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INSIGHT THAT MATTERS

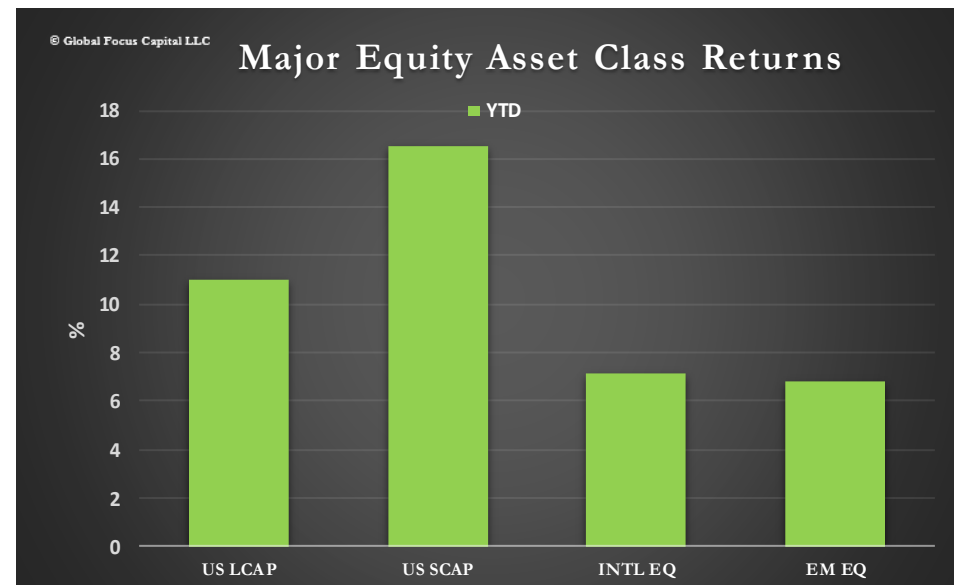
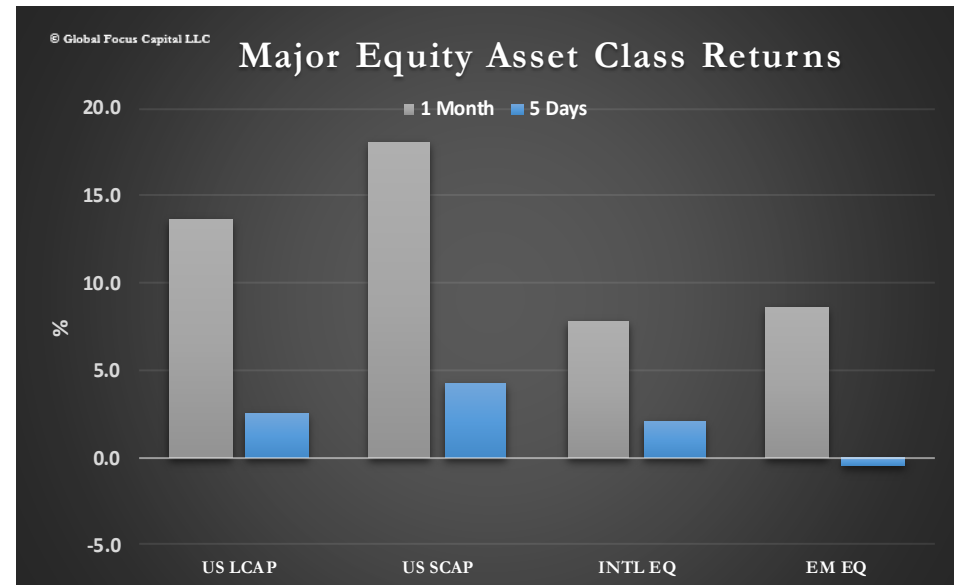
# The Equity Observer

Weekly Review – February 17, 2019

Eric J. Weigel

# Equity markets have had a great start to the year

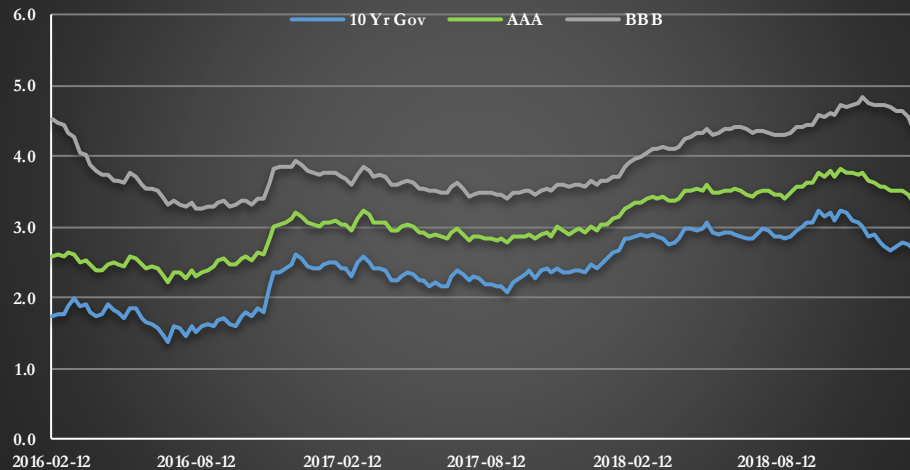
- ▶ Equity markets have staged a remarkable recovery after a dismal Q4
- ▶ Over the last month, US small and large caps have performed the best
- ▶ Over the last 12 months US equities are up slightly while International still show large losses
- ▶ Valuations are still stretched in the US but growth and profitability are hanging in
- ▶ The key for equity markets is global growth and whether we are entering a slowdown or not



