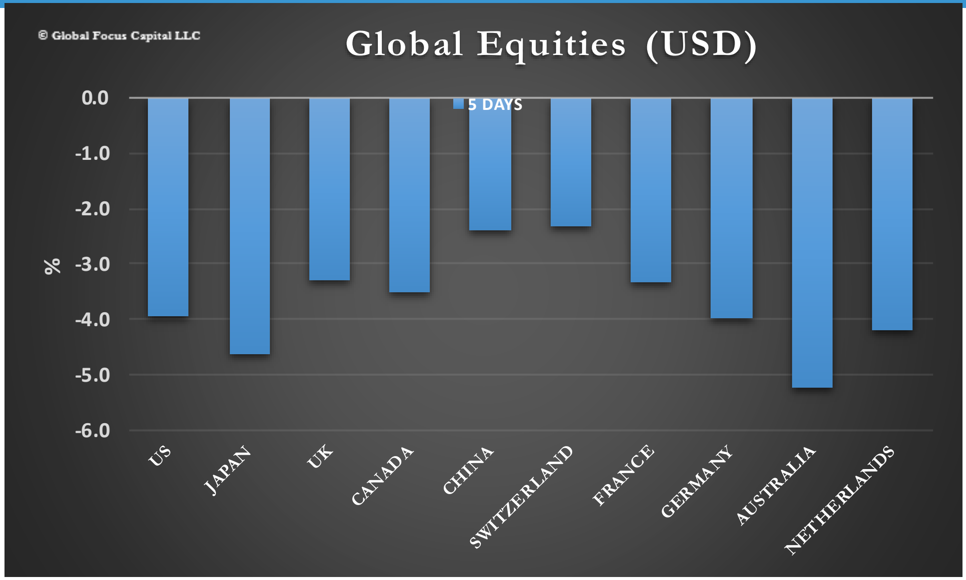


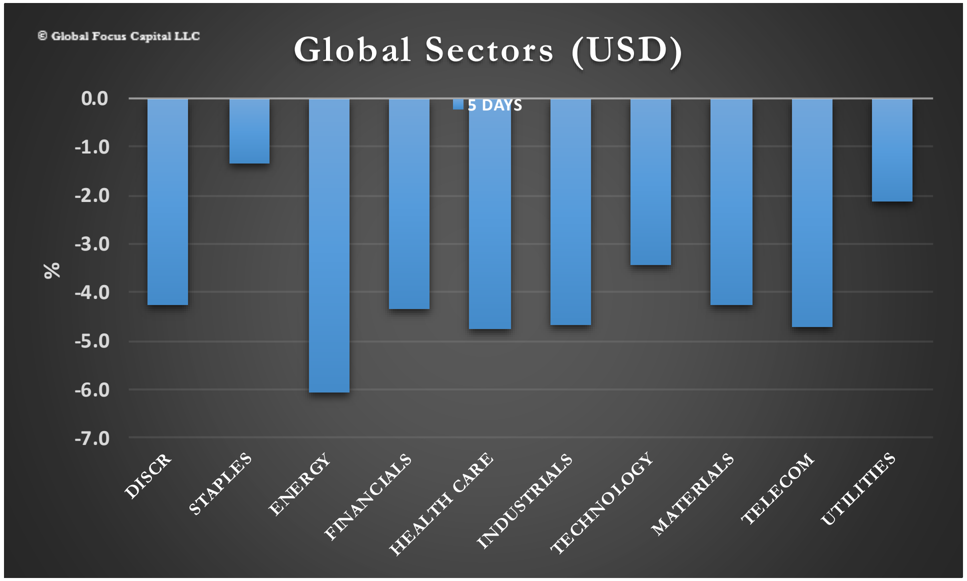




Global Equities

- Carnage all over the place – a global retreat from risky assets
- Equities vastly under-performed bonds last week despite generally higher global interest rates and decent growth
- In the US Growth out-performed Value over the last 5 trading by over 40 bp
- Traditional Value sectors such as Energy, Industrials and Telecom did not provide any downside protection
- Utilities and Staples, two traditional low beta sectors lost the least





