Market Observations – April 2018 Recap

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Spring is finally here, the economy is on sound footing with decent economic growth, corporate earnings growth that has been spectacular, but a paltry 0.4% S&P 500 return for the month. What gives? Well, the 10-year US Treasury yield continued its rise, hitting 3% during the month, making dividend paying stocks less attractive to many investors. There are balance of trade uncertainties which can impact a number of industries. The US Dollar reversed its decline and rose 1.9% during the month, as per the US Dollar index, which could have a negative impact on US multinational companies as their products become more expensive overseas. Lastly, inflation seems to be making more and more of a presence potentially prompting the Fed to impose four rate hikes in 2018 instead of the expected three.

Most interesting is that the S&P 500 is essentially flat for the year-to-date (-0.4%) when corporate earnings have been so strong, resulting in multiple contractions for US equities. This means that stocks are not expensive as they were at the end of 2017. Many market pundits were not concerned about high equity valuations in market run-up through 2017 as interest rates were so low. Holding to that same philosophy it is not so surprising to see multiples contract now that rates are rising. Additionally, it is not surprising to see volatility settle into a higher range like we've seen in April given that we are now in a Fed tightening cycle. The CBOE Volatility index, settled into a range that is about 50% higher than experienced over the course of 2017.

Below is a summary of what occurred in the markets globally during the month of April.

US Equity Summary:

- The S&P 500 was up 0.4% for the month. Small Cap stocks outperformed Mid and Large Cap stocks. Within the Small and Mid-Cap segments the Value style outperformed the Growth style. Within the Large Cap segment Growth and Value performed in line with one another.
- Energy was the top performing sector by a wide margin with a 9.4% return, benefiting from the rising price of oil. Consumer Discretionary, Utilities and Health Care were the only other sectors to outperform the S&P 500 with returns of 2.4%, 2.1%, and 1.2% respectively.
- Consumer Staples, Industrials, Telecom, Real Estate and Financials were the bottom performing sectors, all with negative returns.
- Amazon, Facebook and Microsoft continue to be large contributors to index performance. However, the Energy sector made a strong showing in the top ten contributors with Chevron, Exxon and Occidental Petroleum.
- Based on JPMorgan factors, Earnings Momentum and Growth were the top performing factors. Yield and Low Volatility were the biggest laggards. Price Momentum, which has been the market leader, took a back seat for the month.

Developed and Emerging Market Equity Summary:

- The MSCI EAFE Index 2.3% for the month, while the MSCI EM Index returned -0.4%. Small cap stocks underperformed large Cap stocks in developed and outperformed in emerging markets.
- All sectors posted positive returns in developed markets with the exception of the Health Care sector. Energy, Telecomm, and Consumer Discretionary were the top performing sectors. Health Care, Industrials and Consumer Staples were the weakest performing sectors.
- Earnings Momentum and Value factors were the best performing in developed markets. Price Momentum, Volatility and Growth were the weakest.
- Within emerging markets Materials, Industrials and Energy were the top performing sectors. Health Care, Tech and Financials were the weakest performing. From a factor perspective Value factors were the top performing while Quality was the weakest.
- Frontier markets underperformed the broad emerging markets, as the MSCI Frontier Markets index posted an April return of -3.2%.

Fixed Income Summary:

- The Treasury yield curve steepened at the long end in April. The 10-year Treasury finished the month yielding 2.93% after beginning the month at 2.74%. The steepening of the long end is primarily due to inflation concerns creeping into expectations. The Bloomberg Barclays US Treasury index was down 0.8% while long-dated Treasuries (20+ years) were down 2.0%.
- Within corporate credit, investment grade underperformed high yield corporates, posting a -0.9% return. High yield credit posted positive returns for the month with lower quality high yield outperforming as corporate fundamentals remain strong for the time being.
- Leveraged loan performance was a slight positive for the month, meeting the expectation of performing well when rates rise.
- Investment grade municipal bonds were down for the month while high yield municipals posted a modest positive return.
- Global bonds were challenged by widening credit spreads and a rising US dollar. Local emerging market debt fared the worst, with the JPMorgan GBI-EM Index declining -3.0% for the month. Developed markets via the Citigroup WGBI Index declined -1.9% for the period.

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.

The opinions expressed herein can change anytime without notice.

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 that 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.