# Equity volatility comes way down while yield spreads continue narrowing, inflationary expectations remain low

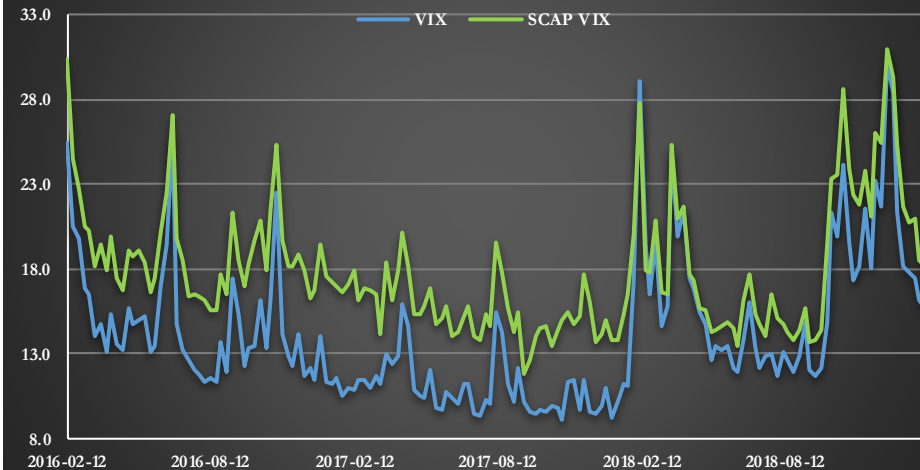
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## US Interest Rates



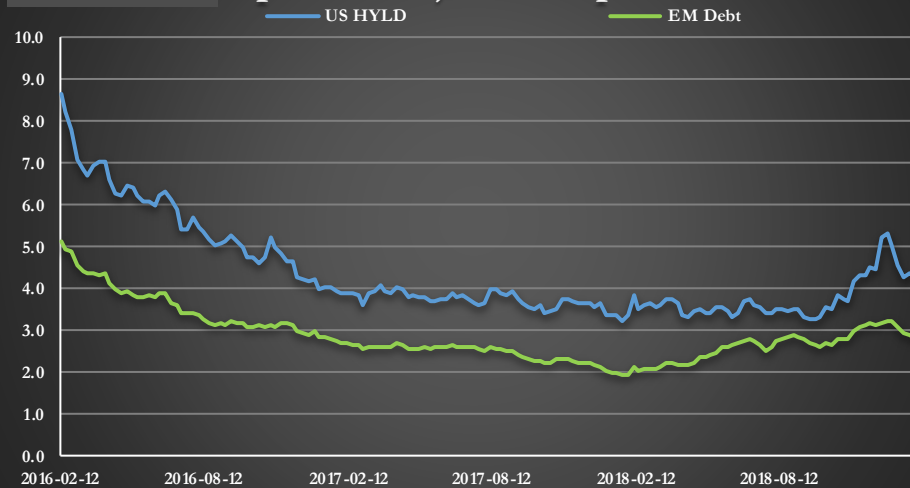
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## Stock Index Implied Volatility



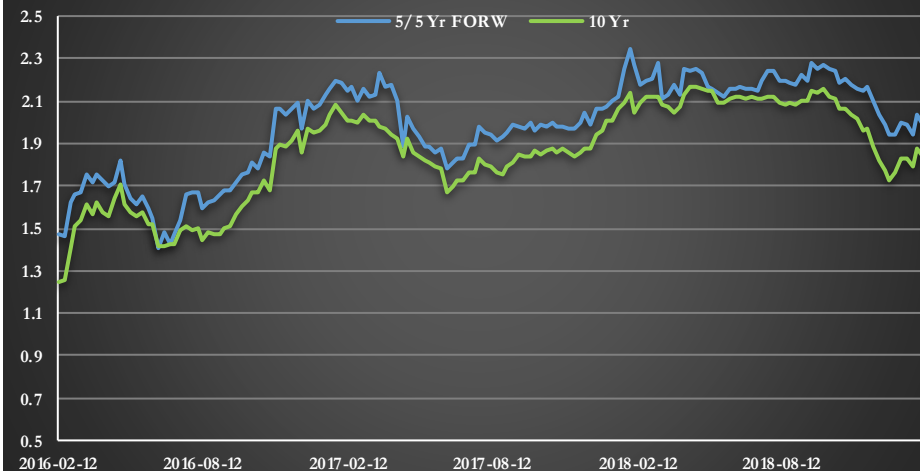
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## Option Adjusted Spreads



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## US Inflationary Expectations

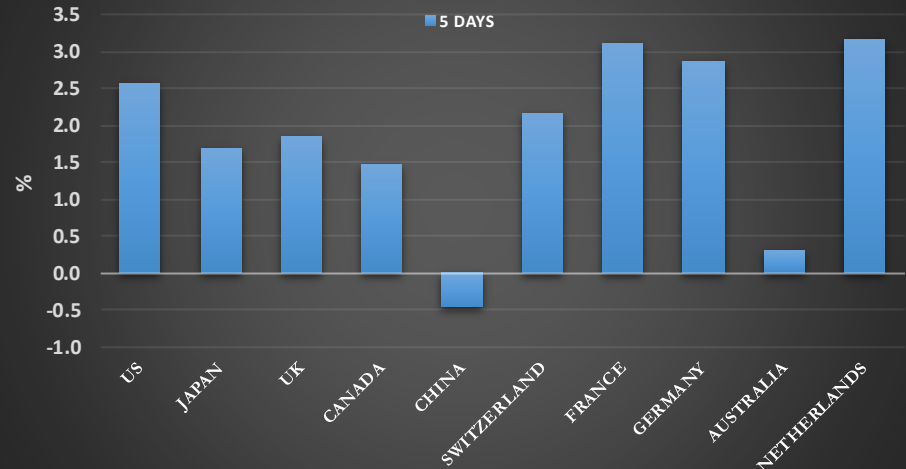


# Global Equities

- ▶ A global recovery for most 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 slightly outperformed Growth last week, but the main style effect was size (the smaller the better)
- ▶ In international markets Value underperformed Growth by a wide margin driven primarily by sector differences
- ▶ Globally, Energy and Industrials performed best last week while interest sensitive sectors such as Telecom and Utilities underperformed

