

# Market Observations – October 2017 Recap

By Jeff Sutton, CFA

Managing Director

Oppenheimer Asset Management

At the end of each month, I receive our team's "Monthly Packet." In addition to a profusion of data, the "Monthly Packet" contains global market returns across asset classes. As I was scanning the trailing one-year and three-year returns, I was not surprised to see the big return that the current market rally has provided. Then a realization hit me – it is easy for investors to be enamored with these returns and take their eyes off the ball. Yes, things are good. Corporate earnings have been strong, economic numbers are surprising to the upside in many cases; the Fed is choreographing its rate normalization, etc. The S&P 500 tagged on another 2.3% in October to bring its year-to-date return to 16.9%. Things are so good that it is easy to take your eye off the ball and tilt your portfolio towards those segments of the market that are working best these days. What is not to like about US large cap tech with a 39% return as per the S&P Information Technology sector over the trailing one year? Emerging market equities are up 26% as per the MSCI EM index. Even MSCI Japan is up 17.7% over the past 12 months. Why bother with bonds when the Barclays US Aggregate Bond index returned 0.9% return over the past 12 months or for diversifying strategies when merger arbitrage and managed futures have not delivered?

Do not take your eye off the ball! The goal is to achieve long-term objectives; not abandon a set asset allocation designed to achieve long-term objectives in return for taking on more risk to chase today's biggest winners. There is a high probability that the outcome will not be good. Despite knowing that human emotion is our own worst enemy we still succumb to making bad decisions because of it. Do not be a victim. Stick to your long-term plan. Enjoy the segments of your portfolio that are performing well in this environment and have peace of mind that those diversifiers in the portfolio that are not performing so well are there for a reason.

With that said, below is a summary of what occurred in the markets globally during the quarter.

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## US Equity Summary:

- The S&P 500 was up a 2.3% for the month. Growth outperformed value across the market cap spectrum.
- Information Technology and Utilities continue to be top performing sectors.
- Apple, Microsoft and Amazon were the top contributing stocks within the S&P 500 for the month. Information Technology as a sector, with a 23.5% weighting, contributed ~1.8% of the S&P 500's 2.3% return.
- Telecom, Consumer Staples, Health Care, and Energy posted negative returns for the month.
- Large-cap stocks outperformed mid and small-cap stocks. Small-cap, the weakest performing segment, was essentially flat for the month as per the Russell 2000 index. Biotech and retailers weighed on the small cap index the most.
- Based on JPMorgan factors Momentum, Beta, and Size were the dominant factors while Value factors performed the weakest.

## Developed and Emerging Market Equity Summary:

- The MSCI EAFE Index was up 1.5% for the month, while the MSCI EM Index returned 3.5%. Small-cap stocks outperformed large-cap stocks in developed markets and performed in line with one another in emerging markets.
- Momentum was the best performing factor in developed markets while Yield was the weakest. Within emerging markets Value was the strongest performing factor while Yield was the weakest.
- The Far East and Pacific regions were the best performing within the developed markets. The European region was the weakest developed market region, although still posting a positive return.
- Emerging Asia was the best performing region within emerging markets, while Latin America was the weakest. Frontier markets underperformed the broad emerging markets for the month, as the MSCI Frontier Emerging Markets index posted an October return of 0.1%.
- Information Technology, Industrials, Consumer Discretionary, and Materials were stronger performing sectors within developed markets while Information Technology, Health Care, and Energy were top performing sectors within emerging markets. Financials posted a negative return within developed markets while Telecom posted a negative return within emerging markets.

## Fixed Income Summary:

- The Treasury yield curve flattened modestly with a majority of the movement taking place at the short end. The 10-year Treasury rose from 2.33% at the end of September to 2.42% at the end of October.
- Higher yielding investments outperformed higher quality investments broadly. Bank loans was the strongest performing US bond segment modestly outperforming the high yield credit segment. Within high yield, higher quality high yield outperformed CCC-rated credits.
- Investment grade and high yield municipal bonds performed similarly during the month; outperforming Treasuries.
- The US dollar's rally in October largely supported US credit markets at the detriment of international bonds, with the US high yield market returning ~0.4% while the Citigroup WGFI returned -0.6%. Furthermore, renewed confidence in ECB accommodation resulted in spread compression in the region's credit market as the BofA Euro High Yield Index returned 1.3% for the month.

## 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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