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INSIGHT THAT MATTERS

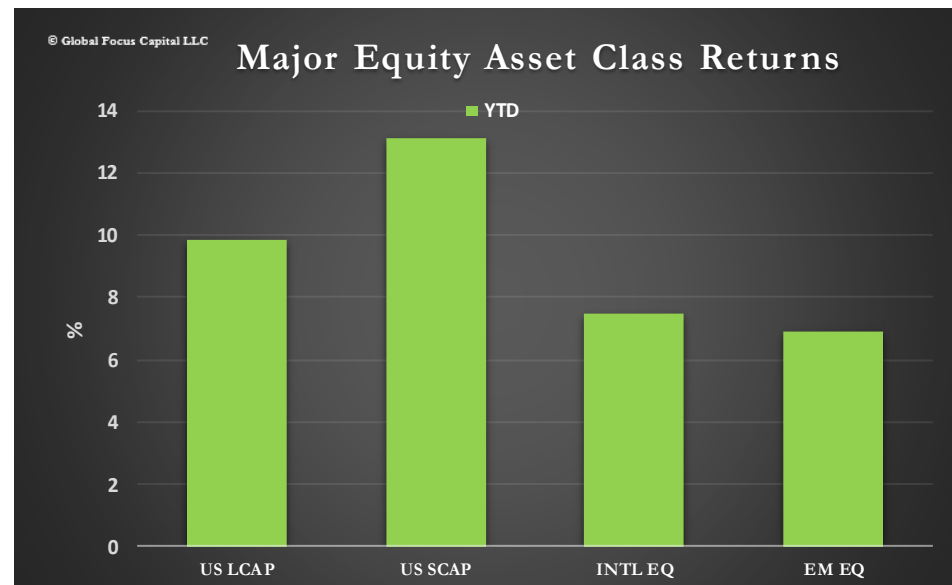
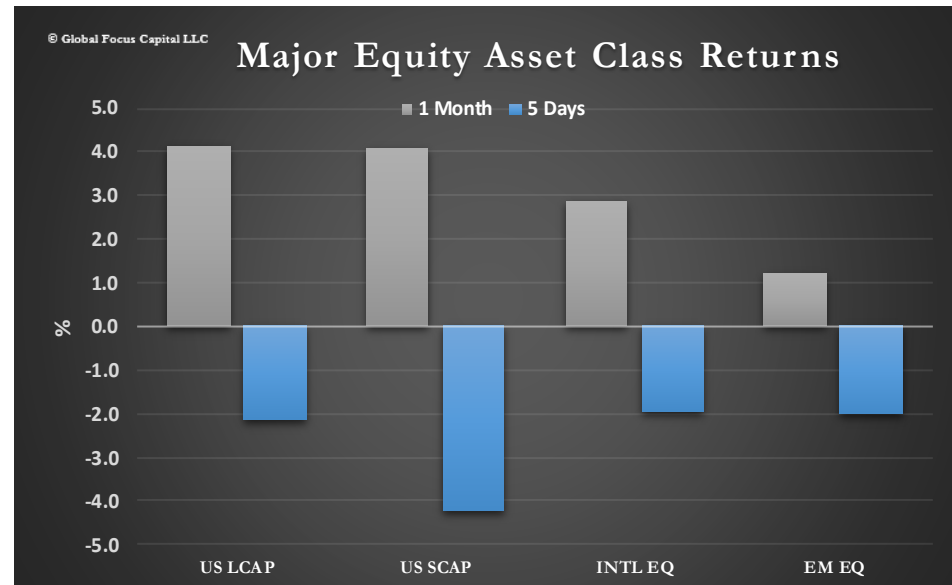
# The Equity Observer