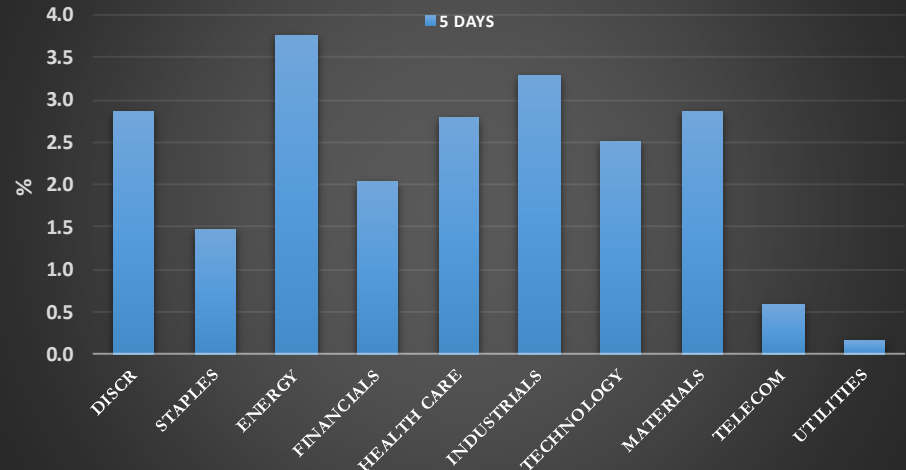
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## Global Equities (USD)



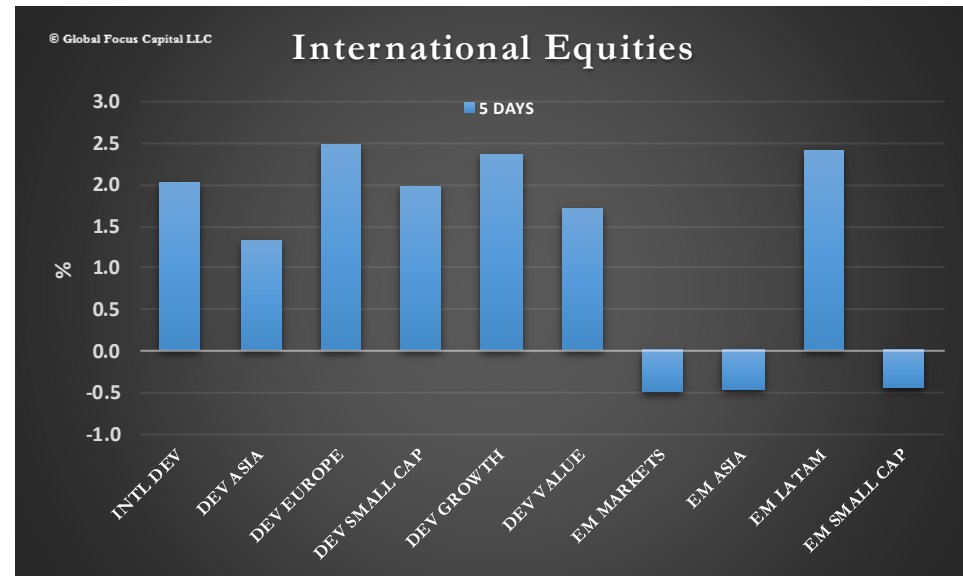
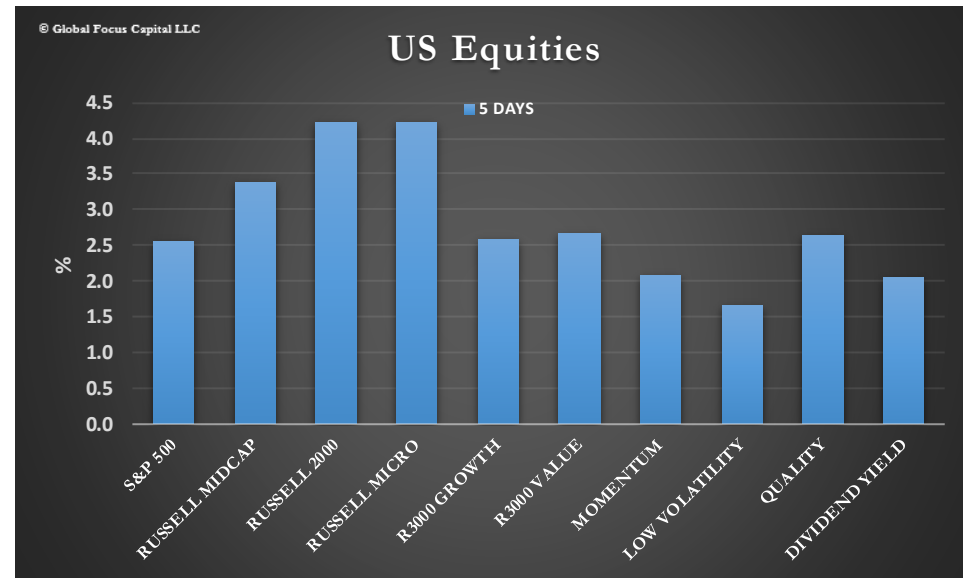
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## Global Sectors (USD)



