

# Market Observations – August 2017 Recap

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Stocks continued their resiliency despite a host of events that could potentially stir up volatility including North Korean nuclear threats, terror attacks in Barcelona, violent protests in Virginia, political quarreling in Washington and a devastating storm barreling down on Texas. Strong second quarter corporate earnings provided good support to continue the rally as did some good economic data. Whether the economic data is good enough for the Fed to raise rates again this year is uncertain.

US equity indices hover around highs despite the aforementioned risk factors. The S&P 500 finished the month with a return of 0.3%, bringing its year-to-date return to 11.9%. The tech sector was a big contributor to the S&P 500's performance for the month with stocks such as Apple, Facebook and Microsoft being the largest contributors. The US Dollar (USD) continued its weakening trend vs. the Euro, Yen and other major currencies which seems to have benefited US exporters and non-US equity returns in USD terms. The MSCI EAFE index, representing international developed market equities, was flat for the month despite appreciating currencies. The MSCI EM index, representing emerging market equities, returned 2.2%, continuing its outperformance over US equities over the year-to-date period.

While equities were resilient, high quality bonds benefited from the risks mentioned above as many investors looked for protection by purchasing long-dated US Treasuries, municipal bonds and investment grade corporate credit. The US Treasury curve flattened during the month, benefiting long duration assets. Lower quality credit experienced modestly negative returns as historically tight spreads widened slightly.

As summer concludes and activity picks up in the month of September it will be interesting to see how the markets absorb the recent events and responds to upcoming issues such as the debt ceiling in Washington and the unveiling of a tax cut proposal by the Trump administration.

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## US Equity Summary:

- The S&P 500 was up a modest 0.3% for the month. Growth outperformed value across the market cap spectrum.
- Information Technology and Utilities were the top performing sectors. Energy, Telecom, Consumer Discretionary, Financials and Consumer Staples all posted negative returns for the month. Energy was the weakest performing sector dragged down by declining oil prices.
- Large-cap stocks outperformed mid and small-cap stocks for the month. Small-cap, the weakest performing segment was down 1.3% as per the Russell 2000 index.
- Apple, Facebook, and Microsoft were the top contributing stocks within the S&P 500 for the month. Information Technology as a sector, with a 22.9% weighting, contributed over half of the index's return.
- Based on JPMorgan factors Momentum, Beta and Size were the dominant factors while Value was the weakest performing factors.

## Developed and Emerging Market Equity Summary:

- The MSCI EAFE Index was flat for the month, while the MSCI EM Index returned 2.2%. Small-cap stocks outperformed large-cap stocks in developed markets while large-cap outperformed small-cap within emerging markets.
- Beta and Value were the best performing factors in developed markets with Value factors being the weakest. Within emerging markets Momentum and Quality were the strongest performing factors while Volatility was the weakest.
- The Pacific region ex Japan was the best performing region within the developed markets, followed by the European region. The Far East region was the weakest developed market region driven by Japan's -0.5% return.
- Eastern Europe was the best performing region within emerging markets, while Emerging Asia was the weakest. Frontier markets underperformed the broad emerging markets for the month, as the MSCI Frontier Emerging Markets index posted a July return of 1.9%.
- Materials, Utilities and Energy were strong performing sectors within developed markets while Materials, Real Estate and Energy were top performing sectors within emerging markets. Health Care, Consumer Staples and Industrials were weakest in both developed and emerging markets.

## Fixed Income Summary:

- Mixed performance across the major bond segments for the month. High quality outperformed low quality overall.
- While the Barclays US Treasury index was up 1.1%, long-dated Treasuries (20+ years) were up 3.6% as the curve flattened.
- High yield credit was the weakest performing segment with a -0.03% return on the BofA ML US High Yield Index. Within high yield, CCC-rated credits performed worst. Leveraged loans were also slightly down for the month.
- Continued risk-on demand for higher yielding assets and stronger currencies propelled emerging market sovereign bonds in August, as the JPMorgan EMBI Global Diversified returned 1.8%. Meanwhile, a notable weakening of the British pound following the BoE's decision to keep rates unchanged in August led to a slightly more muted return for the Citigroup WGBI of 1.2%.

## Disclosures

*Indices are unmanaged and presented for comparison purposes only. Please note that the returns displayed for indices do not take into account any of the costs associated with buying and selling individual securities. Individuals cannot invest directly in an index.*

**Bloomberg Barclays US Corporate High Yield TR USD:** Bloomberg Barclays US Corporate High Yield TR USD

**Bloomberg Barclays US Treasury 1-3 Yr TR USD:** The Bloomberg Barclays Capital US Treasury Bond 1-3yr term index measures the performance of short-term government bonds issued by the US Treasury.

**Bloomberg Barclays US Treasury 10 Yr USD:** The index measures the performance of government bonds issued by the US Treasury.

**Bloomberg Barclays US Treasury 20+ Yr TR USD:** The Index is market capitalization weighted and includes all of the securities that meet the Index criteria. The index includes all publicly issued, U.S. Treasury securities that have a remaining maturity greater than 20 years, are non-convertible, are denominated in U.S. dollars, are rated investment grade (Baa3 or better) by Moody's Investors Service, are fixed rate, and have more than \$150 million par outstanding. Excluded from the Index are certain special issues, such as flower bonds, targeted investor notes (TINs) and state and local government series bonds (SLGs), and coupon issues that have been stripped from assets already included.

