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INSIGHT THAT MATTERS

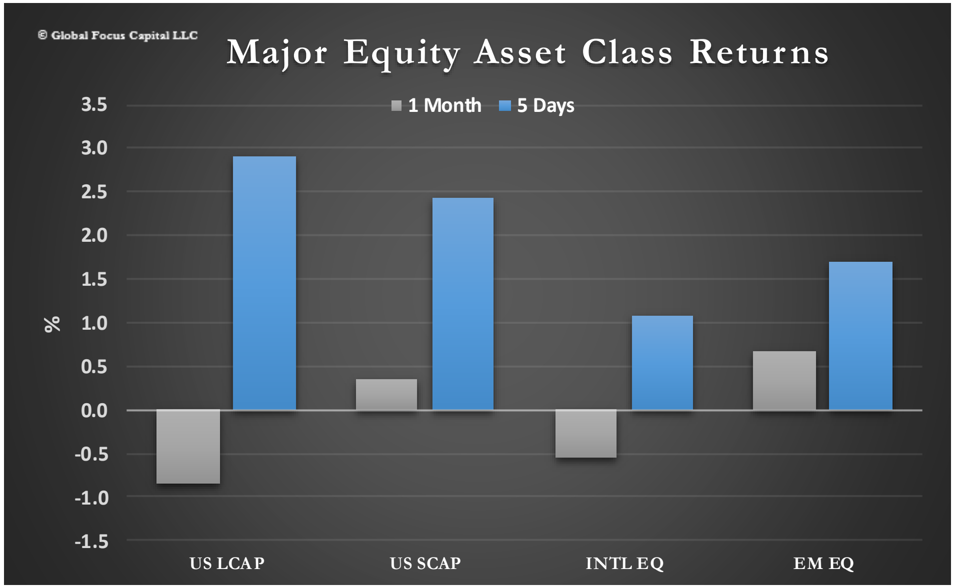
The Equity Observer

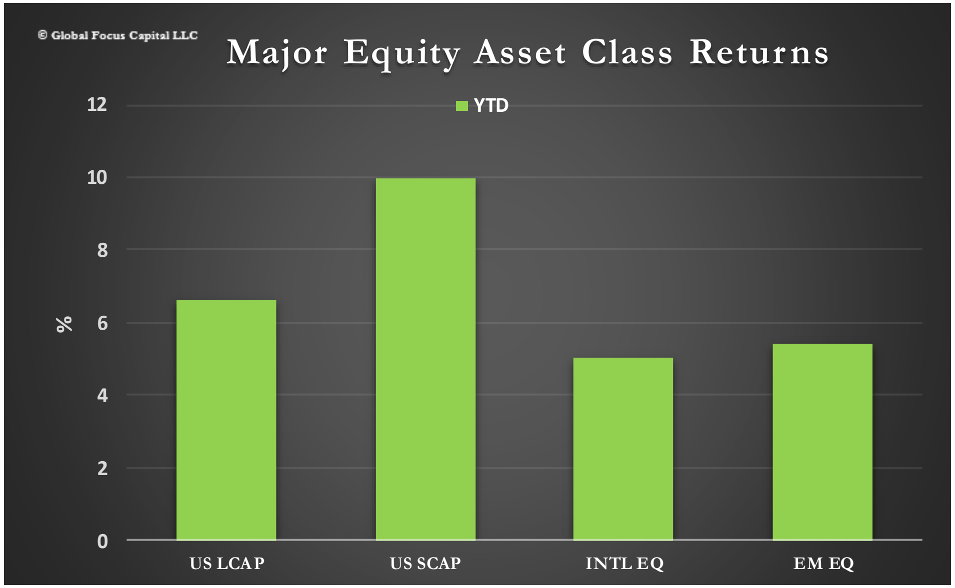
Weekly Review – January 20, 2019

Eric J. Weigel

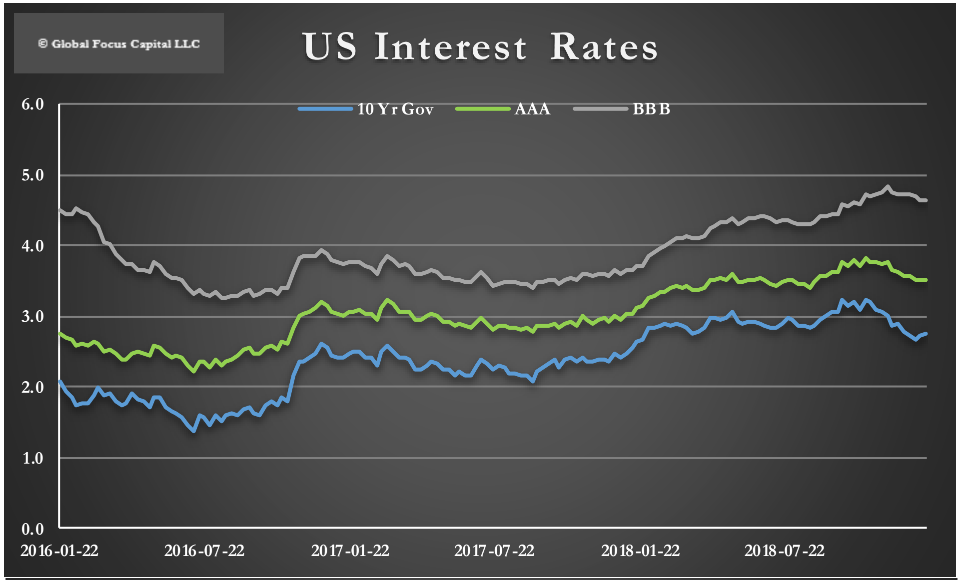
Equity markets have a great start to the year

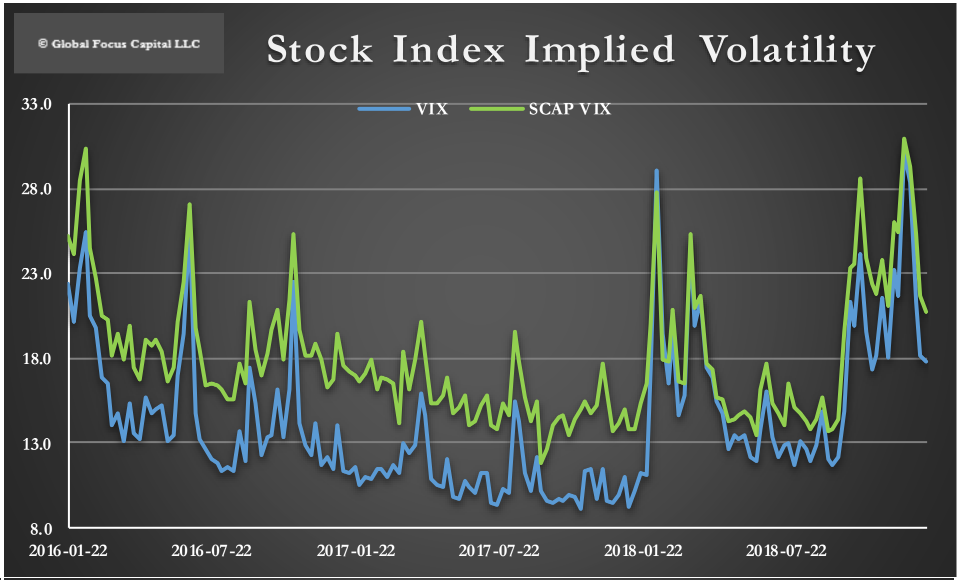
- The seesaw continues for risky assets as small caps take the lead for 2019
- Over the last month, US small caps and EM stocks have made money
- Over the last 12 months all major equity asset classes are down with US Large Cap the least and EM the most
- Valuations while more reasonable than 3 months ago are not yet favorable – we may be seeing a reversal from the q4 downdraft, not a fundamental uptrend
- The key for equity markets is global growth and whether we are entering a slowdown or not