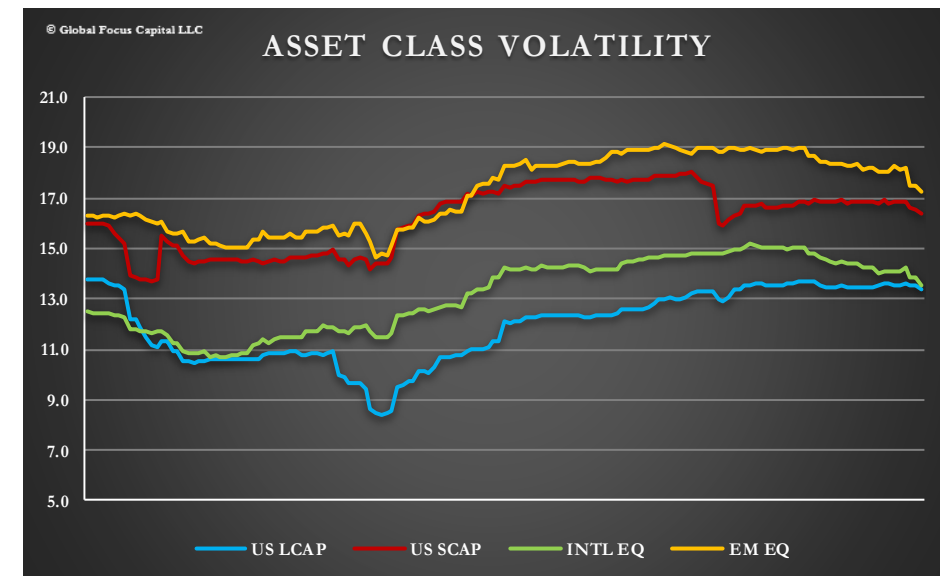
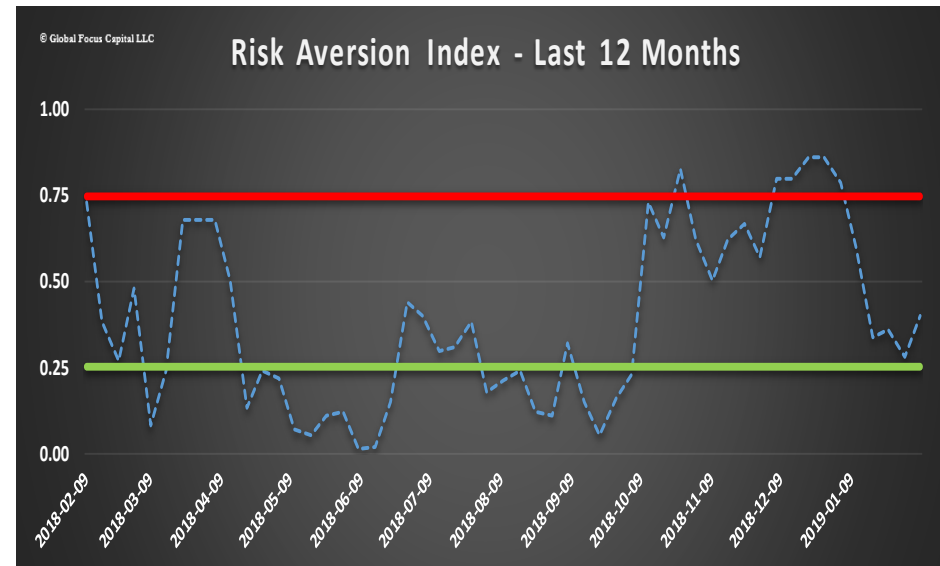
# Style and Geography

- ▶ In the US, we saw Small Caps do best
- ▶ The size effect in the US was really strong last week
- ▶ Within equity styles, Quality strategies continue shining
- ▶ The Momentum has lost all “mo” – momentum stocks have underperformed the general market
- ▶ Developed Europe rebounded strongly last week despite growth concerns
- ▶ Latam has vastly outperformed EM Asia – YTD it is up nearly double the EM index



# Investor Risk Aversion drops dramatically but stays in the Normal Zone

- ▶ Investors seem to be in risk-on mode again – not sure why?
- ▶ Our risk aversion index dropped precipitously a couple of weeks ago 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 ok but leveling off, valuations are high and economic policy is highly uncertain





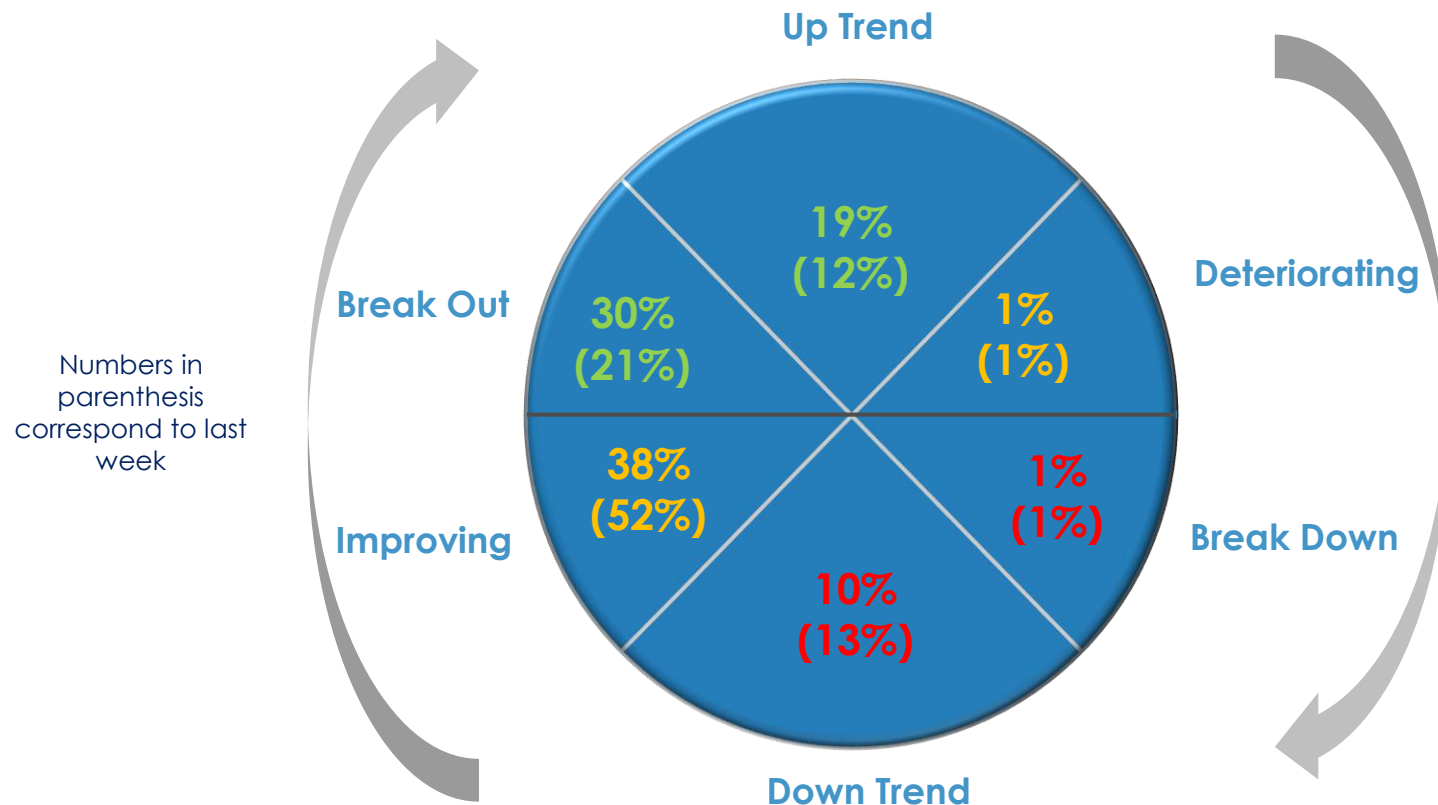
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# US Equities