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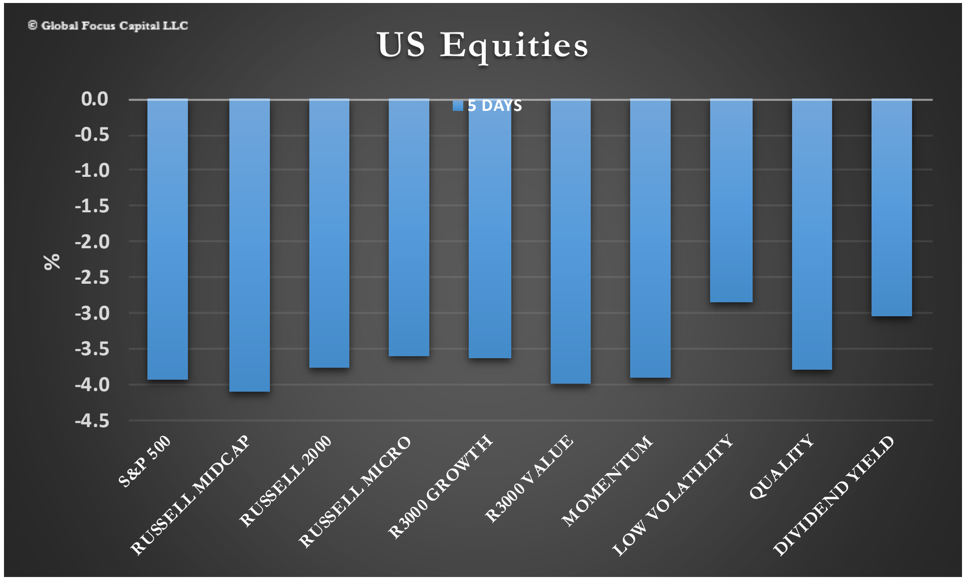
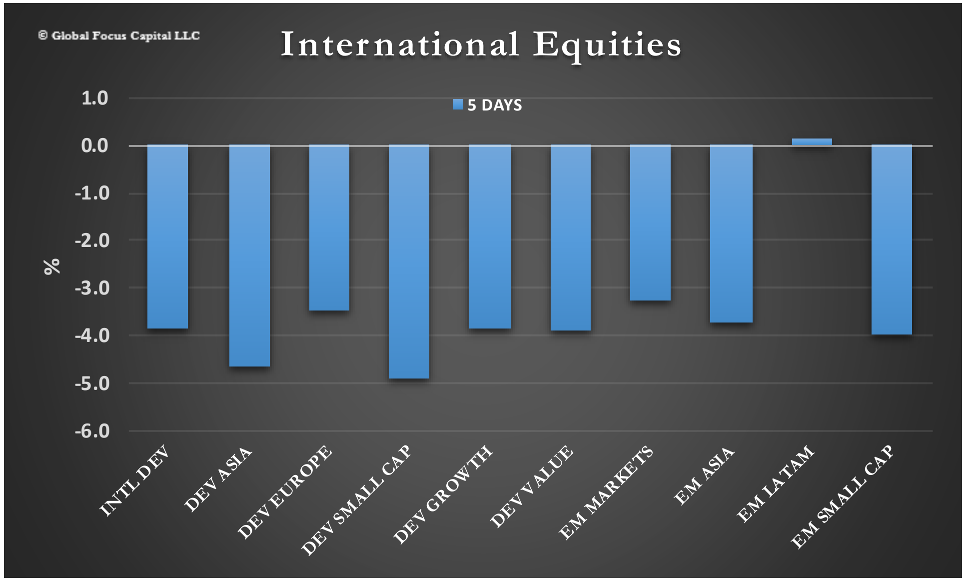
Style and Geography

- In the US, mega-caps underperformed small caps by 10 bp last week
- Value once again under-performed Growth as the Energy and Telecom sectors provided a huge drag
- Growth and Momentum keep dominating YTD among US stocks but the lead is shrinking
- Developed international markets performed in line with US markets but lag significantly YTD
- EM LATAM recovered last week driven by Brazilian election results favoring a pro-business candidate





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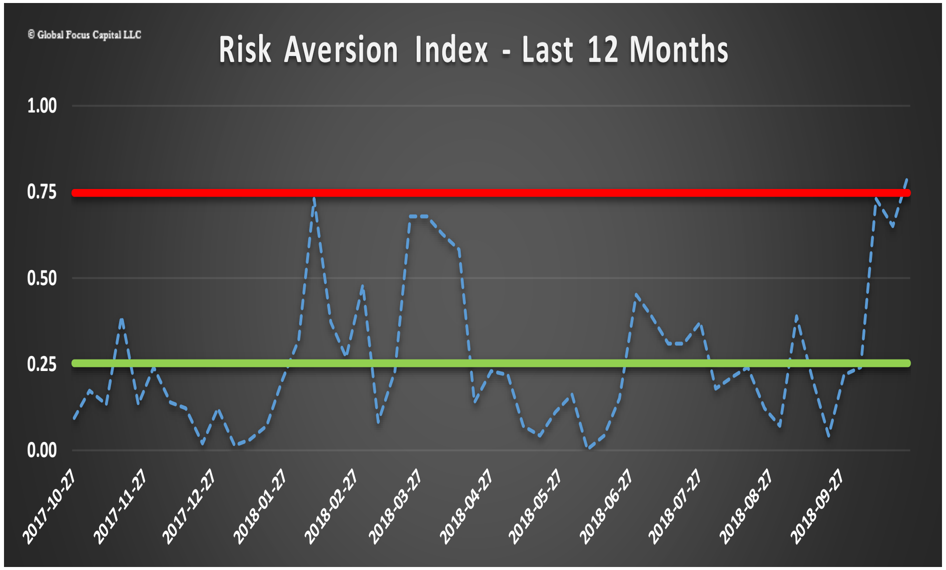
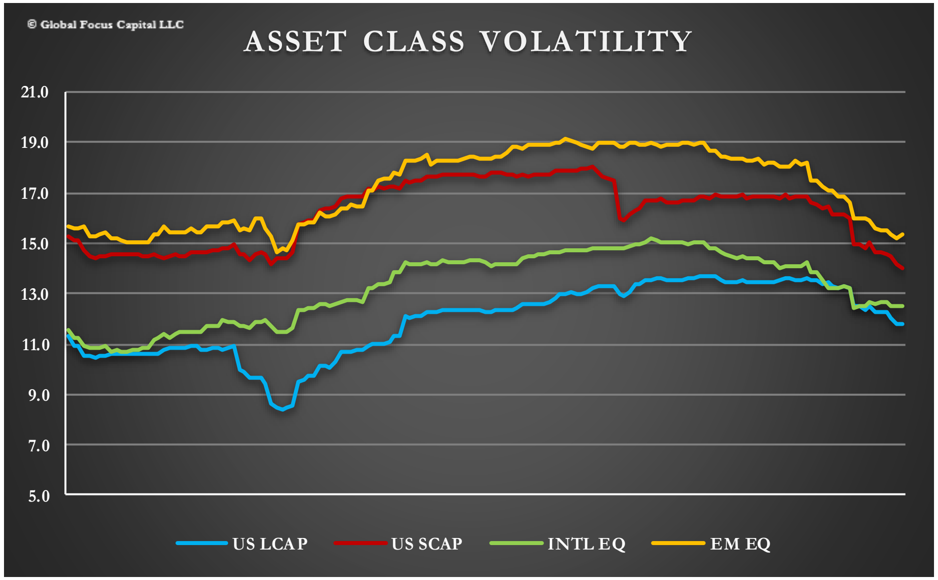
Investor Risk Aversion jumped last week to the top of the Fearful Zone