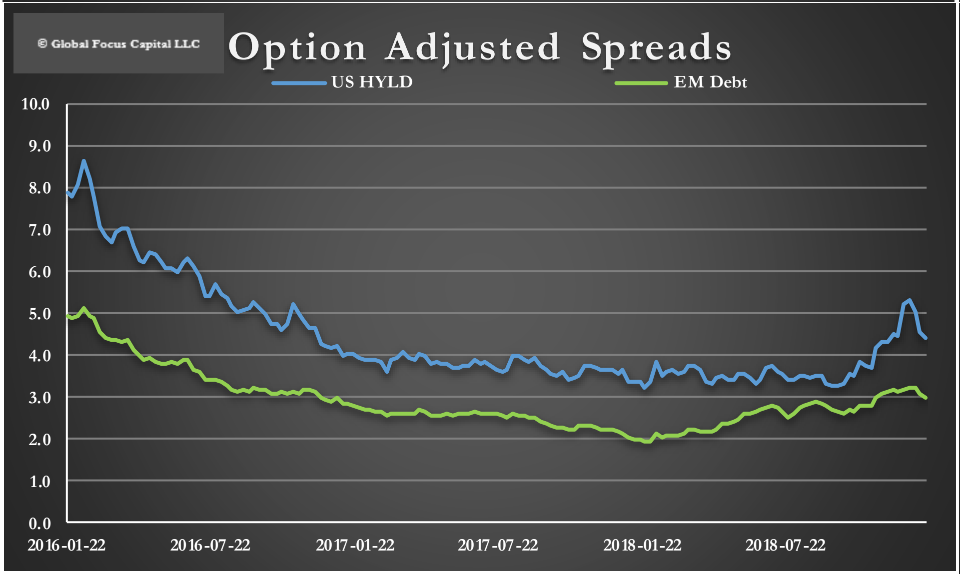


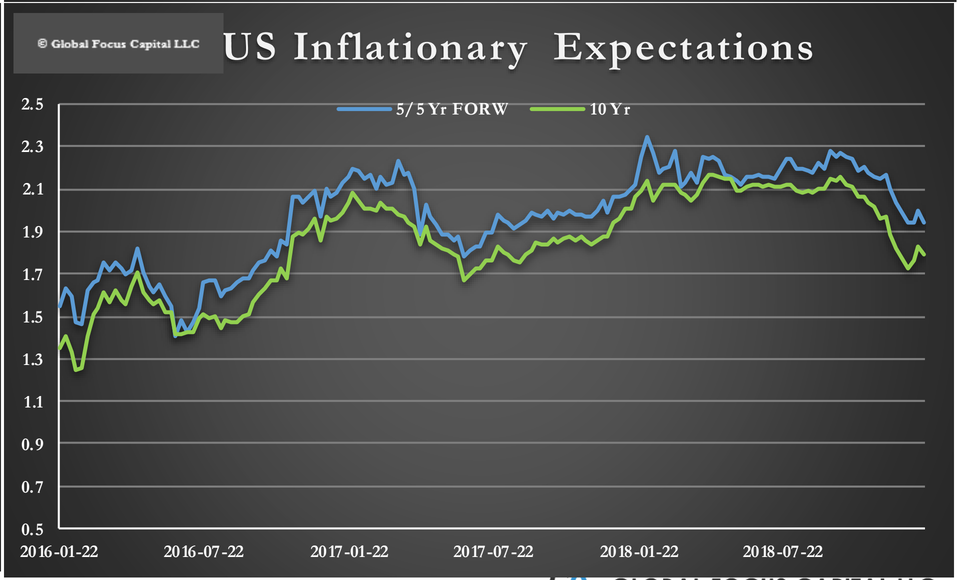


Equity volatility comes down while yield spreads continue narrowing, inflationary expectations trend down









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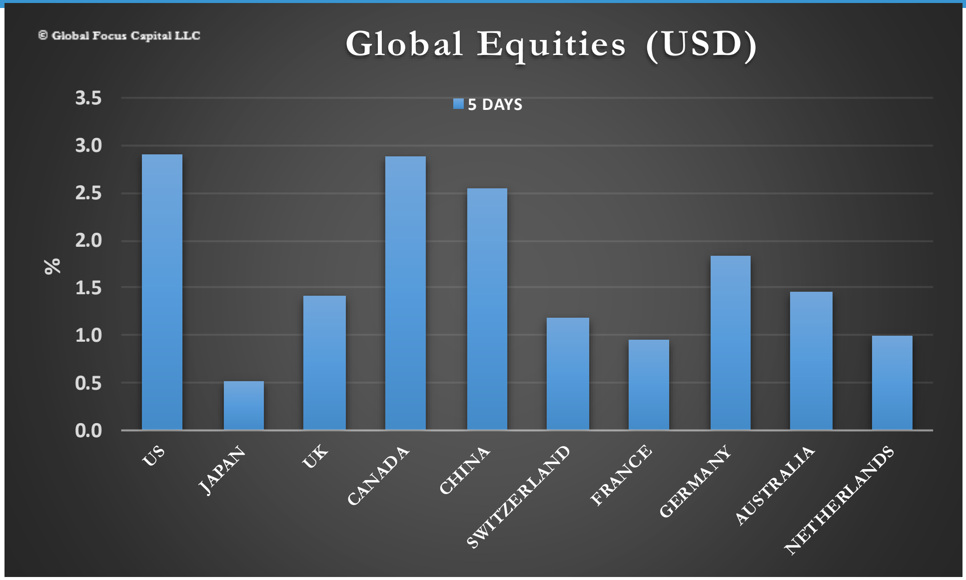
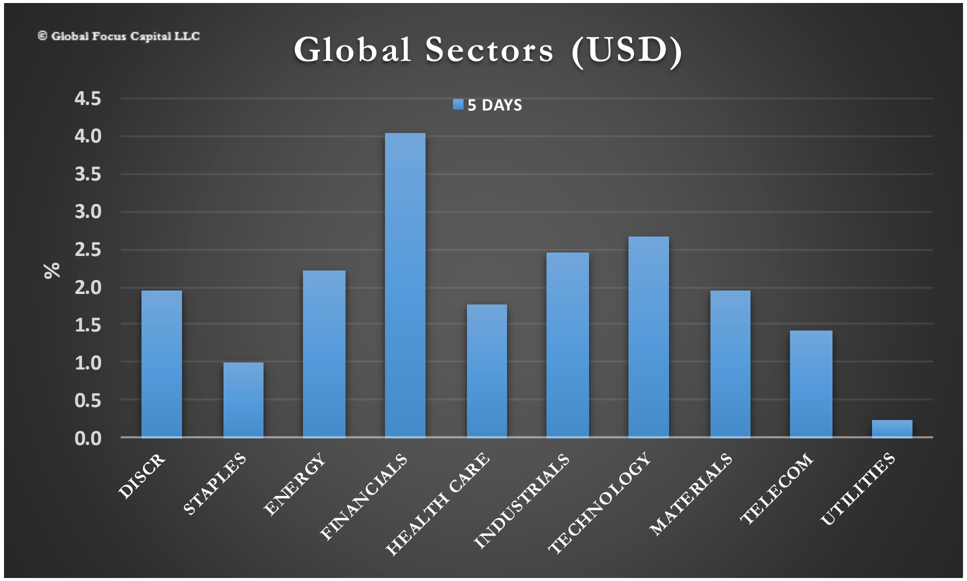
Global Equities