Weekly Review – March 10, 2019

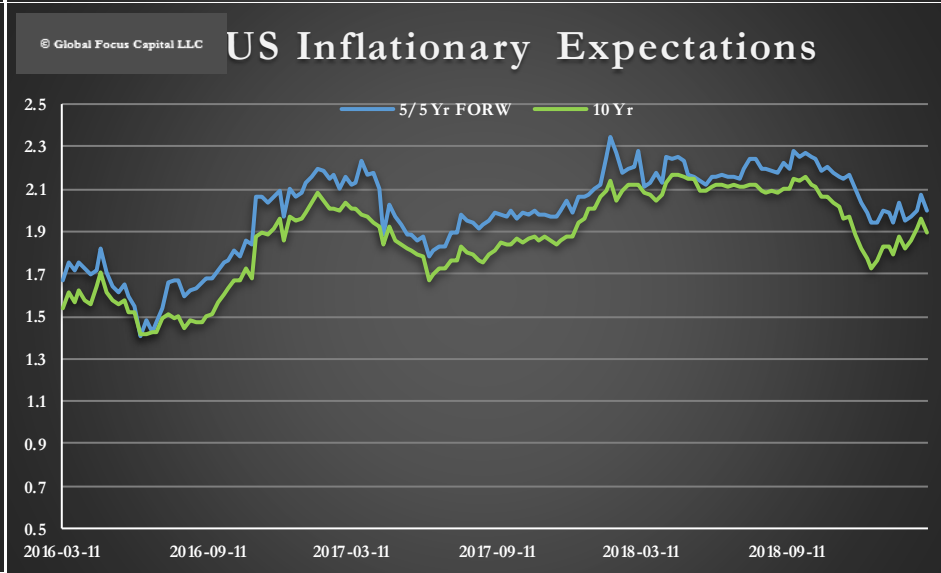
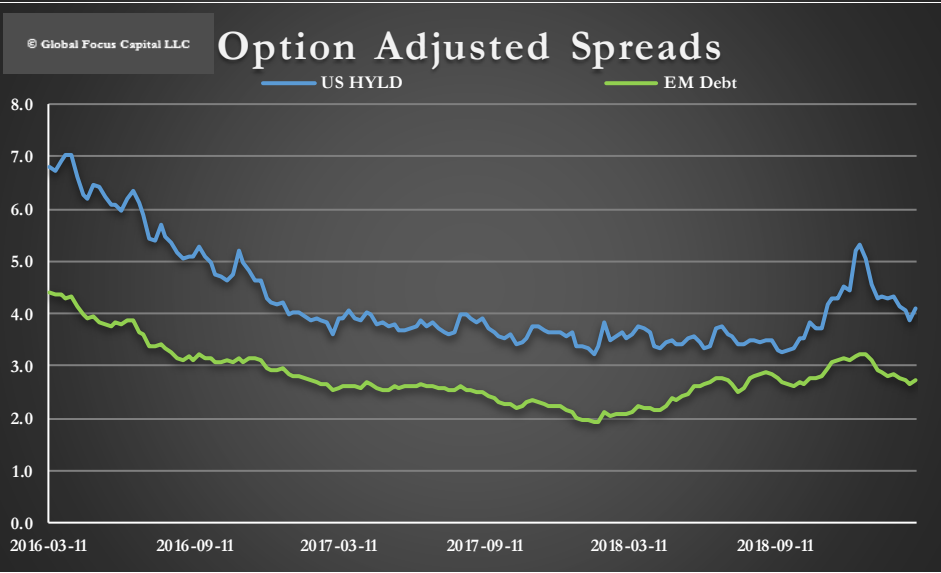
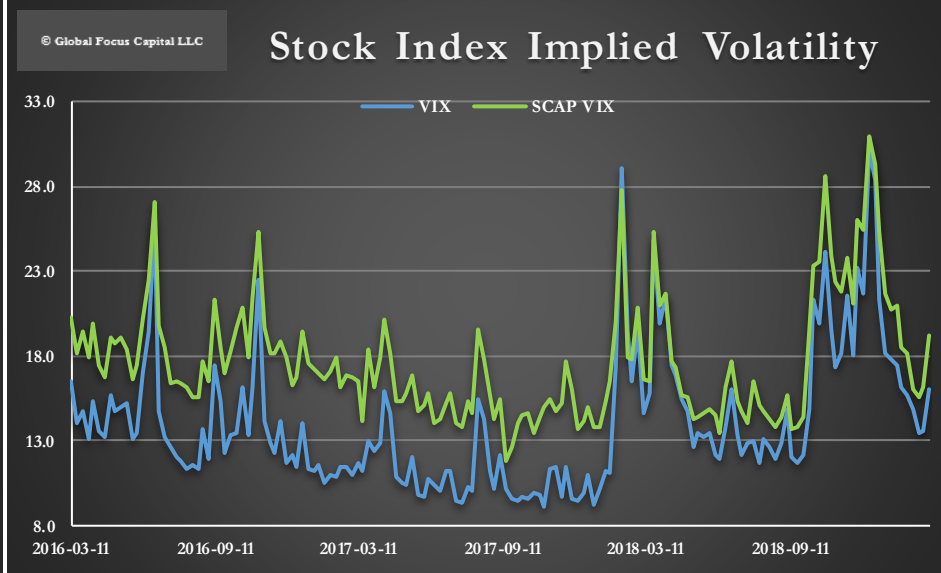
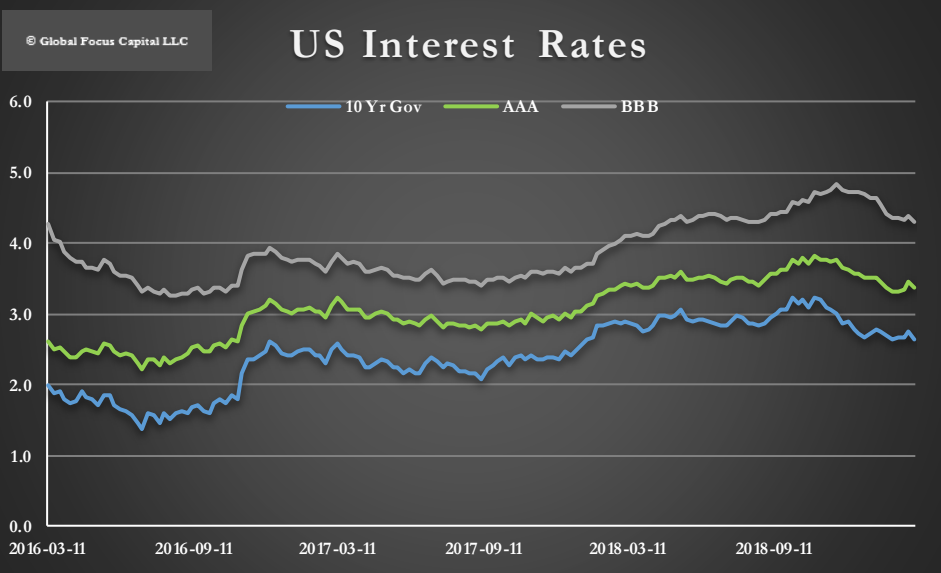
Eric J. Weigel

# Equity markets have had a great start to the year

- ▶ Equity markets have staged a remarkable recovery after a dismal Q4 but last week was a wake up call
- ▶ Over the last month, US small and large caps have performed in line with each other but ahead of international equity strategies
- ▶ Over the last 12 months US large cap equities are up slightly while US small cap and international still show losses
- ▶ Valuations are still a bit 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 wakes up while yield spreads do not move much from last week, inflationary expectations remain low

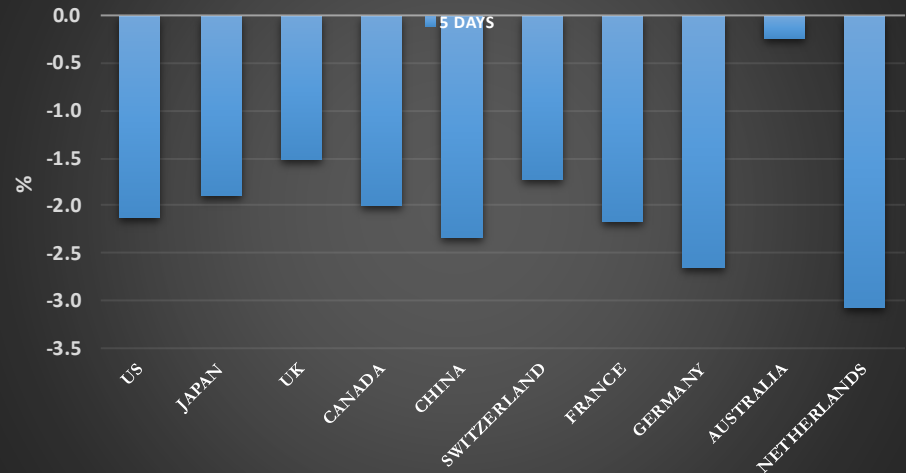


# Global Equities

- ▶ A global recovery for equities was interrupted last week as growth concerns returned to the forefront
- ▶ Commodity indices were flat last week as oil prices firmed but agricultural markets headed south due to excess supply conditions
- ▶ In the US Value slightly under-performed Growth last week, but the main style effect was size (the smaller the worse)
- ▶ In international markets Value under-performed Growth by a wider margin driven primarily by sector differences
- ▶ Globally, Energy, Financials and Health Care under-performed last week while interest sensitive sectors such as Telecom and Utilities held their own