- Investors woke up to capital market risk last week
- Our risk aversion index jumped from the Normal Zone to the bottom of the Fearful 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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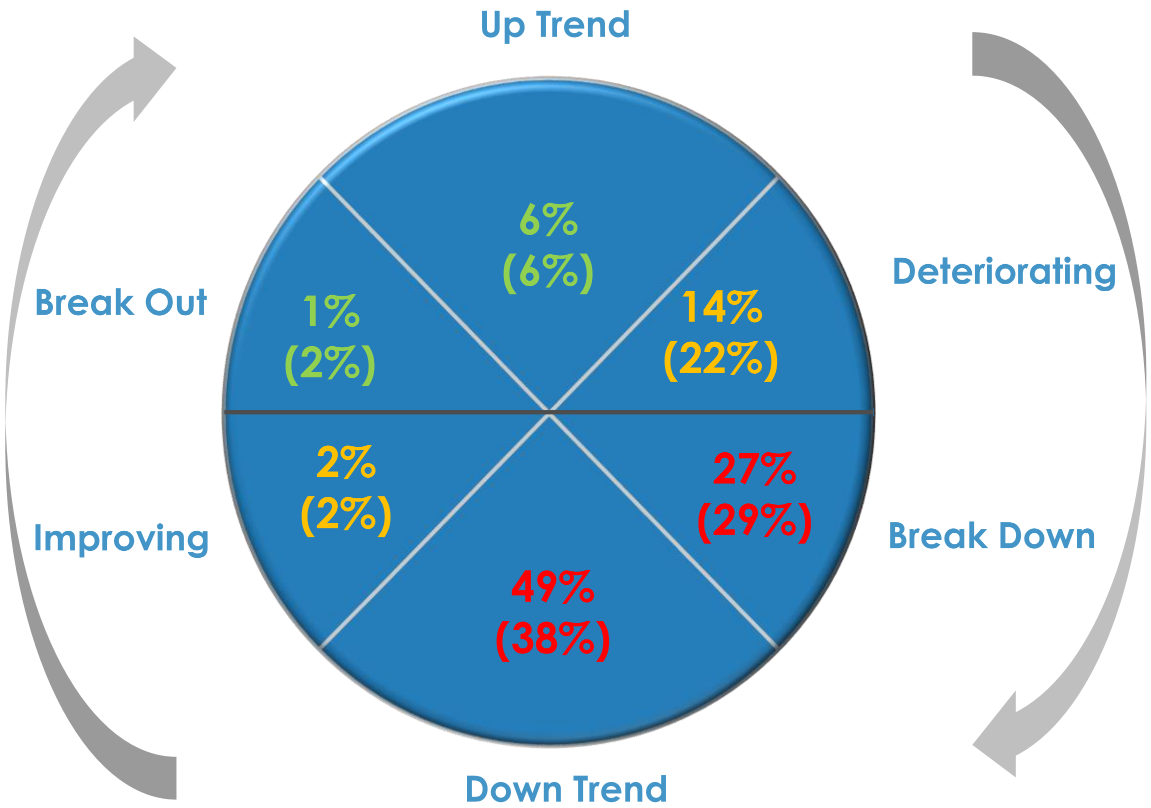
US Equities