- A global recovery but with large differences in global market performance
- Commodity indices continue their recovery as oil prices firmed up helping resource oriented markets
- In the US Value outperformed Growth last week – higher dividend yield underperformed but the sector effect was dominant as was the quality factor
- In international markets Value out-performed Growth by a smaller margin than in the US
- Financials performed best and Utilities did the worst (barely positive)





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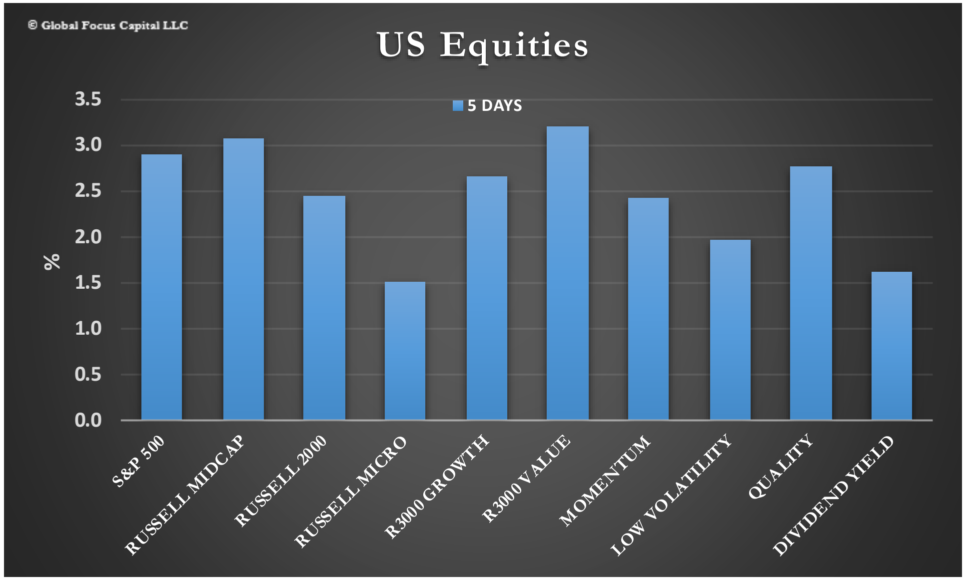
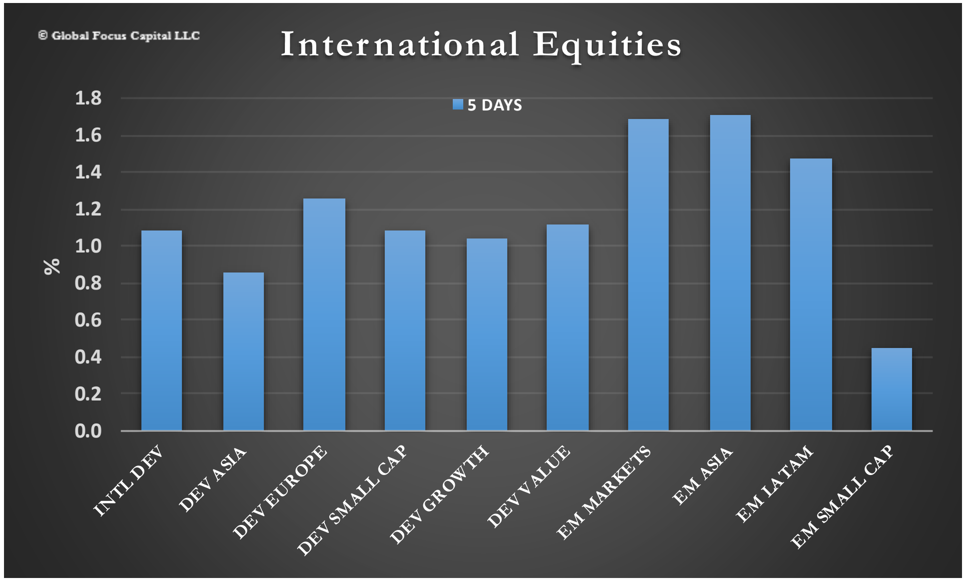
Style and Geography

- In the US, we saw Midcaps do best followed by large caps
- Value performed a bit better than Growth
- Within equity styles, Quality strategies resulted in better performance
- The Momentum trade has made a bit of a comeback in 2019 but the effect is still uncertain
- EM Asia and Latam shot up last week recovering from poor 2018 performance