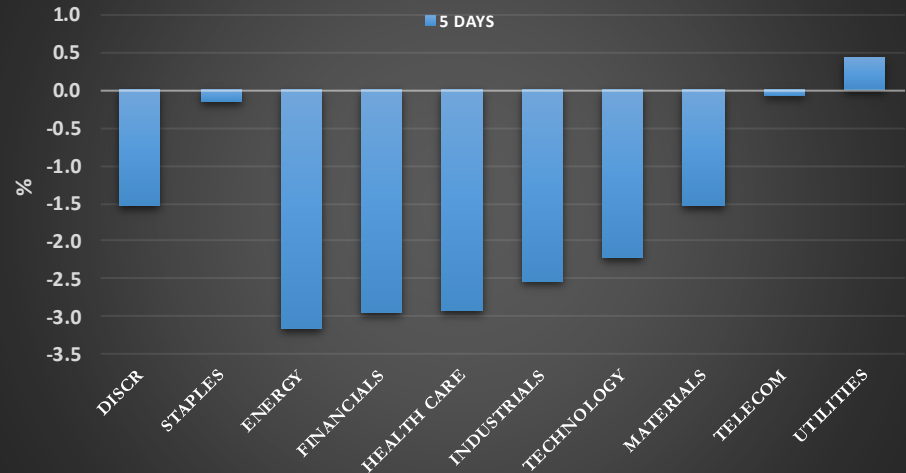
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## Global Equities (USD)



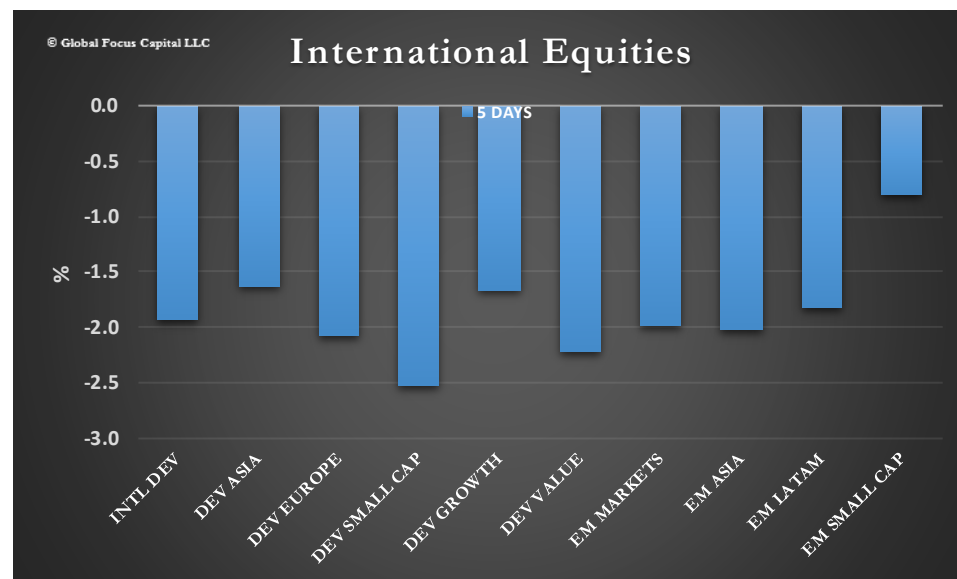
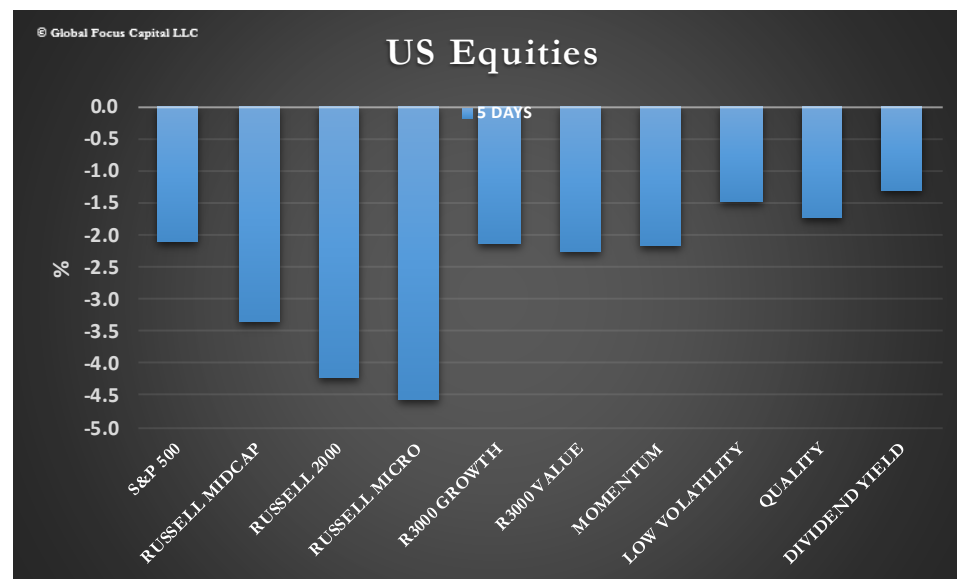
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## Global Sectors (USD)



