

# Market Observations – January 2018 Recap

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Stocks came storming out of the gate in 2018. The S&P 500 finished the month with a 5.7% return. International stocks posted a 5.0% return as per the MSCI EAFE index. Emerging markets certainly were not left behind with an 8.3% return as per the MSCI EM index. U.S. stocks benefited from good economic growth, strong corporate earnings, and a 3.3% decline in the U.S. Dollar which makes U.S. goods cheaper for overseas buyers. Non-U.S. equities also got a boost from the declining greenback when foreign stock returns are translated from local currency into USD. Furthermore, according to the Wall Street Journal, over \$100 billion in investor flows went to equities in the month of January, also aiding the global equity advance.

Bonds underperformed equities globally for the month. In the U.S. the 10-year Treasury yield increased from 2.41% at the beginning of the month to 2.72% at the end of January. Given that rising Treasury yields adversely impact price, the Bloomberg Barclays Treasury index was down 1.4% for the month. The short end of the Treasury curve didn't escape unscathed as the Bloomberg Barclays 1-3 Year Treasury index was down 0.3%. The spread of investment grade corporates over Treasuries was not enough to offset the impact of rising rates, as investment grade credit posted a negative return for the month as well. However, higher yield credit did have enough yield cushion to protect and as a result posted modestly positive returns.

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

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## US Equity Summary:

- The S&P 500 was up 5.7% for the month. All market cap segments and styles ended the month with positive returns. However, growth stocks outperformed value stocks and large cap stocks outperformed small cap stocks.
- Consumer Discretionary, Information Technology and Financials were the top performing sectors. Real Estate and Utilities were the weakest performing sectors, posting negative returns, as they were adversely impacted by rising rates.
- Amazon, Microsoft and Alphabet were the top contributing stocks within the S&P 500 during January. The Information Technology and Consumer Discretionary sectors contributed to 1/2 of the S&P's performance in January.
- Based on JPMorgan factors, Momentum, Size and Quality were the dominant factors while Beta, Volatility, Value were weak factors. Momentum in particular is worth noting as it has been the dominant factor in 2017.

## Developed and Emerging Market Equity Summary:

- The MSCI EAFE Index was up 5.0% for the month, while the MSCI EM Index returned 8.3%. Large Cap and small cap stocks performed in line in developed markets while large cap stocks outperformed small cap stocks within emerging markets.
- Financials, Information Technology and Industrials were the top performing developed and emerging market sectors. Just as in the U.S., Utilities and Telecom were the weakest.
- Momentum and Growth were the best performing factor in developed markets while Beta was the weakest. Within emerging markets Value and Quality were the strongest performing factors while Beta, Volatility and Growth factors were the weakest.
- The Europe and the EU were the best performing regions within developed markets. The Far East and Pacific region were the weakest in developed markets.
- Latin America and Eastern Europe were the best performing regions within emerging markets, while Asia and the Far East were the weakest performing regions. Frontier markets underperformed the broad emerging markets for the month, as the MSCI Frontier Emerging Markets index posted a January return of 4.7%.

## Fixed Income Summary:

- The Treasury yield curve steepened at the long end in January. The 10-year Treasury finished the month yielding 2.72% after beginning the month at 2.41%. The steepening of the long end is primarily due to inflation concerns beginning to creep in to expectations.
- While the Bloomberg Barclays US Treasury index was down 1.4%, long-dated Treasuries (20+ years) were down 3.3%, hurt by rising inflation expectations.
- Within corporate credit, investment grade underperformed high yield corporates, posting a negative return. Within high yield, lower quality high yield outperformed as corporate fundamentals remain strong for the time being.
- Leveraged loan performance was positive for the month, meeting the expectation of performing well when rates rise.
- High yield municipal bonds outperformed investment grade municipal bonds, but both posted negative returns for the month.
- The U.S. dollar decline was the primary contributor to strong international bond returns in January, specifically among Emerging Markets. The JPMorgan GBI-EM Global Diversified Index rose 4.5% in the month, followed by a more modest 1.4% return for Developed Markets (per the Citigroup WGBI Index).

## 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 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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