Market Observations – May 2018 Recap

By Jeff Sutton, CFA
Managing Director
Oppenheimer Asset Management

US equities are back. The S&P 500 posted a 2.4% return for the month of May and is now up 2.8% for the quarter-to-date and 2.0% year-to-date. Equities have benefited from strong earnings growth and an economy that is doing well, but not too well to stir concerns of a fourth rate hike in 2018. There are plenty of things that can stir up volatility such as trade wars, North Korea and Iran nuclear talks, European political anxiety, etc. These risks have for the most part been brushed aside for the time being.

Within US equities we continue to see a fairly narrow market. The Information Technology and Consumer Discretionary sectors represent 2.4% of the S&P 500's 2.8% return over the quarter-to-date period. The usual suspects are driving that performance; Apple, Facebook, Amazon, Netflix, Alphabet. Consumer Staples, Telecom and Utilities, which are the most interest-rate sensitive sectors, continue to lose the battle to rising rates. Outside the US equities were down in May in both developed and emerging markets as declining currencies took a toll as well as potential trade wars and political unrest in Europe.

Within the US bond market, the Treasury curve flattened as the long end declined due to reduced inflationary concerns, and the short end rose as the Fed continues its path of rate increases. The result was improved performance in the bond markets from what we saw during the first quarter when most segments were down along with equities.

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

US Equity Summary:

- The S&P 500 was up 2.4% for the month. Small Cap stocks outperformed Mid and Large Cap stocks. The Value style outperformed the Growth style across all market cap segments.
- Information Technology was the top-performing sector with a return of 7.4%. Energy and Industrials were the only other two sectors to outperform the S&P 500 for the month.
- Telecom, Consumer Staples, Utilities and Financials were the bottom performing sectors, all with negative returns.
- Real estate and MLPs were strong performers during the month. Real estate benefited from dialed down inflation expectations while MLPs benefited from rising oil prices and increased US exports of oil and natural gas.
- Based on JPMorgan factors, Price Momentum and Growth factors regained leadership as the top performing factors. Value, Volatility and Size were the biggest laggards.

Developed and Emerging Market Equity Summary:

- The MSCI EAFE Index was down 2.3% for the month, while the MSCI EM Index returned -3.5%. Small cap stocks outperformed large Cap stocks in both developed and emerging markets.
- Materials, Information Technology, Consumer Discretionary and Health Care were the only sectors to post positive returns for the month in developed markets. Telecom and Financials were the weakest performing sectors.
- Price Momentum, Earnings Momentum and Growth factors were the best performing in developed markets. Value factors were the weakest.
- Within emerging markets Health Care and Information Technology top performing and only positive performing sectors. Telecom, Financials and Industrials were the weakest performing. From a factor perspective Price and Earnings Momentum along with Quality were the top performing while Value factors were the weakest.
- Frontier markets underperformed the broad emerging markets, as the MSCI Frontier Markets index posted a May return of -9.2%.

Fixed Income Summary:

- The Treasury yield curve flattened in May. The flattening of the long end was primarily due to reduced inflation concerns. The Bloomberg Barclays US Treasury index was up 0.9% while long-dated Treasuries (20+ years) were up 2.2%%.
- Within corporate credit, investment grade outperformed broad high yield corporates, posting a 0.5% return. High yield credit was flat for the month. However, lower quality high yield (CCC-rated) outperformed, as corporate fundamentals remain strong for the time being.
- Leveraged loan performance was flat for the month, meeting the expectation of performing well (outperforming high yield) when rates rise.
- Investment grade and high yield municipal bonds were up for the month as spreads tightened, regaining some of the year's earlier losses.
- Global bonds struggled to cope with political flare-ups, a stronger US dollar, and rising US interest rates, as the Citigroup WGBI Index declined 1.6% for the month. More significant was the impact on emerging market debt as the local-currency JPMorgan GBI-EM Index declined 5.0% in the period, with the Mexican peso and Brazilian real declining over 6% relative to the dollar in May.

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.