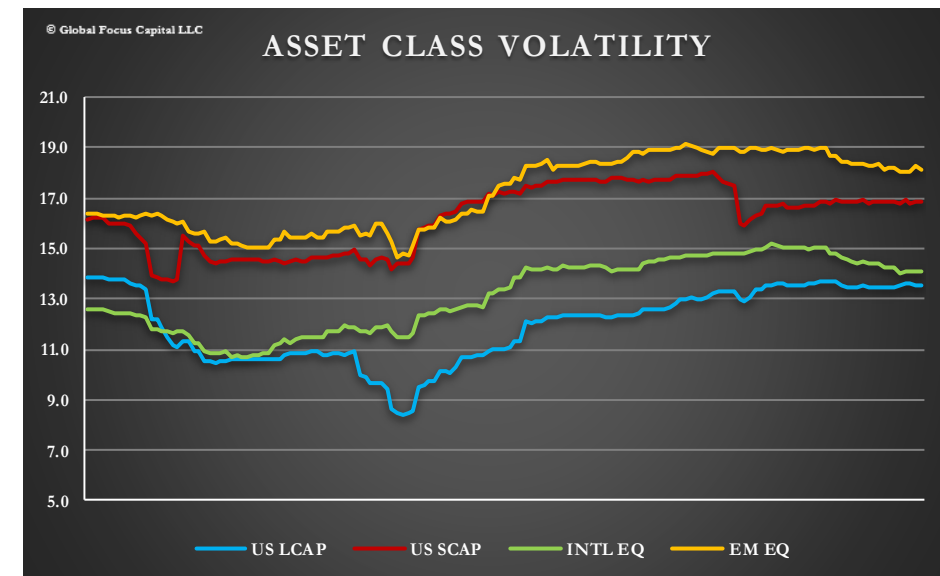
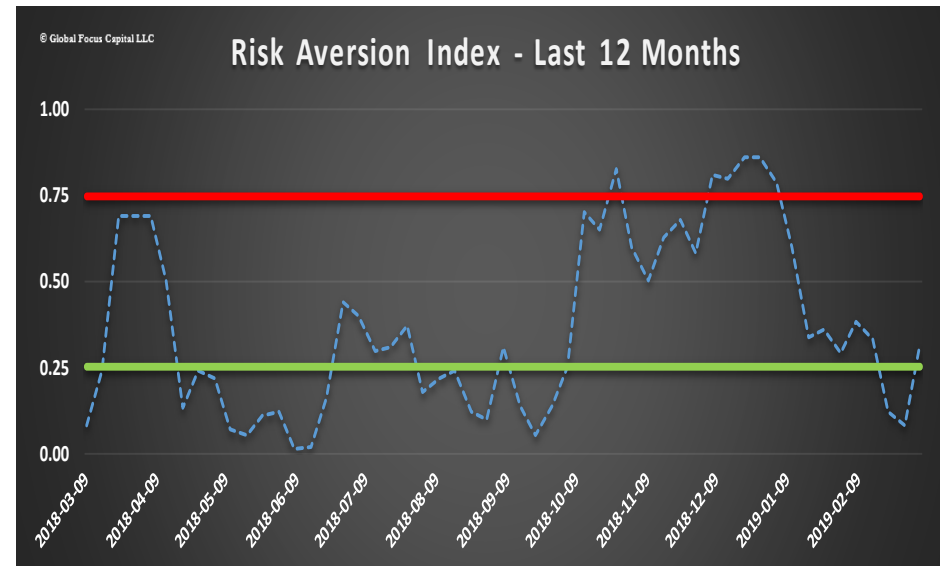
# Style and Geography

- ▶ In the US, we saw Small Caps do worse than large caps
- ▶ The size effect in the US was really strong last week
- ▶ Within equity styles, Quality, Yield and Low Vol strategies delivered lower losses (lower beta)
- ▶ The Momentum has lost “mo” – momentum stocks have under-performed the general market this year
- ▶ International equities last week took a hard hit both in local currency as well as through currency losses
- ▶ On a YTD basis developed Europe has out performed other international strategies



# Investor Risk Aversion increases – ready for a risk off week?

- ▶ 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 but last week may have been a wake up call
- ▶ 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





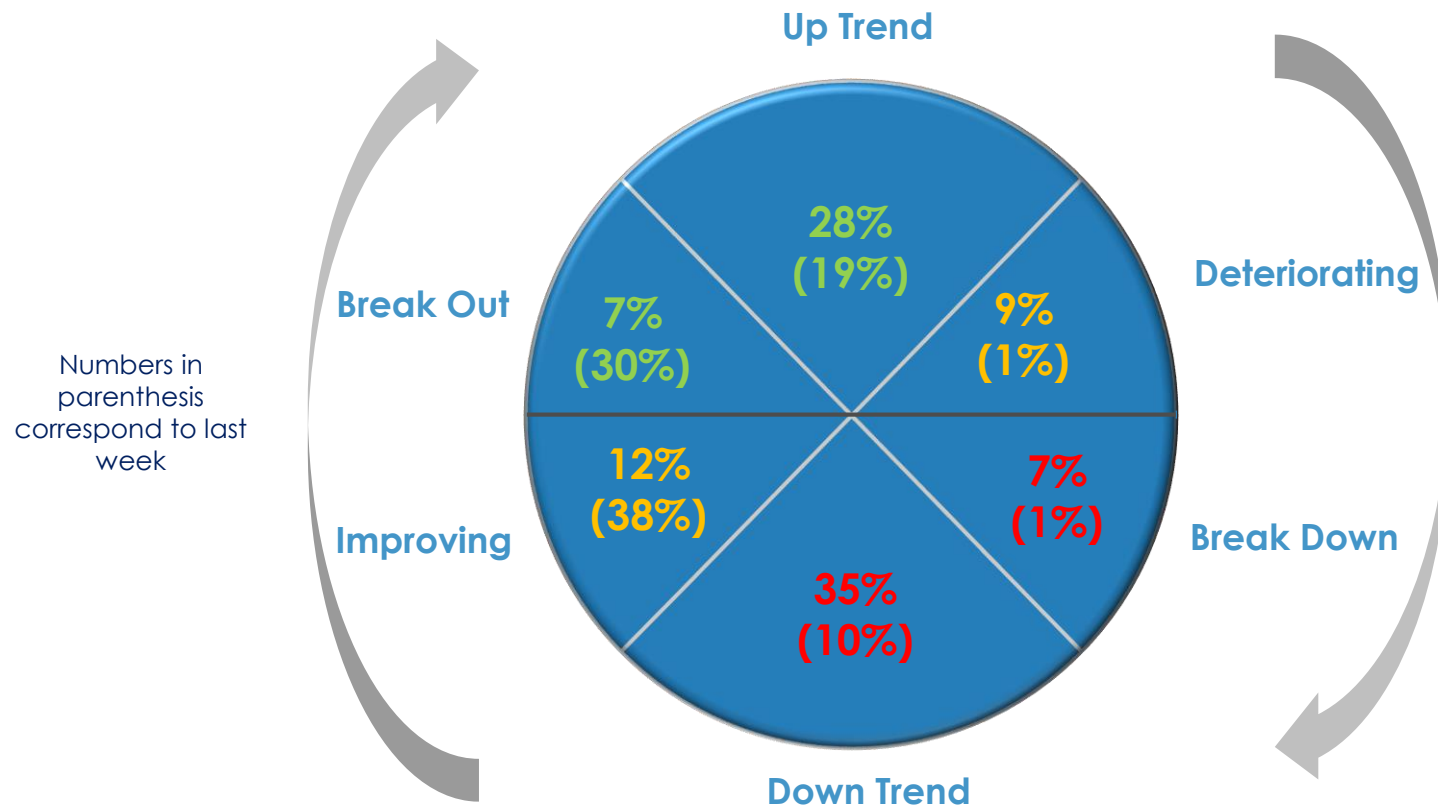
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# US Equities