Weekly Performance

# Maybe the Bear Market is not here after all. We have seen a huge improvement in the technical in 2019 – strong rebound

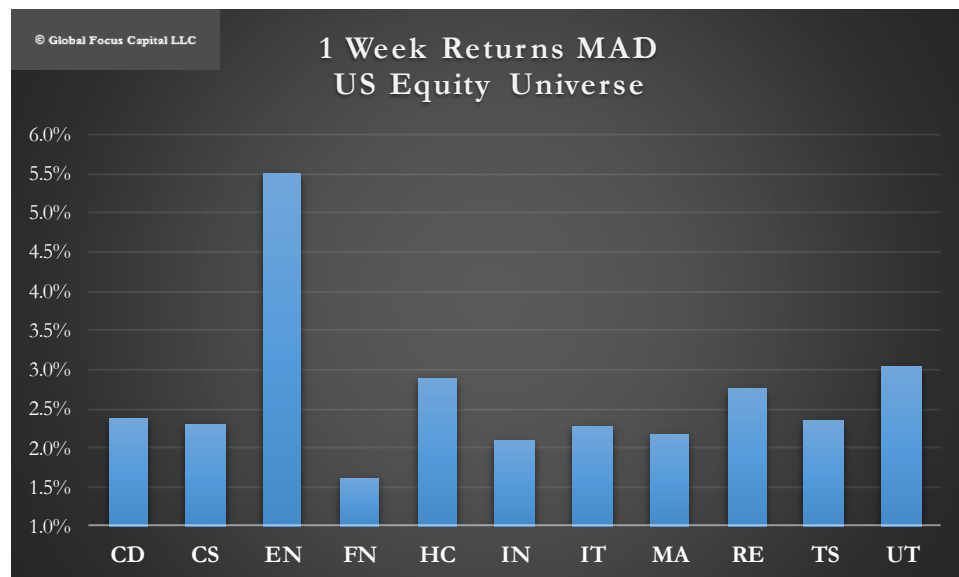
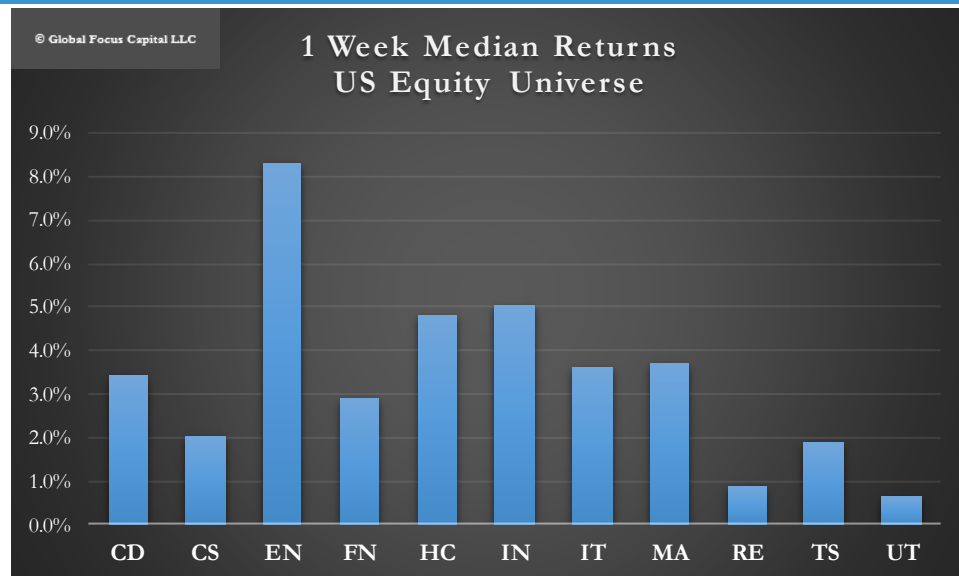


**GF CAP US All Equity Universe**



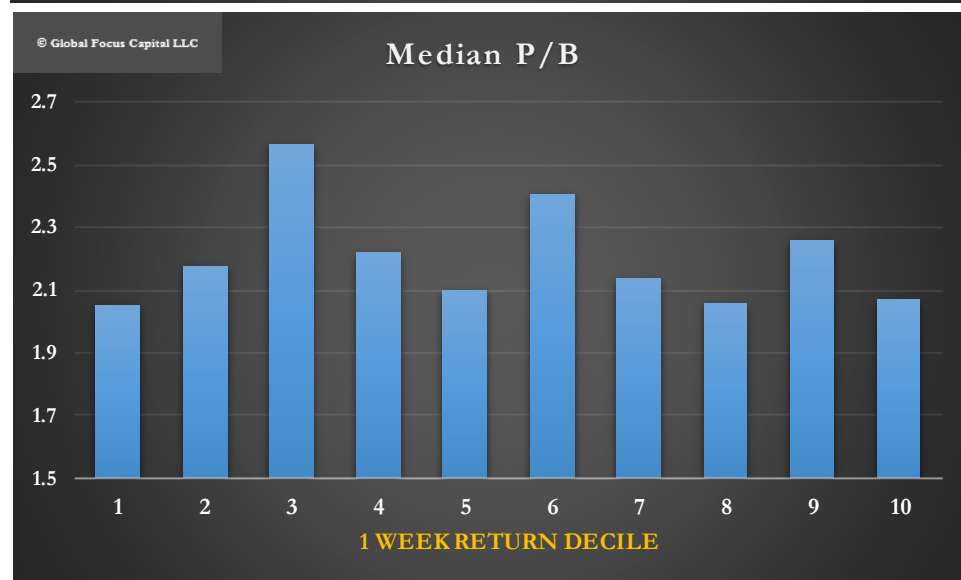
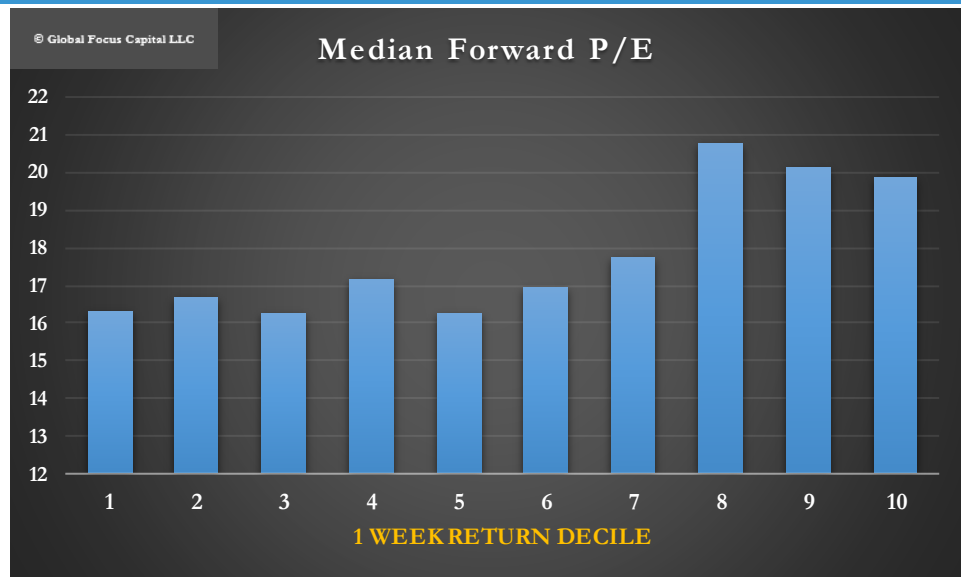
# The Sector Look – median performance and dispersion