Weekly Performance

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

Numbers in parenthesis correspond to last month

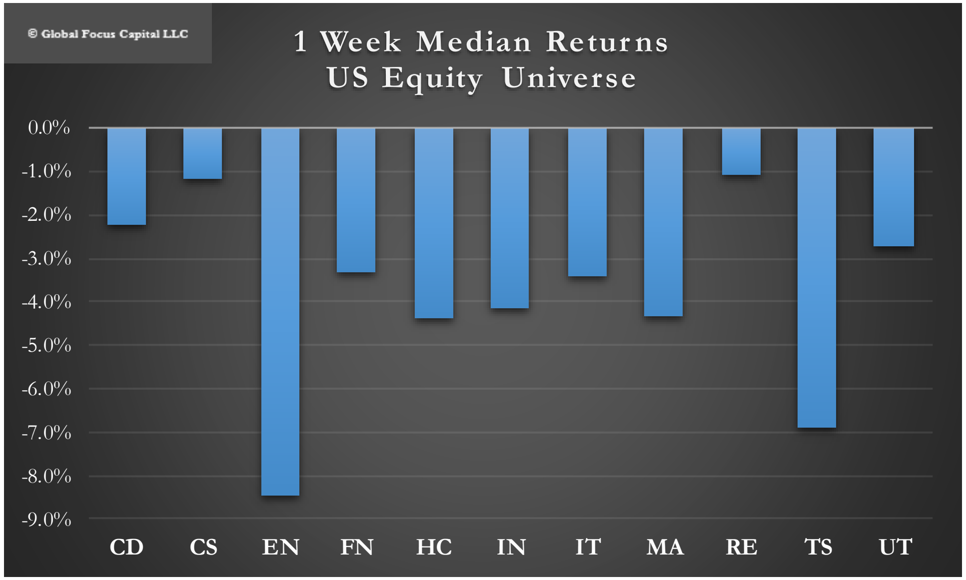


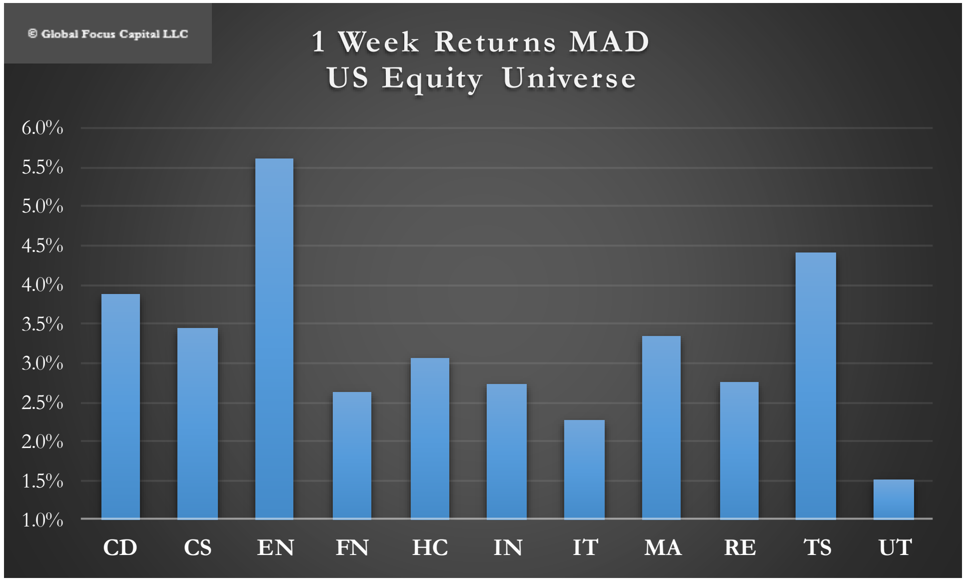
STAGE	LATEST
UP TREND	6.09%
BREAK OUT	0.86%
IMPROVING	2.20%
DOWN TREND	48.99%
BREAK DOWN	27.17%
DETERIORATING	14.39%

GF CAP US All Equity Universe

The Sector Look – median performance and dispersion

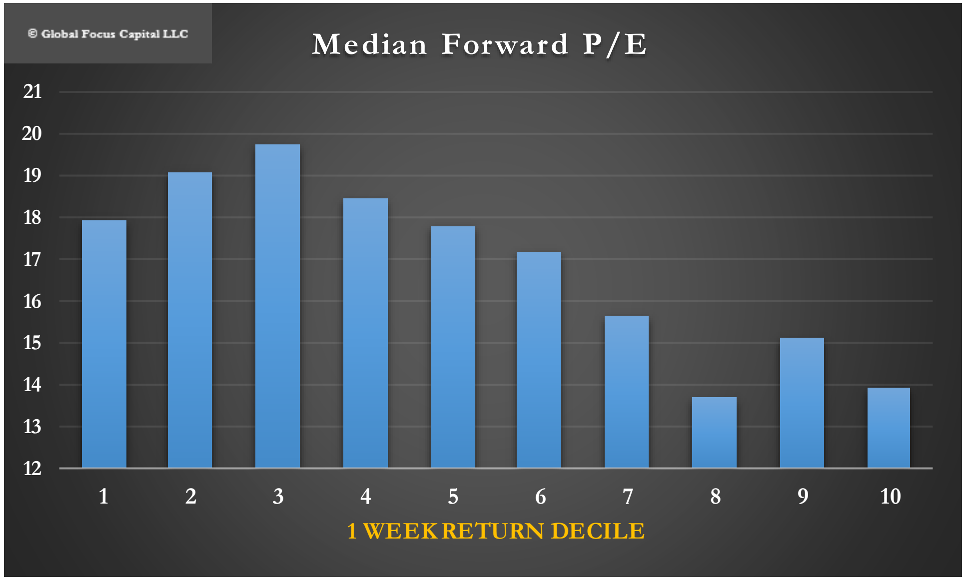
- The mean stock in our universe fell 3.8% over the last 5 trading days
- The smallest losses were seen among consumer discretionary and real estate companies
- Energy and Telecom stocks took the biggest hits last week
- The widest variability in performance was seen in the Energy – good for stock picking
- Utilities showed the most homogeneity in stock price action
- We use the median absolute deviation as a robust measure of within sector variability

