CLEARBROOK

# INVESTMENT COMMITTEE MARKET COMMENTARY

DECEMBER 4, 2017 www.clearbrookglobal.com

## U.S. EQUITIES

**U.S. equity markets rallied last week as the Senate made progress on U.S. tax legislation, but index returns were buffeted by a correction in technology stocks and political uncertainty tied to the guilty plea by former National Security Advisor Michael Flynn for lying to the FBI.**

a) **Dow Jones +3.00%, MTD -0.16%, YTD +25.49%** b) **S&P 500 +1.60%, MTD -0.20%, YTD +20.25%**
c) **Russell 2000 +1.22%, MTD -0.46%, YTD +14.59%**

**Drivers:** I) **Goldman Sachs** reported that mutual-fund managers **cut their allocation to large-cap internet and technology stocks** in the third quarter, turning underweight on the so-call **FAAMG stocks**. Year-to-date gains in the stocks have ranged from 30.8% to nearly 60%. Overall managers are **still overweight** the sector by 1.09%.

II) The **former national-security adviser**, **Michael Flynn, pleaded guilty** last Friday to lying to the FBI. According to the lawsuit, Flynn falsely stated to the FBI that he did not ask Sergey Kislyak, then Russia's ambassador to Washington, to refrain from escalating the situation in response to sanctions President Barack Obama had imposed against the country.

III) The **Institute for Supply Management** reported its **manufacturing index slipped** to a still-**strong reading of 58.2%** last month from October's 58.7%. The ISM's new orders index rose 0.6 % to 64% and the production index climbed 2.9 % to 63.9%, setting a six-year watermark. The employment gauge was little changed at a still-strong 59.7%.

IV) The **PCE index**, the Federal Reserve's preferred inflation gauge, rose by just 0.1% in October. The closely followed "core" rate that excludes food and energy **advanced 0.2%.** The rate of inflation over the **past year** fell slightly **to 1.6%.** The core rate was flat at 1.4%. The central bank believes inflation is excessively low and could pose a long-term impediment to the economy.

V) **Equity prices in December are slightly lower with Large-Cap, Value, Energy and Consumer Staples leading equity price performance. The laggards for the month are Small-Cap, Growth, Industrials and Materials.**

**Capitalization**: **Large Caps -0.19%** (YTD +20.12%), Mid-Caps -0.21% (YTD +17.18%) and **Small Caps -0.46%** (YTD +14.59). **Style: Value -0.31%** (YTD +11.40%) and **Growth -0.38%** (YTD +18.26%). **Industry Groups (Leaders):** Info. Tech -0.60% **(**YTD +36.63%), Tech -0.50% (YTD +33.06%), Healthcare -0.19% (YTD +22.30%), **Materials -0.84%** (YTD +20.49%), Utilities -0.35% (YTD +18.83%), Con. Discretionary +0.02% **(**YTD +19.94%), **Industrials -1.12%** (YTD +19.98%), Financials +0.23% (YTD +19.98%), REITs +0.18% (YTD +11.44%) and **Con. Staples +0.24%** (YTD +10.75%). **(Laggards): Energy +0.82%** (YTD -4.99%) and Telecom +0.21% (YTD -5.64%).

## EUROPEAN EQUITIES

**The MSCI Europe index was lower last week dropping -1.28%.** Markets began December on a negative note, in part following the release of the disappointing Chinese manufacturing report and the looming vote in the Senate on the U.S. tax reform bill after GOP leaders were forced to delay a final vote till Friday evening.

**Drivers:** I) The November **EU** Commission's measure of **economic sentiment (ESI)** r**ose for a sixth consecutive month**. At 114.6, the reading was 0.5 points above its marginally firmer revised October reading and at its **highest level since October 2000**. Confidence was up 0.2 points to a new record of 8.2 and was 0.1 higher in the consumer sector.

II) **November's** flash index of **consumer prices was up 1.5% on the year**, just 0.1% firmer than its final October reading. There was also some disappointing news on the core rates, both of which were unchanged from their respective October readings. The narrowest gauge, which excludes energy, food, alcohol and tobacco, remained at just 0.9%, some 0.3 percentage points below its recent 1.3% August high.