- ▶ The mean stock in our universe was up 3.5% over the last 5 trading days
- ▶ All sectors showed positive median returns but Energy stocks were the standout performers - up, on average, 8.4%
- ▶ There was quite a dispersion in returns among sectors
- ▶ Interest sensitive sectors performed relatively poorly – Utilities, Real Estate and Telecom – as interest rates in the US rose
- ▶ The widest variability in performance was seen in the Energy sector – good for stock picking
- ▶ We use the median absolute deviation as a robust measure of within sector variability



# What did the markets reward last week: Valuation Multiples

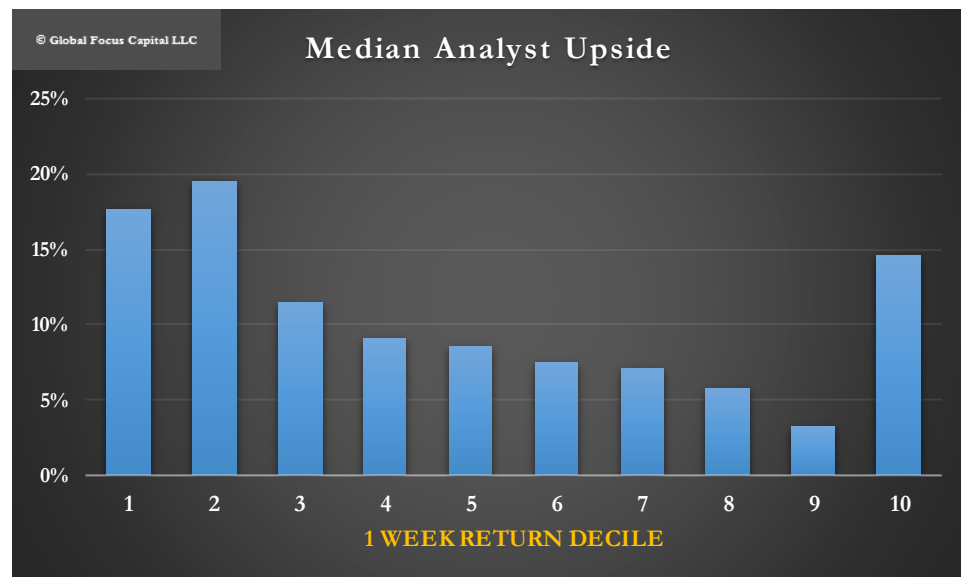
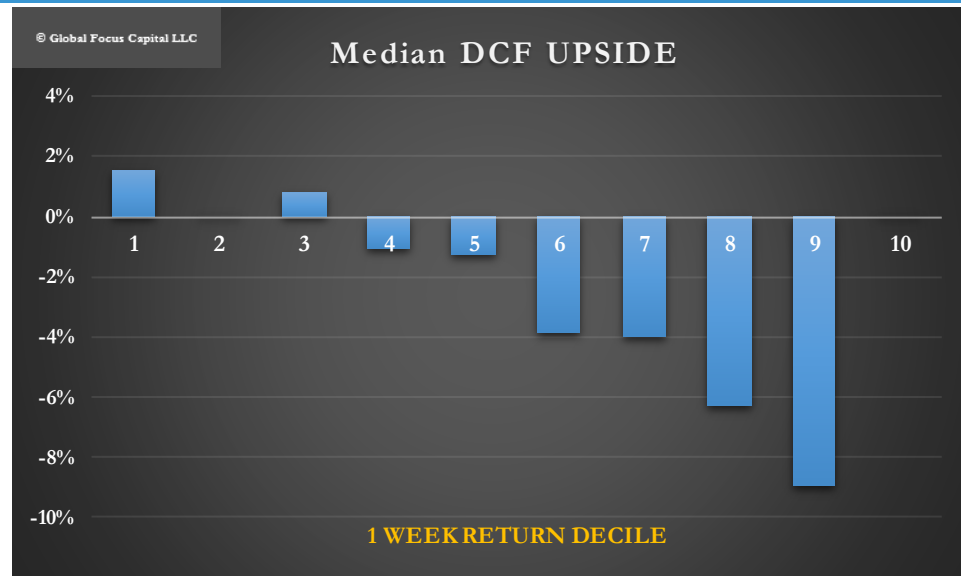
- ▶ Valuation was a decent factor in determining performance last week
- ▶ In general higher P/E stocks did worse
- ▶ We saw a somewhat unequal pattern when using P/B deciles
- ▶ We have started 2019 with a modest Value effect