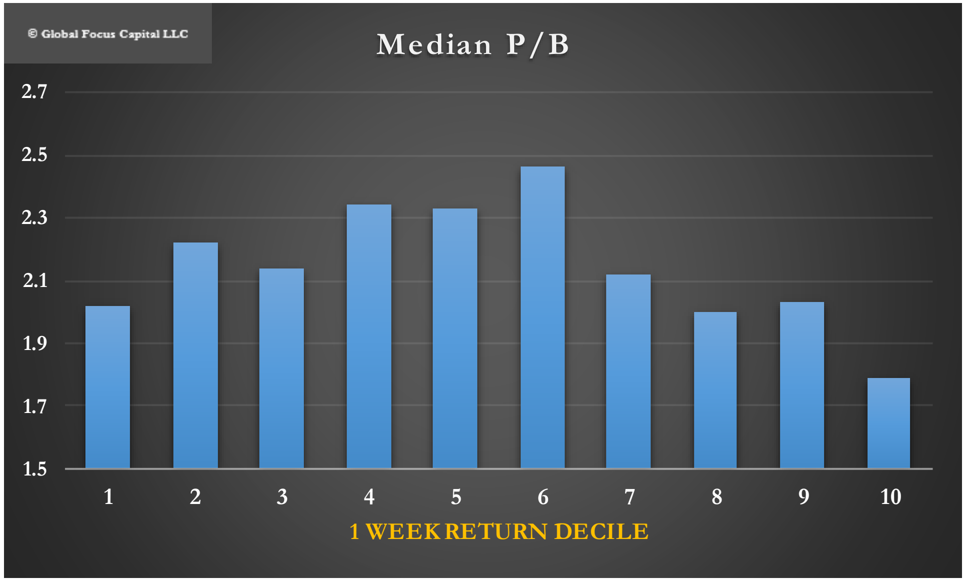




What did the markets reward last week: Valuation Multiples

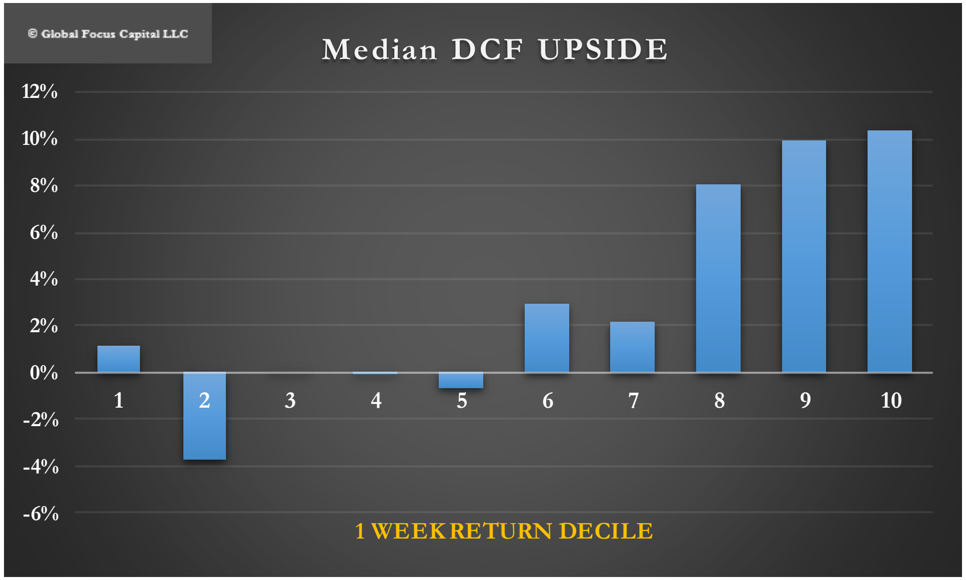
- Valuation as a factor had a poor week especially when looking at P/E ratios
- The best performers over the last 5 days had the higher than average P/E's
- We saw a slightly different pattern for P/B – better performers had slightly higher P/B ratios
- More expensive growth stocks continue to do better YTD

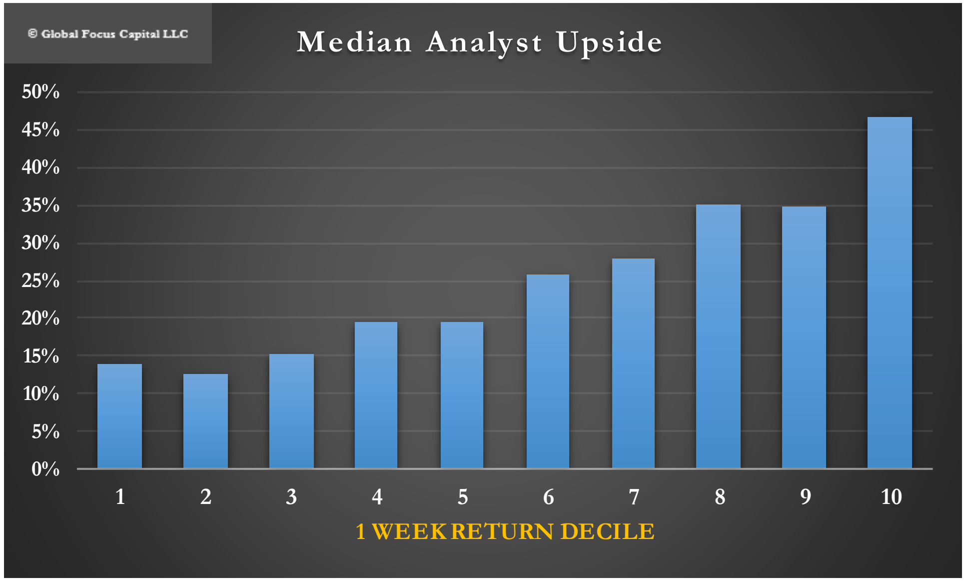




What did the markets reward last week: Valuation Models

- The median stock in our universe is 3% 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