## Weekly Performance

# Maybe the Bear Market is not here after all. We have seen more of a sector rotation market in 2019

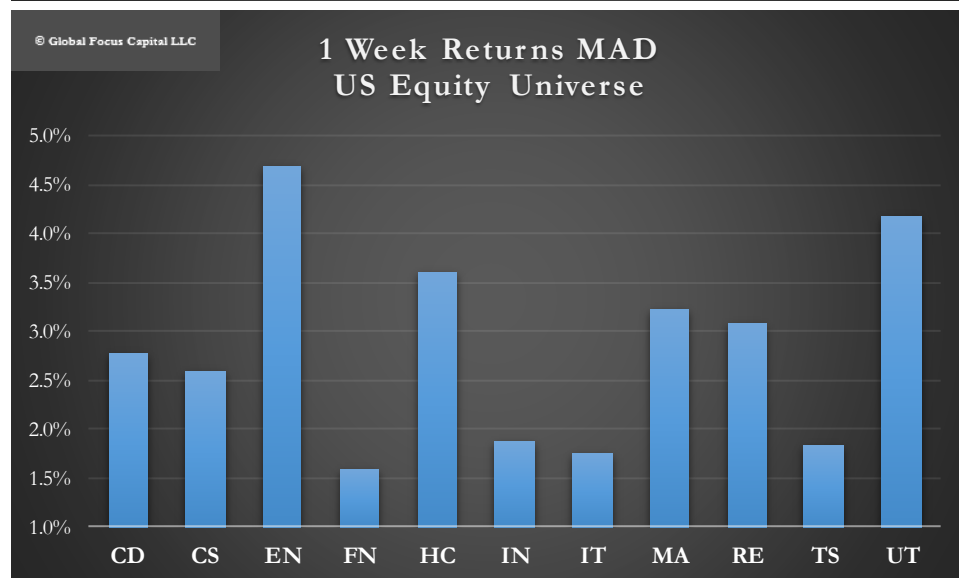
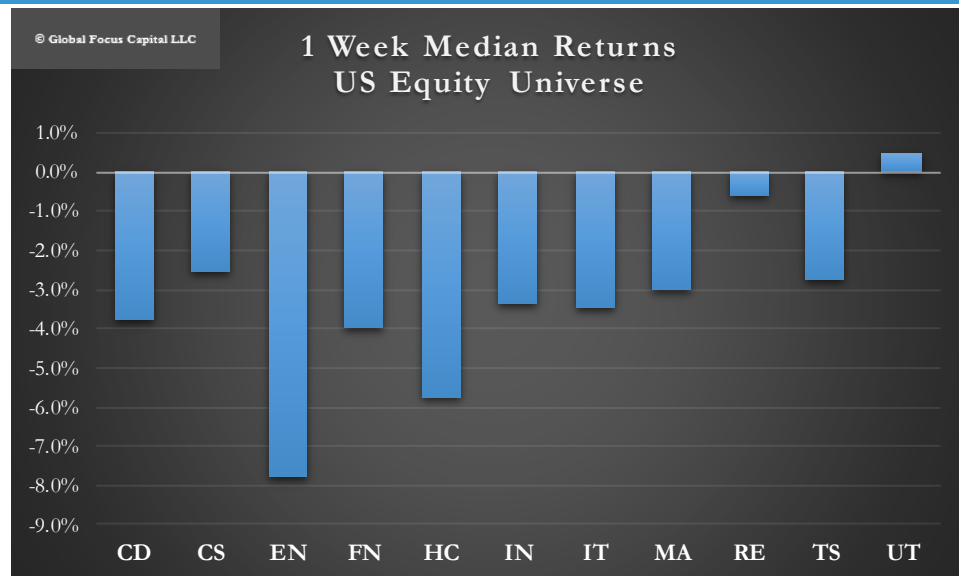


GF CAP US All Equity Universe



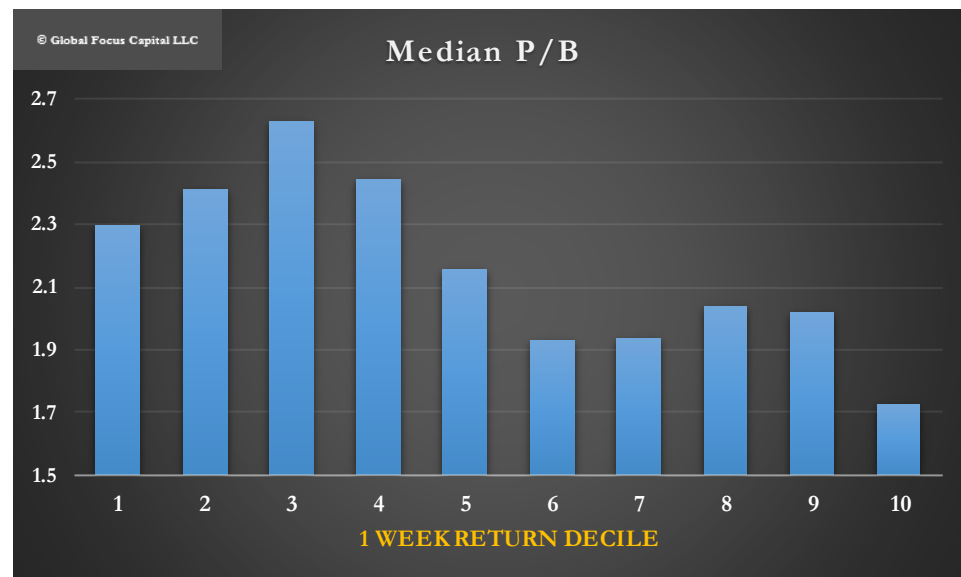
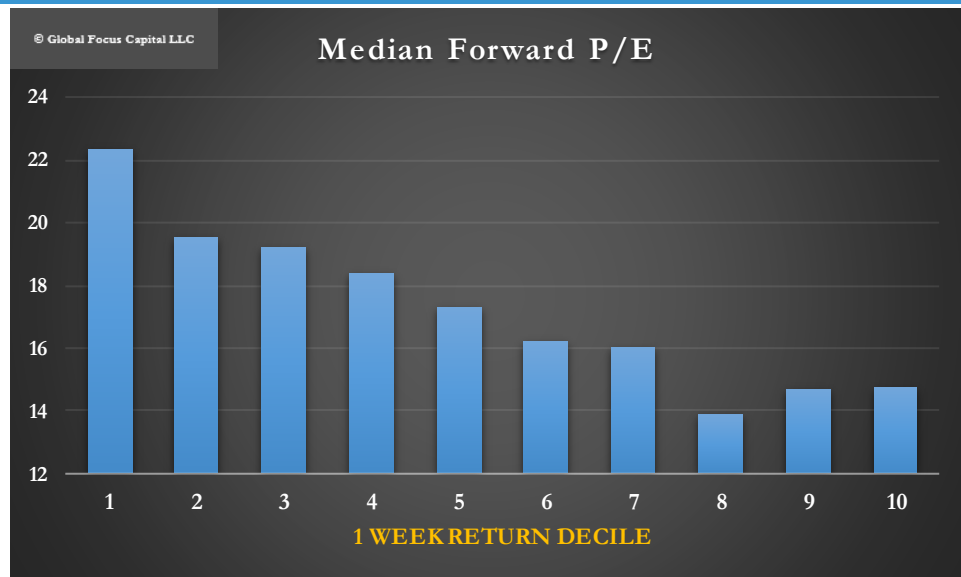
# The Sector Look – median performance and dispersion