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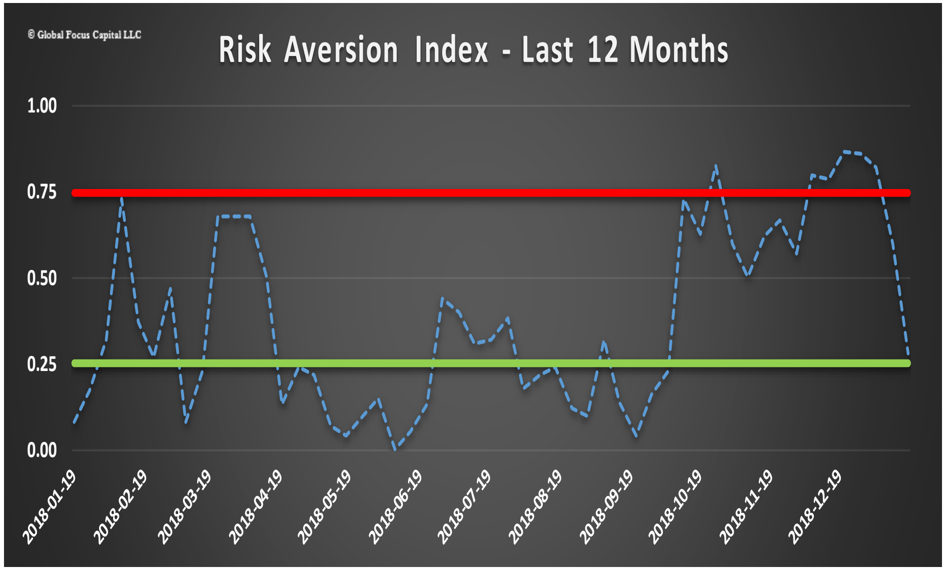
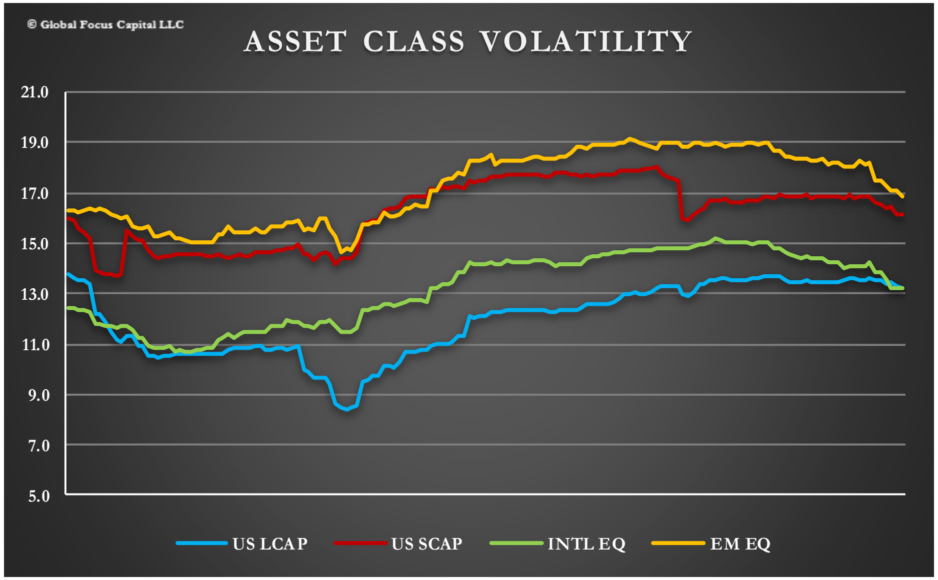
Investor Risk Aversion drops dramatically but stays in the Normal Zone

- Investors seem to be in risk-on mode again
- Our risk aversion index dropped precipitously last week as risky assets have sprinted ahead
- Asset class volatility has risen significantly from the lows of 2017 – in our view volatility is here to stay
- We still see a huge disconnect between volatility, valuations and economic conditions
  - Global growth is still good but leveling off, valuations are high and economic policy is highly uncertain





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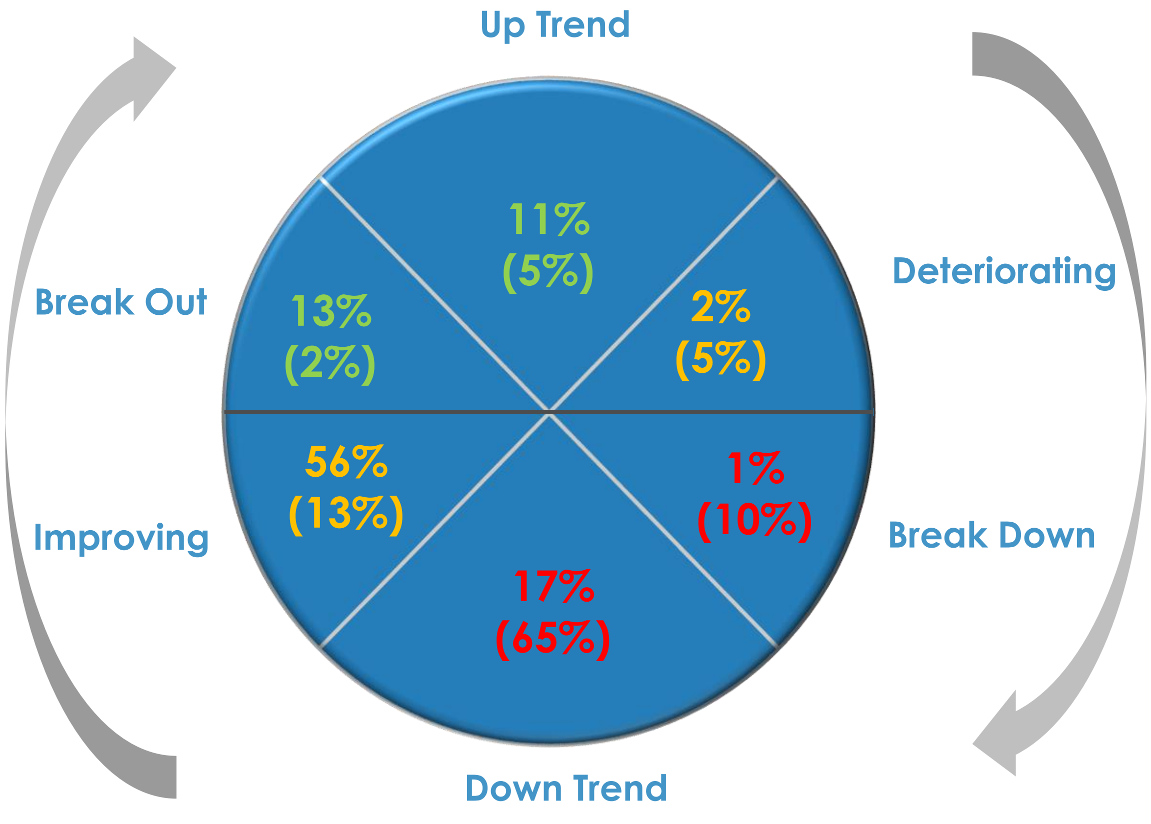
US Equities

Weekly Performance

Maybe the Bear Market is not here after all. We have seen a huge improvement in the technical thus far this year