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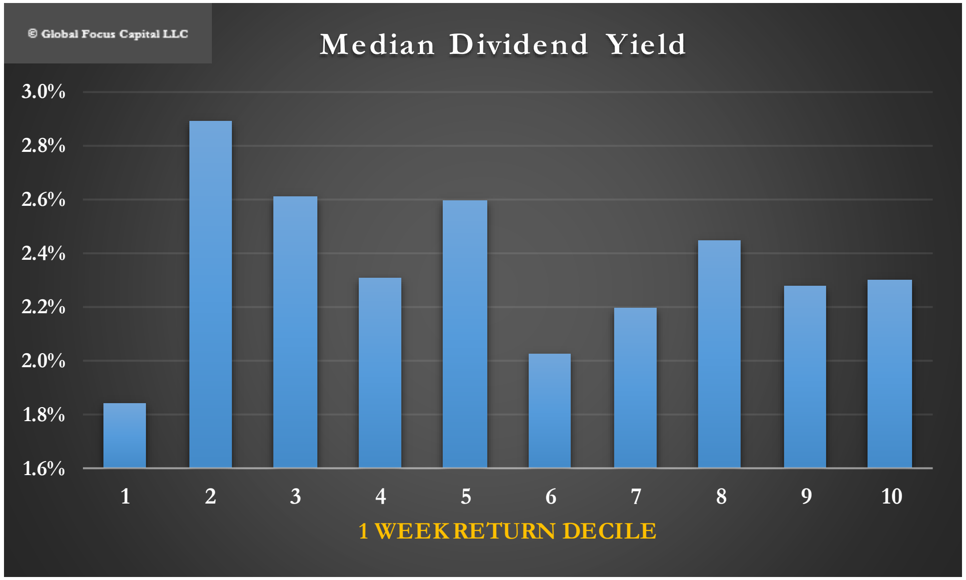
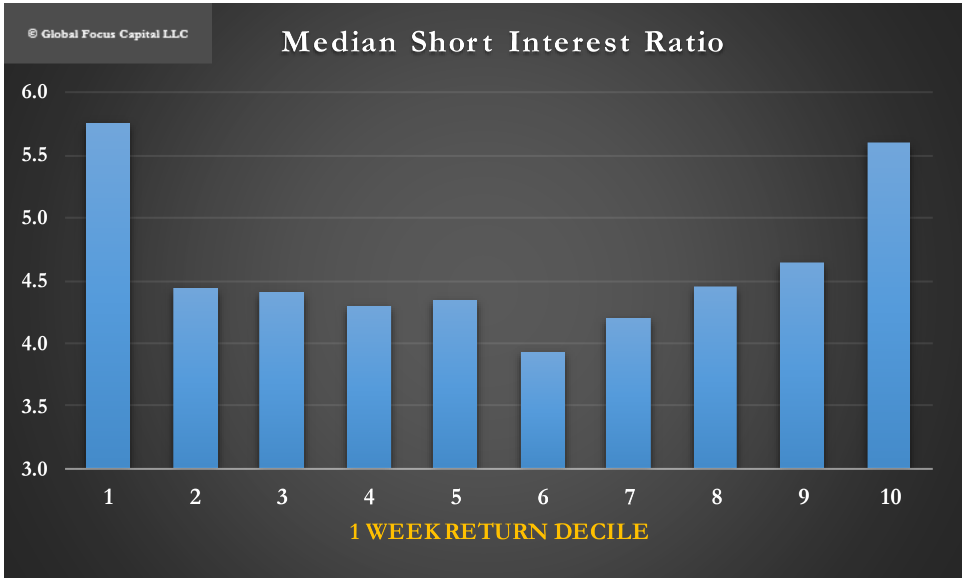
What did the markets reward last week: Yield and Sentiment

- On an equally weighted basis, dividend yield had a decent week
- The best performing stocks had lower than average yields but Deciles 2-5 had significantly higher yields
- Short interest, a measure of sentiment, showed a "U" shaped pattern of returns