- ▶ The mean stock in our universe was down 4.0% over the last 5 trading days
- ▶ All sectors showed negative median returns except Utilities
- ▶ Energy stocks really got pounded despite signs of oil market stability
- ▶ There was quite a dispersion in returns among sectors
- ▶ Interest sensitive sectors performed relatively well – Utilities, Real Estate and Telecom – as interest rates in the US dropped a bit
- ▶ 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

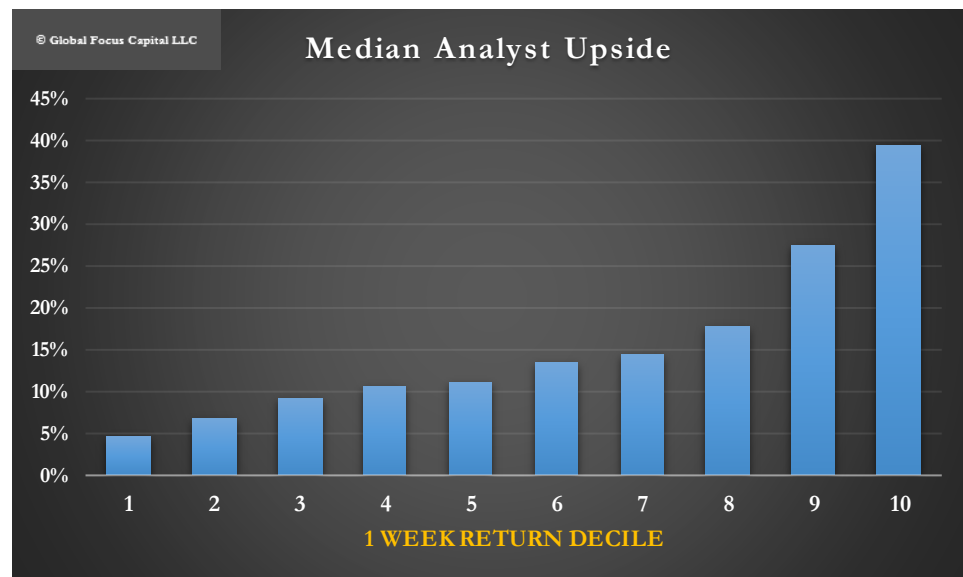
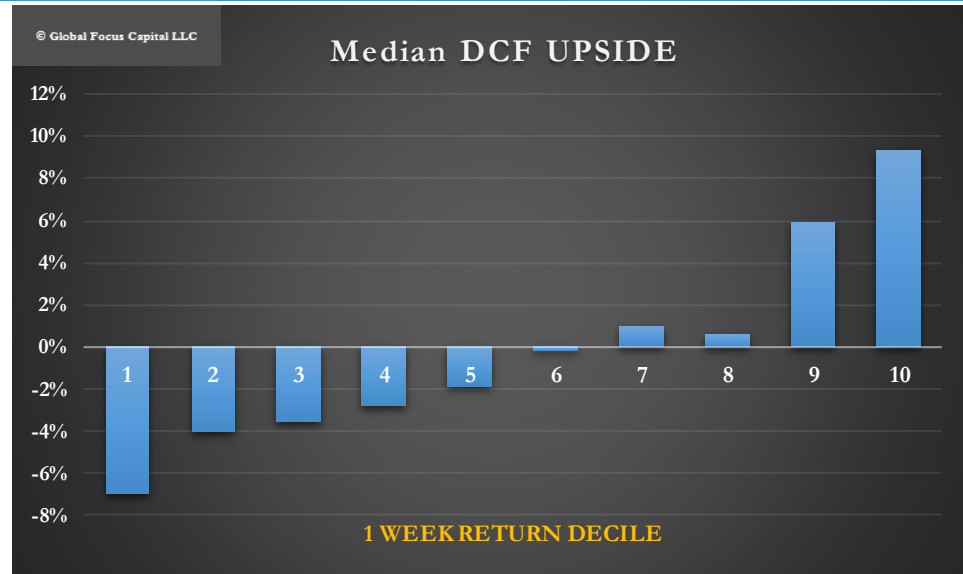
- ▶ Valuation was a terrible factor in determining performance last week
- ▶ In general higher P/E stocks did best
- ▶ We saw roughly the same among P/B deciles
- ▶ We have started 2019 with a modest Growth effect (in terms of indices)