Numbers in parenthesis correspond to last week

STAGE	LATEST
UP TREND	10.93%
BREAK OUT	13.24%
IMPROVING	55.79%
DOWN TREND	16.58%
BREAK DOWN	1.40%
DETERIORATING	2.05%

GF CAP US All Equity Universe

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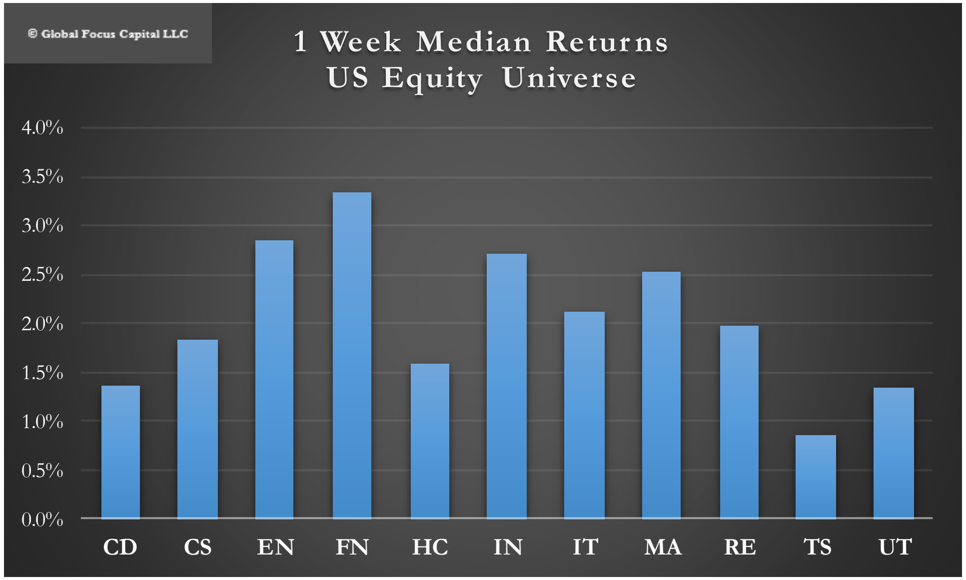
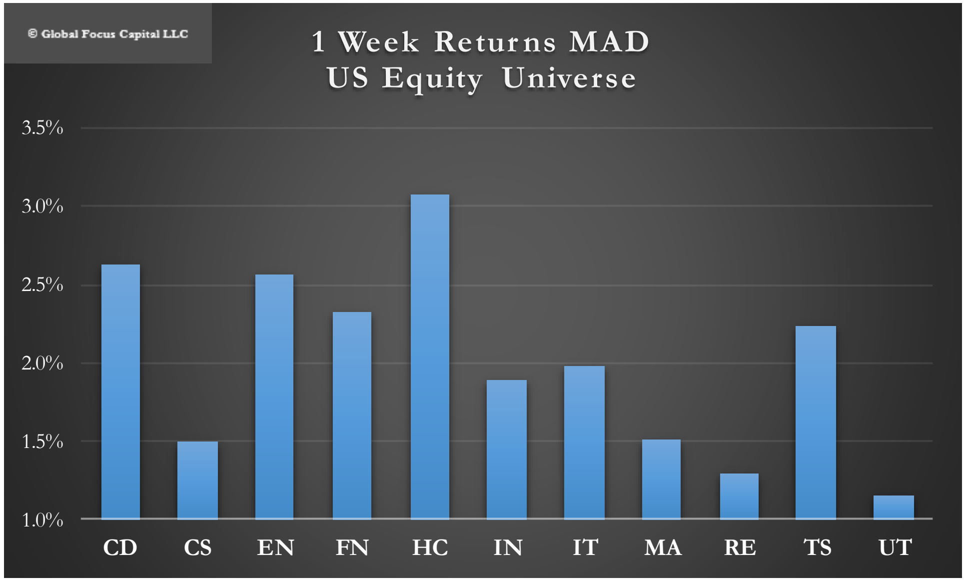
The Sector Look – median performance and dispersion

- The mean stock in our universe was up 2.2% over the last 5 trading days
- All sectors showed positive median returns with Financial stocks leading the pack
- On average, Financials were up 3.2%
- Energy stocks also had a good week – up 2.8% on average
- The widest variability in performance was seen in the Health Care sector – good for stock picking
- We use the median absolute deviation as a robust measure of within sector variability





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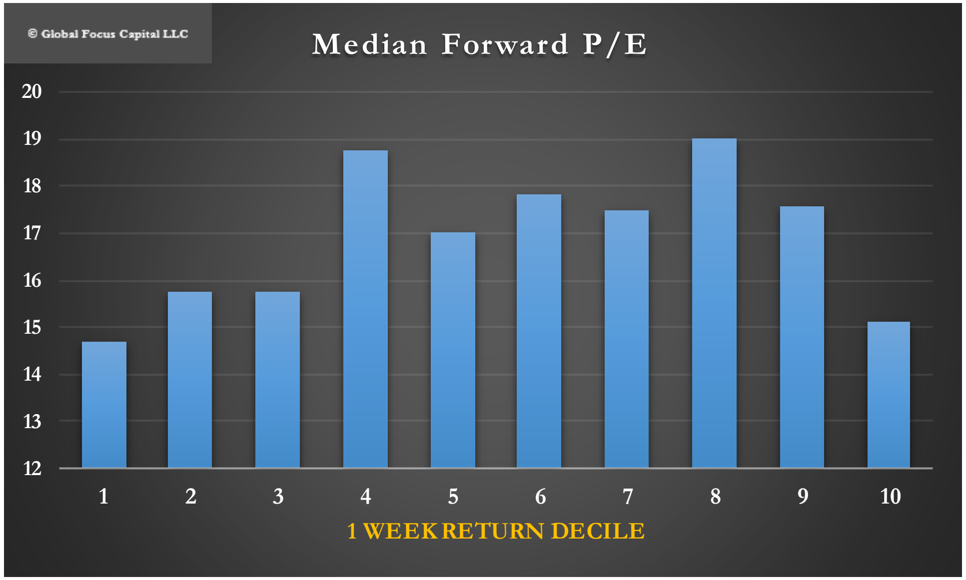
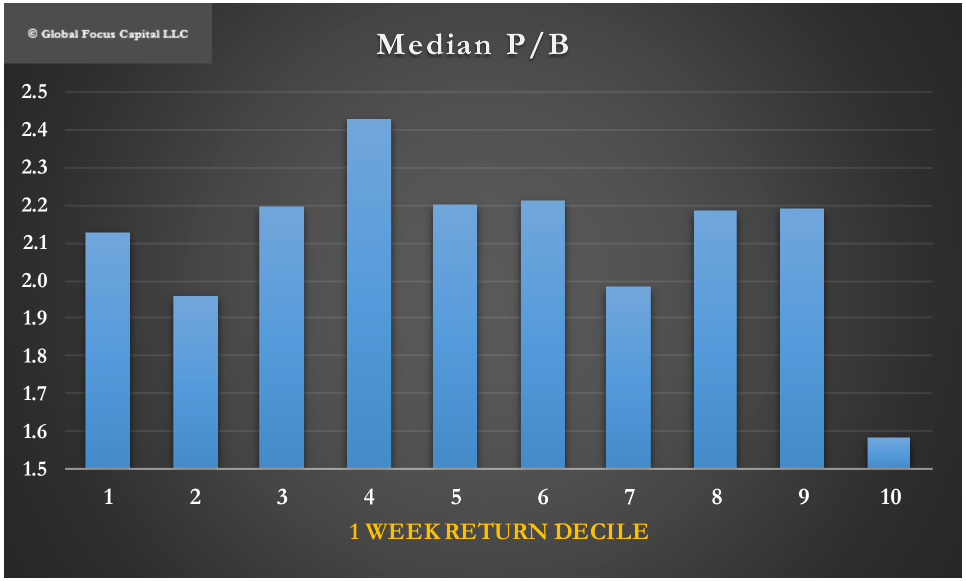
What did the markets reward last week: Valuation Multiples