**Bloomberg Barclays US Aggregate Bond Index:** The U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The Index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM pass throughs), ABS, and CMBS sectors. The U.S. Aggregate Index is a component of the U.S. Universal Index in its entirety.

**MSCI EM Index:** The MSCI Emerging Markets Index captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 822 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country

**MSCI EAFE Index:** The MSCI EAFE Index is recognized as the pre-eminent benchmark in the United States to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia and the Far East.

**S&P 500 Index:** The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted Index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value. The Index is one of the most widely used benchmarks of US Equity Large Cap performance.

**Alerian MLP Index:** The Alerian MLP Index is the leading gauge of energy Master Limited Partnerships (MLPs). The float-adjusted, capitalization-weighted index, whose constituents represent approximately 85% of total float-adjusted market capitalization, is disseminated real-time on a price-return basis (AMZ) and on a total-return basis (AMZX).

### **J.P. Morgan Factor Definitions**

**Yield:** Stocks are ranked by trailing 12 month dividend yield. Positive factor performance indicates that the highest yielding stocks outperformed the lowest yielding stocks (as well as those stocks that did not pay any dividends) in the universe.

**Size:** Stocks are ranked by their month end market cap. A negative Size factor return would indicate that smaller cap stocks generally outperformed larger cap stocks.

**Quality:** Combines ROE and Earnings Risk (inverted such that stocks with tightest forecasts are rewarded with a higher score).

**Price Momentum:** The 12 Month Price Momentum factor is calculated by ranking stocks by their total return over the previous 12 months.

**Earnings Momentum:** This factor ranks stocks by their forward earnings momentum (1Mth + 3 Mth). For each stock, the change in FY1 earnings over the last month and the last 3 months, and the change in FY2 earnings over the last month and the last 3 months are calculated. A 3-month revision number and a 1-month revision number is calculated by taking the average of the change in FY1 and FY2. A composite value as the average of the 1 month and 3 month values is then calculated.

**Book-to-Price:** Stocks are ranked by their 12 month trailing Book/Market ratio with the cheapest stocks exhibiting the lowest ratio. A positive factor return indicates that stocks with a lower book-to-price ratio outperformed higher book-to-price stocks in the universe.

**Beta:** Beta for the stock relative to its local benchmark index. Note this is a fundamental beta not a calculated Beta.

USD: United States Dollar.

EURO: The official currency of the Eurozone.

CAD: The official currency of Canada.

AUD: The official currency of Australia.

BRL: The official currency of Brazil.

CHF: The official currency of Switzerland.

JPY: The official currency of Japan.

INR: The official currency of India.

**West Texas Intermediate (WTI):** West Texas Intermediate (WTI) crude oil is the underlying commodity of the New York Mercantile Exchange's oil futures contracts. The success of an investment program may be affected by general economic and market conditions, such as interest rates, availability of credit, inflation rates, economic uncertainty, changes in laws and national and international political circumstances. These factors may affect the level and volatility of securities prices and the liquidity of a portfolio's investments. Unexpected volatility or illiquidity could result in losses.

Investing in securities is speculative and entails risk. There can be no assurance that one's investment objectives will be achieved or that an investment strategy will be successful. Significant losses could result if a strategy involves the use leverage, short sales and derivative transactions, investment in foreign or illiquid securities, and potentially limited diversification.

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Any forward looking statements are not guaranteed and can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements

#### **Special Risks of Foreign Securities**

Investments in foreign securities are affected by risk factors generally not thought to be present in the US. The factors include, but are not limited to, the following: less public information about issuers of foreign securities and less governmental regulation and supervision over the issuance and trading of securities.

#### **Special Risks of Master Limited Partnerships**

Master limited partnerships (MLPs) are publicly listed securities that trade much like a stock, but they are taxed as partnerships. MLPs are typically concentrated investments in assets such as oil, timber, gold and real estate. The risks of MLPs include concentration risk, illiquidity, and exposure to potential volatility, tax reporting complexity, fiscal policy and market risk. MLPs are not suitable for all investors.

#### **Special Risks of Small Market Capitalization Securities**

Investments in companies with smaller market capitalization are generally riskier than investments in larger, well-established companies. Smaller companies often are more recently formed than larger companies and may have limited product lines, distribution channels and financial and managerial resources. These companies may not be well known to the investing public, may not have significant institutional ownership and may have cyclical, static or moderate growth prospects. There is often less publicly available information about these companies than there is for larger, more established issuers, making it more difficult for the Investment Manager to analyze that value of the company. The equity securities of small and mid capitalization companies are often traded over-the-counter or on regional exchanges and may not be traded in the volume typical for securities that are traded on a national securities exchange. Consequently, the Investment Manager may be required to sell these securities over a longer period of time (and potentially at less favorable prices) than would be the case for securities of larger companies. In addition, the prices of the securities of small and mid capitalization companies may be more volatile than those of larger companies.

#### **Special Risks of Fixed Income Securities**

For fixed income securities, there is a risk that the price of these securities will go down as interest rates rise. Another risk of fixed income securities is credit risk, which is the risk that an issuer of a bond will not be able to make principal and interest payments on time.

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