# What did the markets reward last week:

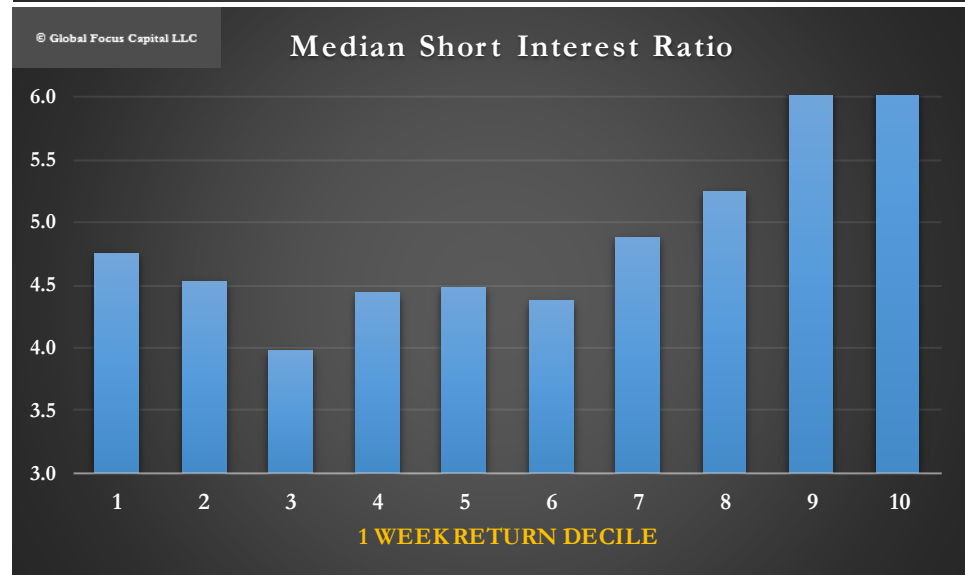
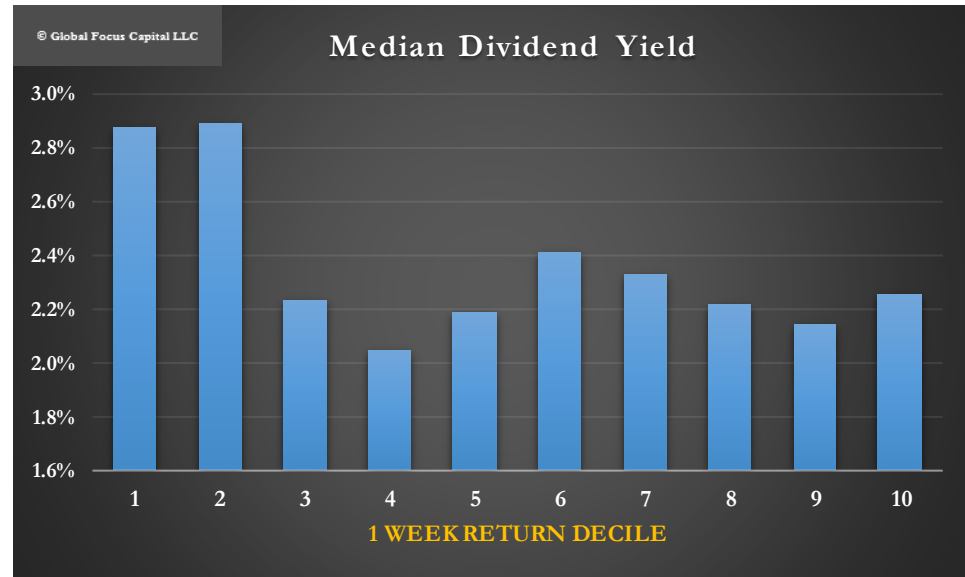
## Valuation Models

- ▶ The median stock in our universe is over-valued by 0.2% according to a DCF valuation – fair valuation conditions from a bottom up perspective
- ▶ The markets last week rewarded slightly over-valued stocks and penalized under-valued stocks
- ▶ In terms of analyst price targets, stocks with the highest positive deviation from target did worse



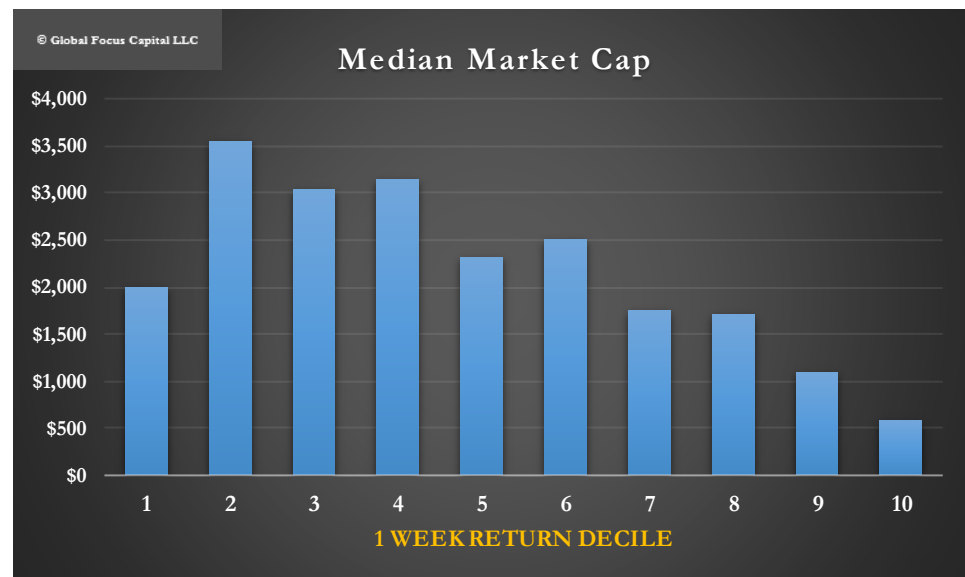
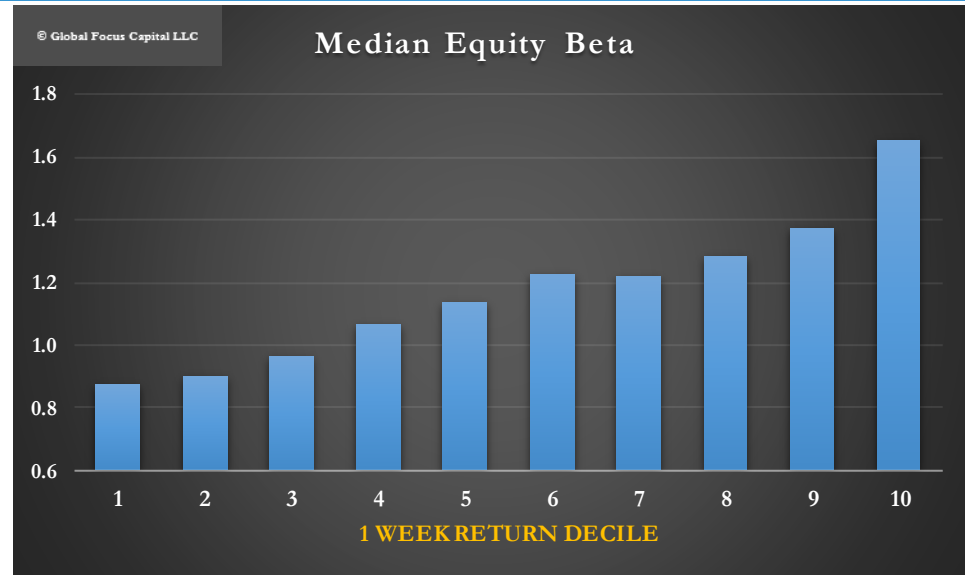
# What did the markets reward last week: Yield and Sentiment

- ▶ Higher dividend yield stocks performed better than average last week
- ▶ The positive effect was quite strong and uniform
- ▶ Short interest, a measure of sentiment, likewise showed a strong pattern of returns
- ▶ The best performing stocks had the lowest median levels of short interest