# What did the markets reward last week:

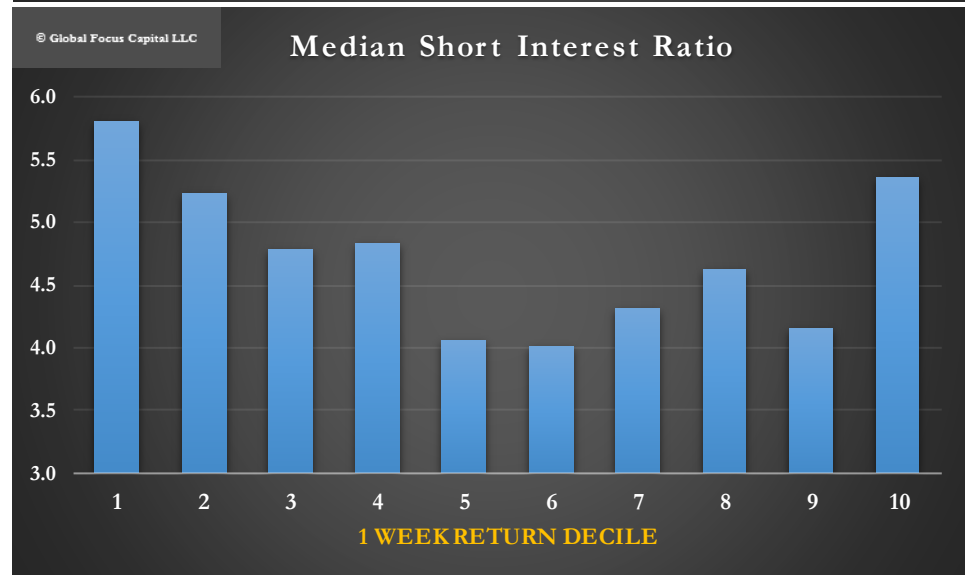
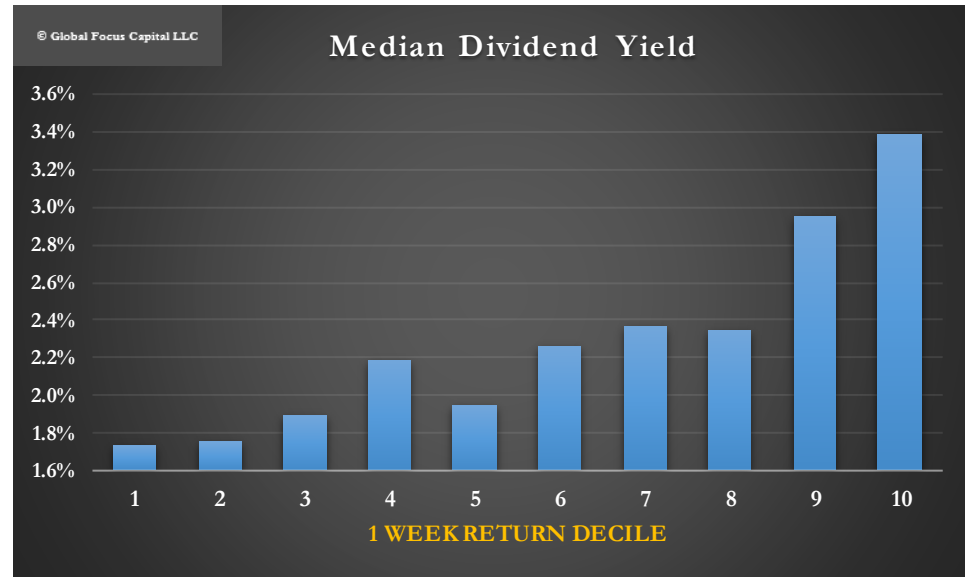
## Valuation Models

- ▶ The median stock in our universe is over-valued by 2.5% according to a DCF valuation
- ▶ The markets last week rewarded slightly under-valued stocks and penalized over-valued stocks
- ▶ In terms of analyst price targets, stocks with the highest positive deviation from target did best
- ▶ The exception was Decile 10 stocks which had positive analyst price targets



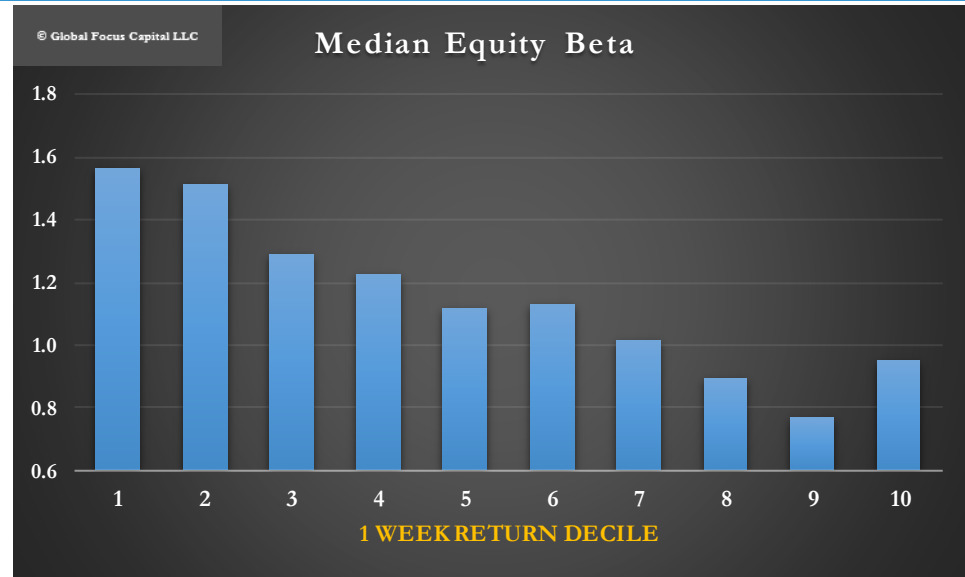
# What did the markets reward last week: Yield and Sentiment

- ▶ Higher dividend yield stocks performed worse than average last week
- ▶ The negative effect was quite strong and uniform
- ▶ Short interest, a measure of sentiment, showed a U pattern of returns
- ▶ The worst as well as the top performing stocks last week had higher levels of short interest