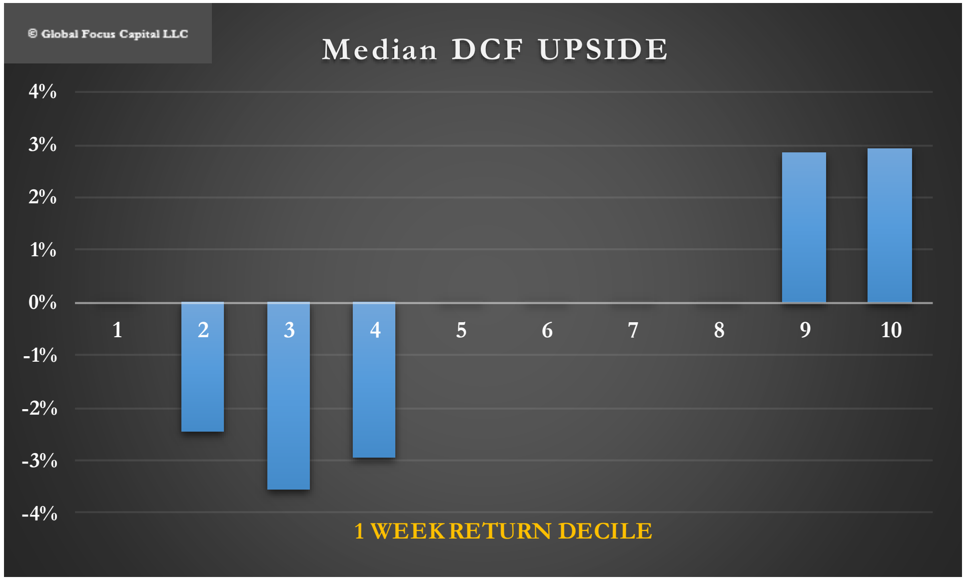
- Valuation was a mixed factor in determining performance last week
- In general lower P/E stocks did best but the effect was not uniform
- We saw a different pattern for P/B with higher ratios seen in the best performing deciles
- We have started 2019 with a strong Value effect

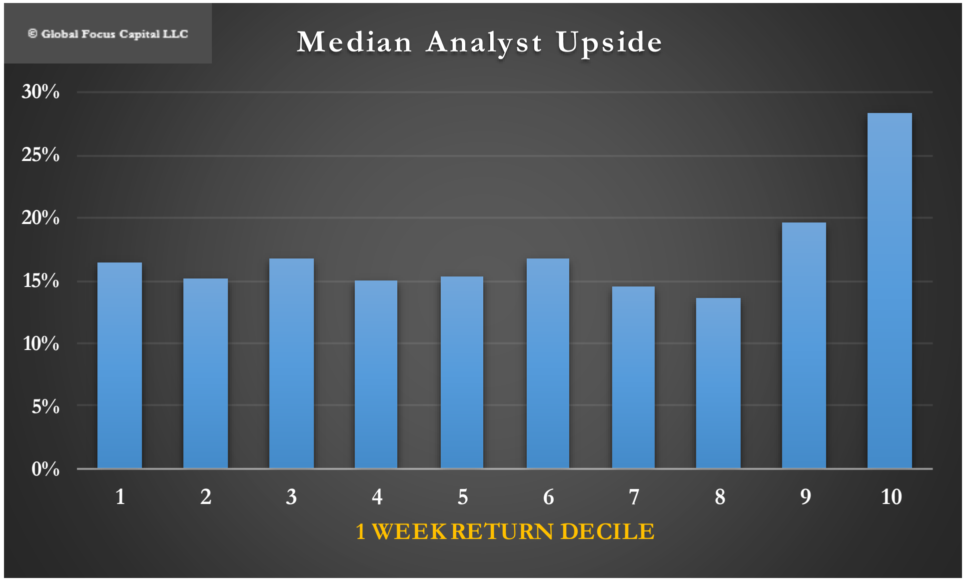




What did the markets reward last week: Valuation Models

- The median stock in our universe is under-valued by 1.8% according to a DCF valuation
- The markets last week rewarded over-valued stocks but the effect was weak
- In terms of analyst price targets, there was little relationship
- The top 8 quintiles for performance have nearly identical median deviations from target prices (13%)





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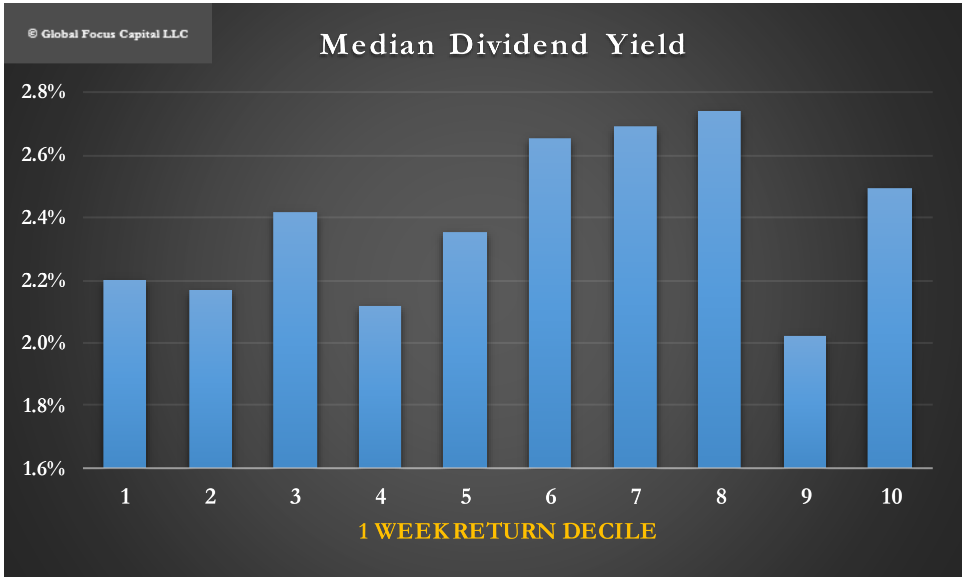
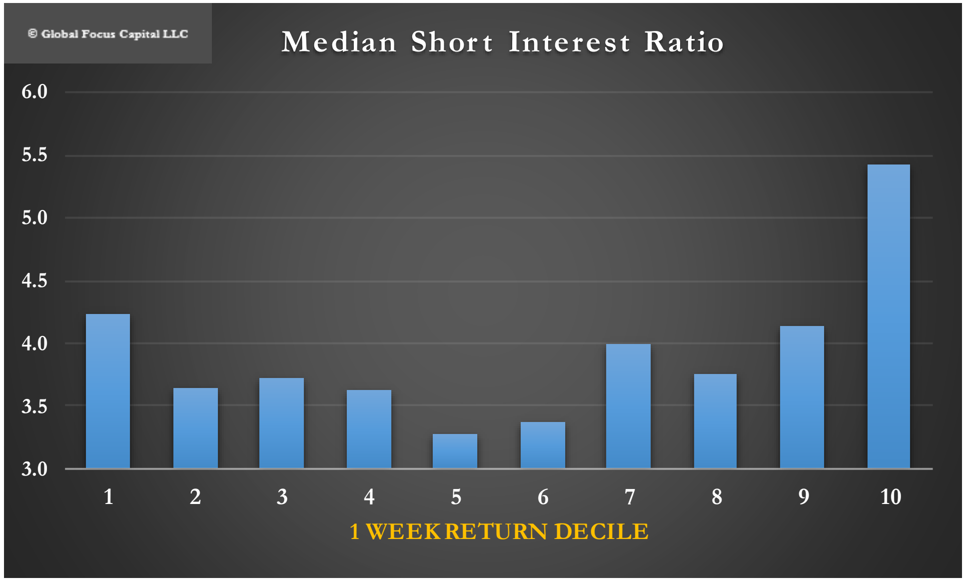
What did the markets reward last week: Yield and Sentiment