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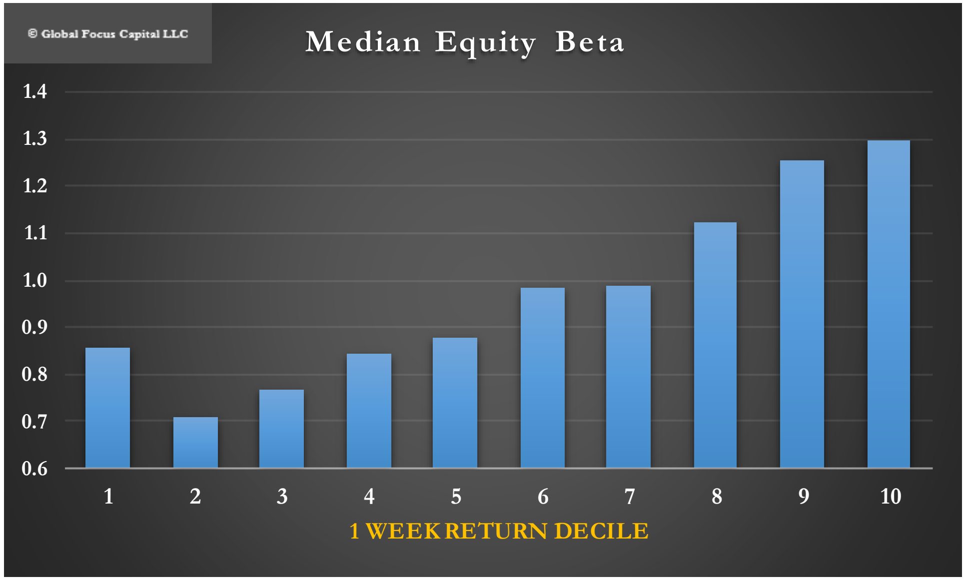
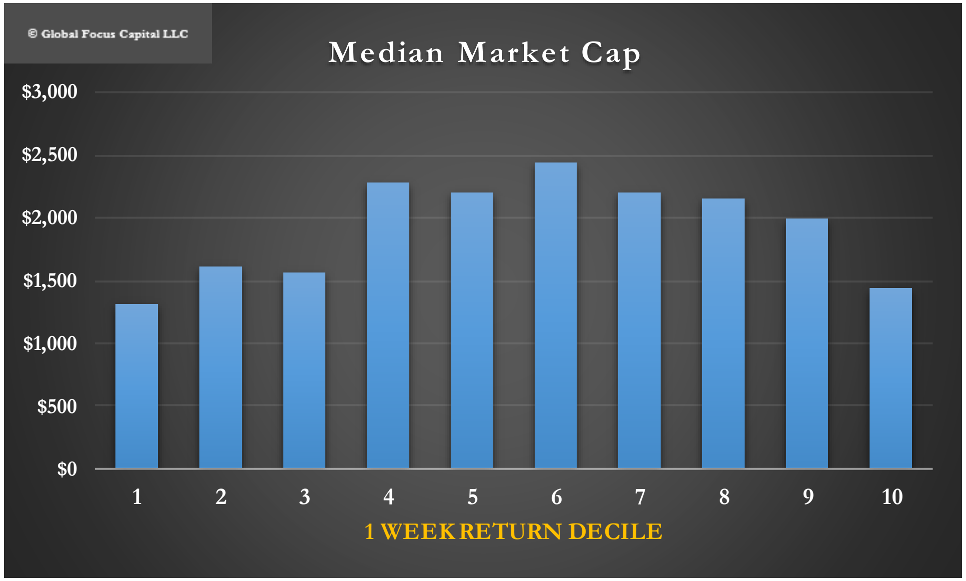
What did the markets reward last week: Beta and Size