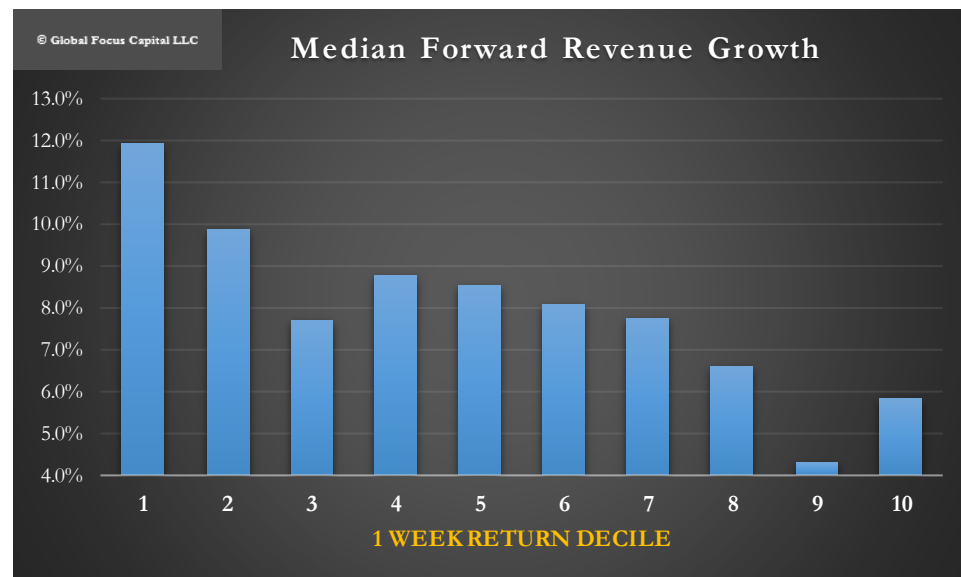
# What did the markets reward last week: Beta and Size

- ▶ Beta worked extremely well last week
- ▶ The higher the beta the higher the return
- ▶ In terms of market cap over the last week we have seen microcaps doing best – a very strong size effect
- ▶ The Russell 2000 index outperformed the S&P 500 by 1.6% over the last 5 trading days



# What did the markets reward last week: Momentum and Growth

- ▶ The 1 year momentum effect worked perversely last week
- ▶ Stocks down the most over the last year out-performed last year's relative winners
- ▶ The industry rotation that started about 20 weeks ago is gaining strength
- ▶ Revenue growth as a factor exhibited a direct relationship to return – higher growth companies showed better performance last week



# Big Movers – Last 5 Days

## Down

Newell Brands Inc.	NWL	Consumer Discretionary
Six Flags Entertainment Co	SIX	Consumer Discretionary
LogMein, Inc.	LOGM	Information Technology
Qualys, Inc.	QLYS	Information Technology
AMN Healthcare Services	AMN	Health Care
Varonis Systems, Inc.	VRNS	Information Technology
Blucora, Inc.	BCOR	Financials
McDermott International, Inc.	MDR	Energy
Houghton Mifflin Harcourt	HMHC	Consumer Discretionary
TrueCar, Inc.	TRUE	Communication Services
On Deck Capital, Inc.	ONDK	Financials
Amyris, Inc.	AMRS	Materials
Inovio Pharmaceuticals, Inc.	INO	Health Care
Enzo Biochem, Inc.	ENZ	Health Care
Manitex International, Inc.	MNTX	Industrials
New Home Company Inc.	NWHM	Consumer Discretionary
NantKwest, Inc.	NK	Health Care
PHI, Inc.	PHIIK	Energy
Bristow Group Inc	BRS	Energy
Achaogen, Inc.	AKAO	Health Care

## Up

Hilton Worldwide Holding	HLT	Consumer Discretionary
Arista Networks, Inc.	ANET	Information Technology
Liberty Global plc	LILA	Communication Services
SS&C Technologies Holdings	SSNC	Information Technology
Marathon Oil Corporation	MRO	Energy
Devon Energy Corporation	DVN	Energy
Apache Corporation	APA	Energy
ConAgra Brands, Inc.	CAG	Consumer Staples
Zebra Technologies Corporation	ZBRA	Information Technology
Coty Inc.	COTY	Consumer Staples
IPG Photonics Corporation	IPGP	Information Technology
Jones Lang LaSalle Incorporated	JLL	Real Estate
Charles River Laboratories	CRL	Health Care
WPX Energy, Inc.	WPX	Energy
Inspireity, Inc.	NSP	Industrials
Murphy Oil Corporation	MUR	Energy
Teladoc, Inc.	TDOC	Health Care
Ingevity Corporation	NGVT	Materials
OneMain Holdings, Inc.	OMF	Financials
TriNet Group, Inc.	TNET	Industrials

# This Coming Week

## Reporting Soon

Wal-Mart Stores, Inc.	WMT	Consumer Staples
Medtronic plc	MDT	Health Care
CVS Health Corporation	CVS	Health Care
Duke Energy Corporation	DUK	Utilities
Intuit Inc.	INTU	Information Technology
The Kraft Heinz Company	KHC	Consumer Staples
Southern Company (The)	SO	Utilities
Ecolab Inc.	ECL	Materials
Analog Devices, Inc.	ADI	Information Technology
Agilent Technologies, Inc.	A	Health Care
Concho Resources Inc.	CXO	Energy
Consolidated Edison Inc	ED	Utilities
Hormel Foods Corporation	HRL	Consumer Staples
Eversource Energy	ES	Utilities
Hewlett Packard Enterprise	HPE	Information Technology
PPL Corporation	PPL	Utilities
SBA Communications Corp	SBAC	Real Estate
Realty Income Corporation	O	Real Estate
Verisk Analytics, Inc.	VRSK	Industrials
FirstEnergy Corporation	FE	Utilities
Edison International	EIX	Utilities
American Water Works	AWK	Utilities
Newmont Mining Corporation	NEM	Materials
Continental Resources, Inc	CLR	Energy
Diamondback Energy, Inc.	FANG	Energy
Entergy Corporation	ETR	Utilities
BioMarin Pharmaceutical Inc	BMRN	Health Care
Genuine Parts Company	GPC	Consumer Discretionary
Avangrid, Inc.	AGR	Utilities
Synopsys, Inc.	SNPS	Information Technology

- ▶ It's been a huge surprise how strong equity markets have been this year especially in the US
- ▶ Equity Technicals have improved to the point that only 13% of stocks remain in the Down Trend Phase
- ▶ The strength of the stock price recovery has been so extreme that a quick reversal would not be out of the question
- ▶ 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 staring 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
- ▶ 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.
- ▶ While Value is holding its own with Growth we still see the action at the sector level rather than in terms of pure valuation



# Contact & Subscription Information

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