- Higher dividend yield stocks performed worse than average last week
- These stocks have been top performers over the last 3 months so maybe this is a bit of a giveback
- Short interest, a measure of sentiment, showed a flat pattern of returns
- The worst performing stocks last week had higher levels of short interest but there was not a lot of information in the middle or left tail





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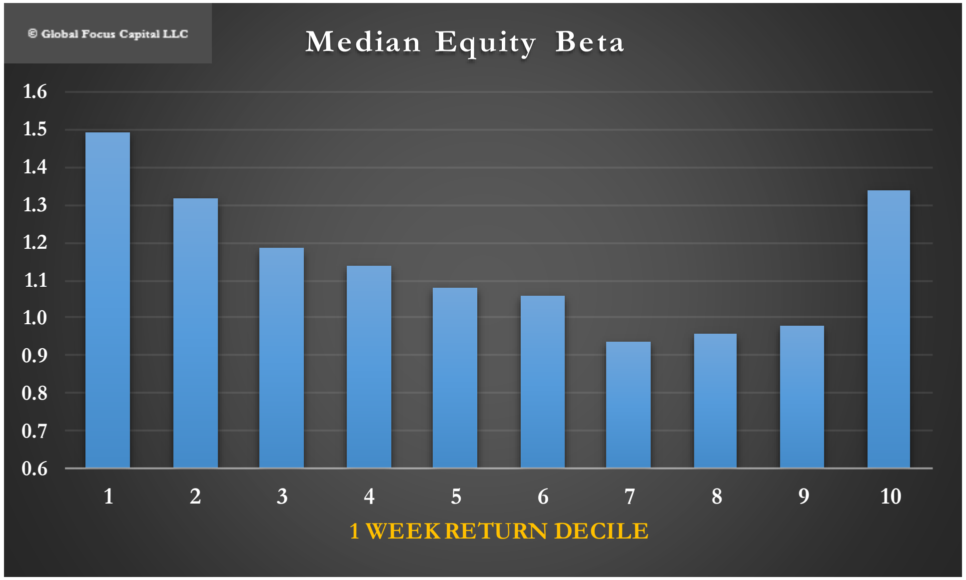
What did the markets reward last week: Beta and Size

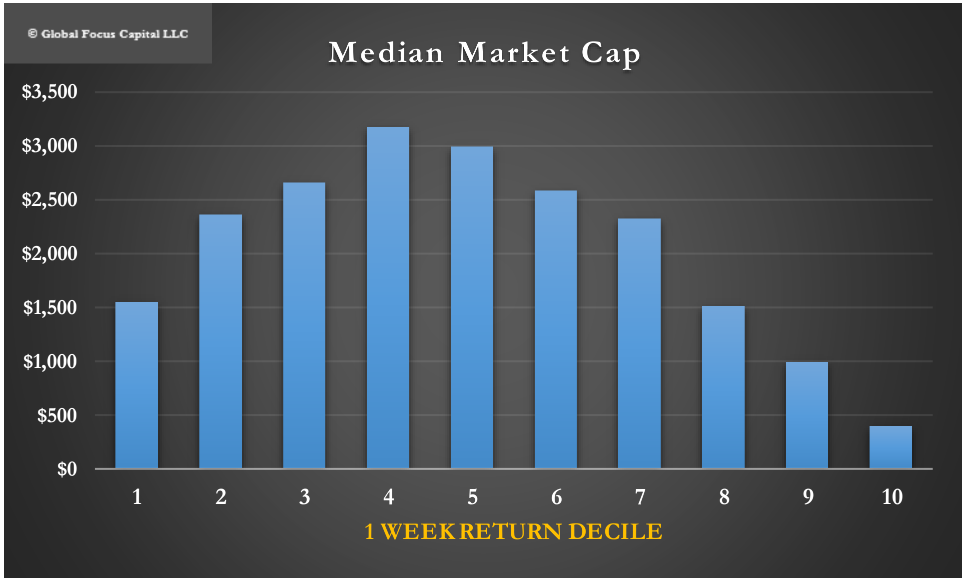
- Beta worked extremely well last week except in Q10

- The higher the beta the higher the return

- In terms of market cap over the last week we have seen midcaps doing best – an inverted V shape

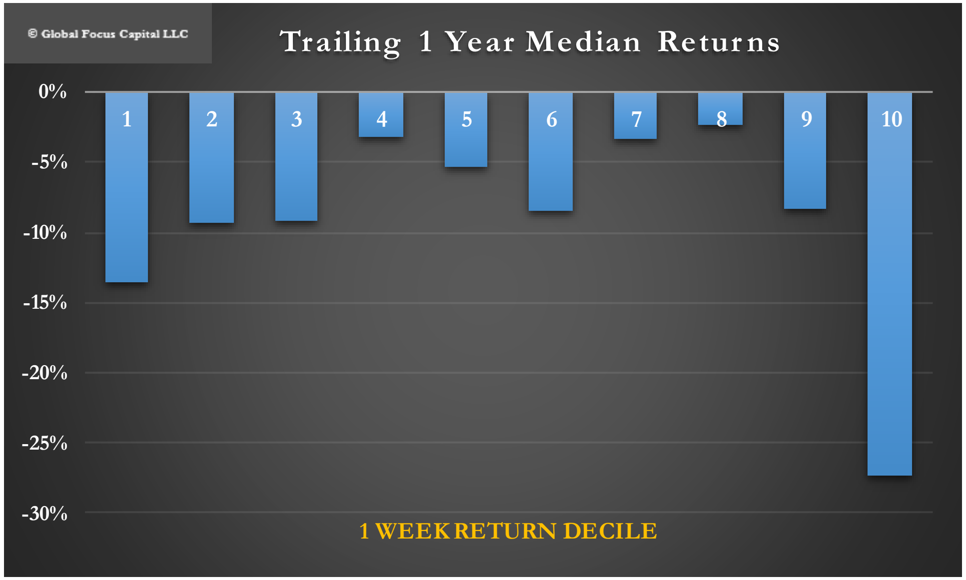
- The Russell 2000 index under-performed the S&P 500 by 0.5% over the last 5 trading days