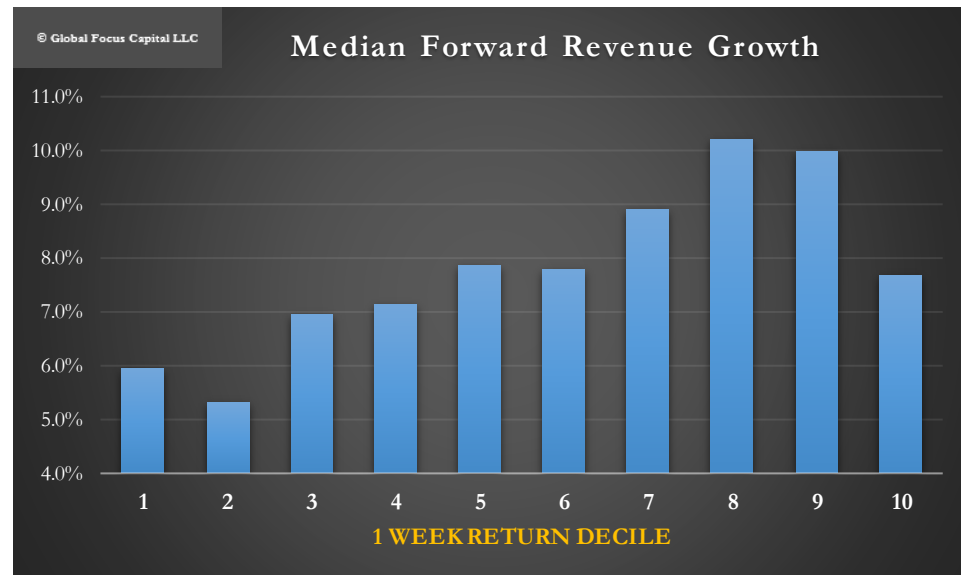
# What did the markets reward last week: Beta and Size

- ▶ Beta worked extremely well last week
- ▶ The higher the beta the worst the return
- ▶ In terms of market cap over the last week we have seen microcaps doing the worst – a very strong size effect
- ▶ The Russell 2000 index underperformed the S&P 500 by 2.1% over the last 5 trading days



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

- ▶ The 1 year momentum effect worked last week on a relative basis
- ▶ Stocks down the most over the last year under-performed last year's relative winners
- ▶ The industry rotation that started about 4 months ago is gaining strength
- ▶ Revenue growth as a factor exhibited a perverse relationship to return – higher growth companies showed the biggest losses last week



# Big Movers – Last 5 Days

## Down

Walgreens Boots Alliance, Inc.	WBA	Consumer Staples
EOG Resources, Inc.	EOG	Energy
Halliburton Company	HAL	Energy
McKesson Corporation	MCK	Health Care
Kroger Company (The)	KR	Consumer Staples
Align Technology, Inc.	ALGN	Health Care
Continental Resources, Inc.	CLR	Energy
Cardinal Health, Inc.	CAH	Health Care
Devon Energy Corporation	DVN	Energy
FMC Corporation	FMC	Materials
National Oilwell Varco, Inc.	NOV	Energy
Gap, Inc. (The)	GPS	Consumer Discretionary
Burlington Stores, Inc.	BURL	Consumer Discretionary
Sarepta Therapeutics, Inc.	SRPT	Health Care
DaVita Inc.	DVA	Health Care
bluebird bio, Inc.	BLUE	Health Care
GrubHub Inc.	GRUB	Consumer Discretionary
Chesapeake Energy Corporation	CHK	Energy
United Therapeutics Corporation	UTHR	Health Care
HealthEquity, Inc.	HQY	Health Care

## Up

Liberty Global plc	LILA	Communication Services
The Hain Celestial Group, Inc.	HAIN	Consumer Staples
Abercrombie & Fitch Company	ANF	Consumer Discretionary
Cardiovascular Systems, Inc.	CSII	Health Care
Big Lots, Inc.	BIG	Consumer Discretionary
Ra Pharmaceuticals, Inc.	RARX	Health Care
Upland Software, Inc.	UPLD	Information Technology
Lindblad Expeditions Holdings Inc.	LIND	Consumer Discretionary
ArQule, Inc.	ARQL	Health Care
DXP Enterprises, Inc.	DXPE	Industrials
Rosetta Stone	RST	Communication Services
Marinus Pharmaceuticals, Inc.	MRNS	Health Care
La Jolla Pharmaceutical Company	LJPC	Health Care
BioTime, Inc.	BTX	Health Care
Kopin Corporation	KOPN	Information Technology
Vuzix Corporation	VUZI	Consumer Discretionary
GTx, Inc.	GTXI	Health Care
Zion Oil & Gas Inc	ZN	Energy

# This Coming Week

## Reporting Soon

Oracle Corporation	ORCL	Information Technology
Adobe Systems Incorporated	ADBE	Information Technology
Broadcom Limited	AVGO	Information Technology
Progressive Corporation (T	PGR	Financials
Dollar General Corporation	DG	Consumer Discretionary
Ulta Salon, Cosmetics & Fi	ULTA	Consumer Discretionary
Coupa Software Incorporated	COUP	Information Technology
Caseys General Stores, Inc.	CASY	Consumer Staples
Williams-Sonoma, Inc.	WSM	Consumer Discretionary
Jabil Circuit, Inc.	JBL	Information Technology
Dick's Sporting Goods Inc	DKS	Consumer Discretionary
Semtech Corporation	SMTC	Information Technology
Inter Parfums, Inc.	IPAR	Consumer Staples
Shenandoah Telecommuni	SHEN	Communication Services
Arena Pharmaceuticals, Inc	ARNA	Health Care
Kronos Worldwide Inc	KRO	Materials
TeleTech Holdings, Inc.	TTEC	Information Technology
Benefitfocus, Inc.	BNFT	Information Technology
Valhi, Inc.	VHI	Materials
Signet Jewelers Limited	SIG	Consumer Discretionary
3D Systems Corporation	DDD	Information Technology
Caleres, Inc.	CAL	Consumer Discretionary
Weis Markets, Inc.	WMK	Consumer Staples
Loral Space & Communica	LORL	Communication Services
National CineMedia, Inc.	NCMI	Communication Services
Revlon, Inc.	REV	Consumer Staples
Epizyme, Inc.	EPZM	Health Care
Natera, Inc.	NTRA	Health Care
Genesco Inc.	GCO	Consumer Discretionary
NorthStar Realty Europe C	NRE	Real Estate

- ▶ The strength of the equity market recovery has been impressive especially among small caps
- ▶ We believe that a risk on/off market is likely this year
- ▶ Given the low levels of investor risk aversion we would expect a reversal in the near future
- ▶ Equity Technicals have deteriorated to the point that 35% 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 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
- ▶ 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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