- 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

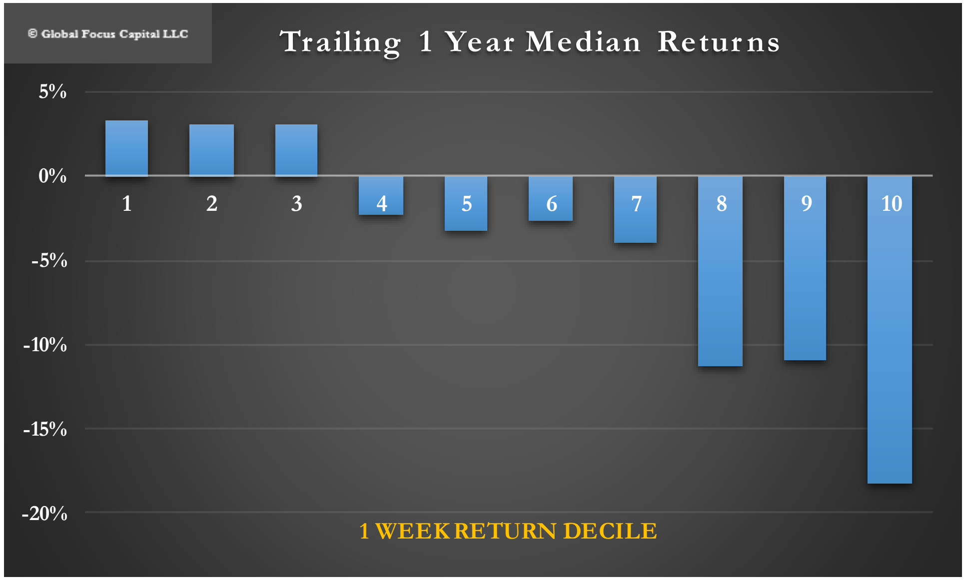


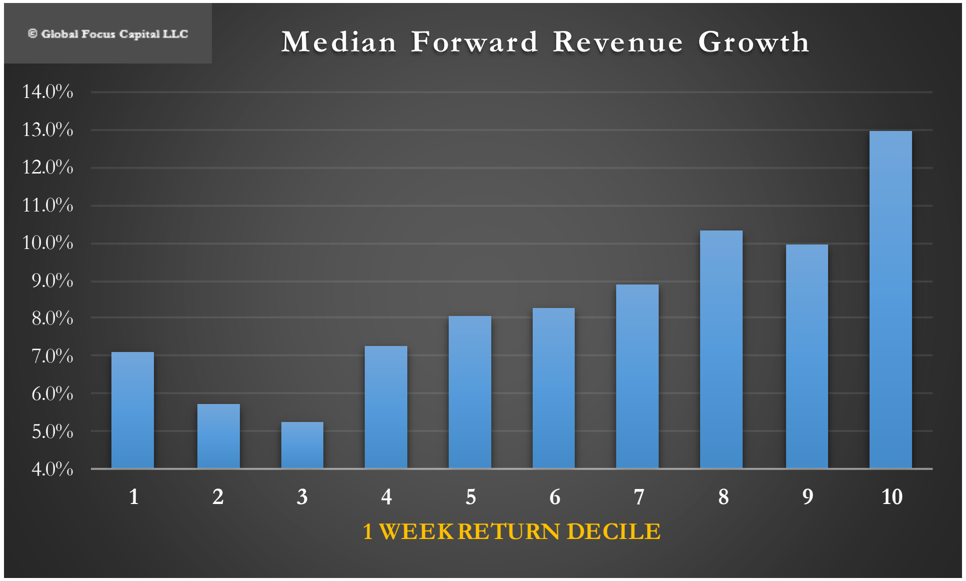
- The Russell 2000 index outperformed the S&P 500 by 0.1% over the last 5 trading days
  - Over the last 3 months large caps have, however, been soundly beating small caps



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
- The industry rotation that started about 6 weeks ago is gaining strength
- Revenue growth as a factor exhibited a perverse relationship to return – higher growth companies showed the worst performance





Big Movers – Last 5 Days

Down

AT&T Inc.	T	Telecommunication Service
NVIDIA Corporation	NVDA	Information Technology
General Electric Company	GE	Industrials
Caterpillar, Inc.	CAT	Industrials
Celgene Corporation	CELG	Healthcare
General Dynamics Corpora	GD	Industrials
Northrop Grumman Corpo	NOC	Industrials
Micron Technology, Inc.	MU	Information Technology
American International Gro	AIG	Financials
Regeneron Pharmaceuticals	REGN	Healthcare
Anadarko Petroleum Corpo	APC	Energy
Moody's Corporation	MCO	Financials
Southwest Airlines Compar	LUV	Industrials
Centene Corporation	CNC	Healthcare
Pioneer Natural Resources	PXD	Energy
Discover Financial Services	DFS	Financials
McKesson Corporation	MCK	Healthcare
CenturyLink, Inc.	CTL	Telecommunication Service
Royal Caribbean Cruises Lt	RCL	Consumer Discretionary
DXC Technology Company	DXC	Information Technology

Up

Tesla Motors, Inc.	TSLA	Consumer Discretionary
Twitter, Inc.	TWTR	Information Technology
Cadence Design Systems, I	CDNS	Information Technology
PulteGroup, Inc.	PHM	Consumer Discretionary
National Instruments Corp	NATI	Information Technology
Morningstar, Inc.	MORN	Financials
Monro Muffler Brake, Inc.	MNRO	Consumer Discretionary
Dorman Products, Inc.	DORM	Consumer Discretionary
Lithia Motors, Inc.	LAD	Consumer Discretionary
Tupperware Brands Corpo	TUP	Consumer Discretionary
Granite Construction Incor	GVA	Industrials
SPS Commerce, Inc.	SPSC	Information Technology
Meritage Homes Corporati	MTH	Consumer Discretionary
Revlon, Inc.	REV	Consumer Staples
NeoGenomics, Inc.	NEO	Healthcare
Asbury Automotive Group I	ABG	Consumer Discretionary
American Railcar Industries	ARII	Industrials
Abercrombie & Fitch Comp	ANF	Consumer Discretionary
ATN International, Inc.	ATNI	Telecommunication Service
Endurance International Gr	EIGI	Information Technology

This Coming Week

Reporting Soon

Apple Inc.	AAPL	Information Technology
Facebook, Inc.	FB	Information Technology
Pfizer, Inc.	PFE	Healthcare
Mastercard Incorporated	MA	Information Technology
Coca-Cola Company (The)	KO	Consumer Staples
Amgen Inc.	AMGN	Healthcare
General Electric Company	GE	Industrials
Starbucks Corporation	SBUX	Consumer Discretionary
Anthem, Inc.	ANTM	Healthcare
The Kraft Heinz Company	KHC	Consumer Staples
American Tower Corporati	AMT	Real Estate
Aetna Inc.	AET	Healthcare
EOG Resources, Inc.	EOG	Energy
Allergan plc.	AGN	Healthcare
Automatic Data Processing	ADP	Information Technology
Mondelez International, In	MDLZ	Consumer Staples
T-Mobile US, Inc.	TMUS	Telecommunication Service
Express Scripts Holding C	ESRX	Healthcare
Cigna Corporation	CI	Healthcare
Marathon Petroleum Corpo	MPC	Energy
Dominion Resources, Inc.	D	Utilities
The EstÃ©e Lauder Comp	EL	Consumer Staples
General Motors Company	GM	Consumer Discretionary
HCA Holdings, Inc.	HCA	Healthcare
Ecolab Inc.	ECL	Materials
Zoetis Inc.	ZTS	Healthcare
Intercontinental Exchange	ICE	Financials
Exelon Corporation	EXC	Utilities
Cognizant Technology Solu	CTSH	Information Technology
MetLife, Inc.	MET	Financials

- Risk Aversion should stay high and we expect choppy markets this coming week again
- Technicals have deteriorated massively – sure looks like a bear market or at least a very serious correction
- We are starting to see oversold conditions but our RAI needs to remain another week in the Fearful Zone to act
- 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 is heavy in the US – looking for commentary on tariffs, slowing growth and inflationary pressures

Contact & Subscription Information

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