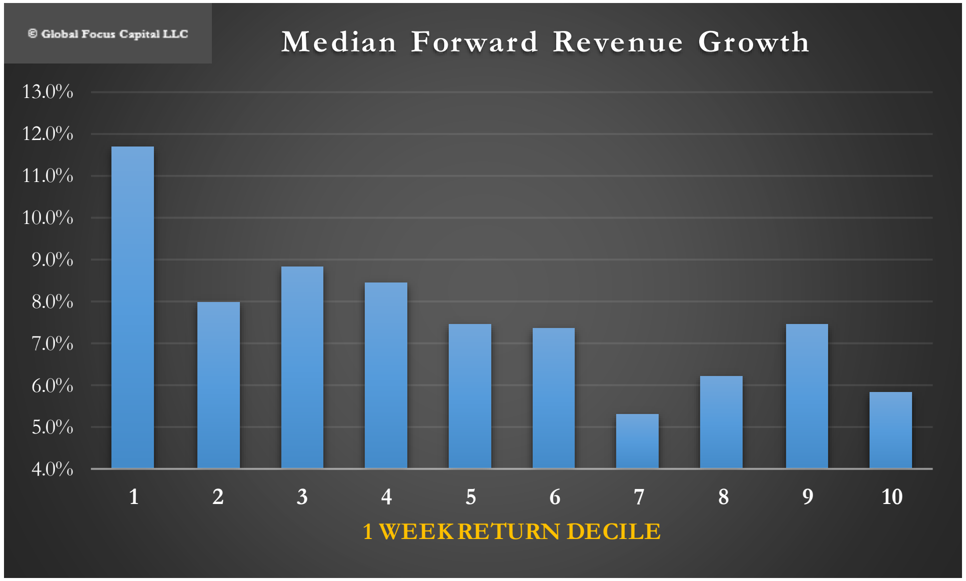




What did the markets reward last week: Momentum and Growth

- The 1 year momentum effect did not have much information last week
- Stocks down the most over the last year vastly under-performed last year's relative winners
- The industry rotation that started about 16 weeks ago is gaining strength
- Revenue growth as a factor exhibited a direct relationship to return – higher growth companies showed better performance last week





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Big Movers – Last 5 Days

Down

Tesla Motors, Inc.	TSLA	Consumer Discretionary
PG&E Corporation	PCG	Utilities
Intelsat S.A.	I	Communication Services
Immunomedics, Inc.	IMMU	Health Care
Ligand Pharmaceuticals In	LGND	Health Care
Acceleron Pharma Inc.	XLRN	Health Care
Xencor, Inc.	XNCR	Health Care
Signet Jewelers Limited	SIG	Consumer Discretionary
MSG Networks Inc.	MSGN	Communication Services
Prestige Brands Holdings,	PBH	Health Care
Aimmune Therapeutics, In	AIMT	Health Care
Hecla Mining Company	HL	Materials
Revance Therapeutics, Inc.	RVNC	Health Care
Lexicon Pharmaceuticals, I	LXRX	Health Care
Tailored Brands, Inc.	TLRD	Consumer Discretionary
MacroGenics, Inc.	MGNX	Health Care
Quantenna Communication	QTNA	Information Technology
Donnelley Financial Solutic	DFIN	Financials
Insteel Industries, Inc.	IIIN	Industrials
Unifi, Inc.	UFI	Consumer Discretionary

Up

Bank of America Corporati	BAC	Financials
Citigroup Inc.	C	Financials
Goldman Sachs Group, Inc	GS	Financials
Edwards Lifesciences Corp	EW	Health Care
LyondellBasell Industries I	LYB	Materials
V.F. Corporation	VFC	Consumer Discretionary
First Data Corporation	FDC	Information Technology
lululemon athletica inc.	LULU	Consumer Discretionary
Align Technology, Inc.	ALGN	Health Care
Liberty Global plc	LILA	Communication Services
FIRST REPUBLIC BANI	FRC	Financials
Comerica Incorporated	CMA	Financials
Nutanix, Inc.	NTNX	Information Technology
Nektar Therapeutics	NKTR	Health Care
bluebird bio, Inc.	BLUE	Health Care
Sage Therapeutics, Inc.	SAGE	Health Care
HubSpot, Inc.	HUBS	Information Technology
New Relic, Inc.	NEWR	Information Technology
Penumbra, Inc.	PEN	Health Care
Coupa Software Incorporat	COUP	Information Technology

This Coming Week

Reporting Soon

Johnson & Johnson	JNJ	Health Care
Verizon Communications I	VZ	Communication Services
Procter & Gamble Compan	PG	Consumer Staples
Intel Corporation	INTC	Information Technology
Comcast Corporation	CMCSA	Communication Services
Netflix, Inc.	NFLX	Communication Services
Abbott Laboratories	ABT	Health Care
Union Pacific Corporation	UNP	Industrials
International Business Ma	IBM	Information Technology
United Technologies Corp	UTX	Industrials
Texas Instruments Incorp	TXN	Information Technology
Starbucks Corporation	SBUX	Consumer Discretionary
Bristol-Myers Squibb Com	BMY	Health Care
Intuitive Surgical, Inc.	ISRG	Health Care
Norfolk Southern Corporat	NSC	Industrials
Raytheon Company	RTN	Industrials
Las Vegas Sands Corp.	LVS	Consumer Discretionary
Crown Castle International	CCI	Real Estate
ProLogis, Inc.	PLD	Real Estate
Kimberly-Clark Corporatio	KMB	Consumer Staples
Capital One Financial Corp	COF	Financials
Progressive Corporation (T	PGR	Financials
American Electric Power C	AEP	Utilities
Ford Motor Company	F	Consumer Discretionary
The Travelers Companies,	TRV	Financials
V.F. Corporation	VFC	Consumer Discretionary
TD Ameritrade Holding C	AMTD	Financials
Southwest Airlines Compar	LUV	Industrials
Halliburton Company	HAL	Energy
Amphenol Corporation	APH	Information Technology

- Risk Aversion should spring up this week unless China and the US reach a deal on tariffs
- Equity Technicals have improved to the point that only 17% of stocks remain in the Down Trend Phase
- Political drama in Washington is exacerbating the uncertainty of market participants but investors seem to be in denial thus far in 2019
- Brexit is up for the spring but prospects of passing Parliament are slim. Could we be starring at Referendum 2.0?
- 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 but have had a nice a nice recovery in 2019
- Surprisingly EM equities have outperformed developed markets in the last month.
- Our models still favor a reduction in risk in our portfolios with positive active allocations to cash and bonds
- The price of higher equity returns is discomfort – volatility has been too low in the last few years
- This coming week has huge earnings implications. Lots of companies reporting Q4.

Contact & Subscription Information

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