III) **Performance of European Indexes for the week, month-to-date and year-to-date. The MSCI Europe Index was lower by -1.28% for the week (MTD -1.17%, YTD +22.19%).**

### ASIAN EQUITIES

**Asian markets were mixed for the week as investors closely monitored the progress of tax reform through the U.S. Senate. The Dow Jones Asia Index fell by -1.09% for the week, (MTD +0.44%, YTD +22.71%).**

**Drivers:** I) In **Japan, October retail sales** were **down 0.2%** on the year after increasing 2.3% in September. This was the first annual decline in retail sales in 12 months. The decline in sales was mainly driven by **weaker sales of food and beverages**, down 1.5% on the year after an increase of 0.6% in September. Sales also declined for general merchandise, machinery and equipment, and non-store retailers

II) October **industrial production in Japan was up a monthly 0.5%** after a revised decline of 1.0% in September. On the year, the industrial production index increased 4.1% in October. Stronger headline industrial production growth reflected increased output of electrical machinery, transport equipment and general-purpose, production and business-oriented machinery.

III) **Performance of Asian Indexes for the week, month-to-date and year-to-date. The Nikkei was higher by +1.19% (MTD +0.41%, YTD +21.44%), the Hang Seng Index fell by -2.69% (MTD -0.39%, YTD +31.21%) and the Shanghai Composite was down by -1.08% (MTD +0.01%, YTD +6.89%).**

### FIXED INCOME

**Treasury yields were mostly higher last week, pushed higher by solid economic data and expectations that US tax legislation would be passed by the US Senate.**

**Performance:** I) **The 10-year Treasury yield was higher last week ending at 2.363%, up from 2.344%. The 30-year yield was essentially unchanged last week easing from 2.764% to 2.763%.**

II) **Performance for the week, month-to-date and year-to-date. The Bloomberg Barclays US Aggregate Bond Index fell -0.03% last week, MTD +0.29% and YTD +3.36%. The Bloomberg Barclays US MBS TR was down -0.11% last week, MTD +0.14% and YTD +2.28%. The Bloomberg Barclay's US Corporate HY Index rose by +0.13%, MTD +0.01% and YTD +7.19%.**

### COMMODITIES

**The DJ Commodity Index was higher by +1.46 last week and is up month to date +1.03% (YTD +2.39%), as gold finished higher due to political uncertainty in the U.S. and the rise in agricultural commodities such as cotton, which rose due to output concerns.**

**Performance:** I) **Oil prices dropped last week by -1.15%,** down to $58.29, but was higher month to date for November, up +5.55% (YTD +8.16%). Oil was lower last week over concerns that **higher prices would spur higher production levels**. But the commodity finished higher on Friday, after major oil producers negotiated an agreement that was widely expected, to extend ongoing production curbs through 2018.

II) The **ICE USD Index**, a gauge of the U.S dollar's movement against six other major currencies, **rose +0.14%** from 92.76 to 92.89 for the week (MTD -1.58% YTD -9.27%). The U.S. dollar was driven higher last week by positive US economic data, but fell on Friday after former national security adviser Michael Flynn pleaded guilty to lying to federal investigators. A news report said he would testify that President Donald Trump directed him to contact Russian officials.

III) **Gold finished higher on Friday, paring its loss for the week,** as the U.S. dollar weakened and equities dropped in the wake of news surrounding former national security adviser Michael Flynn. Gold was down by -0.73% last week, dropping from $1292.6 to $1283.1 (MTD +0.49% YTD +11.38%).

## HEDGE FUNDS

**Hedge fund returns in December are mixed, as core strategies Equity Hedge and Distressed are in positive territory. Event Driven, Macro and Relative Value are lower on the month.**

**Performance:**

**I) The HFRX Global Hedge Fund Index is higher at +0.07% MTD and +5.52% YTD.**
**II) Equity Hedge is up +0.87% MTD and is up +8.85% YTD.**
**III) Event Driven has declined MTD -0.35% and is higher YTD +6.06%.**
**IV) Distressed Debt is higher by +0.47% MTD and is positive YTD +2.20%**
**V) Macro/CTA has fallen by -0.15% MTD and is up +1.67% YTD.**
**VI) Relative Value Arbitrage has declined by -0.25% and is higher by +3.11% YTD.**

## ECONOMIC DATA WATCH AND MARKET OUTLOOK

In a look forward to the **upcoming week** of trading, investors will try to see if the **guilty plea** agreed to **by former National Security Advisor, Michael Flynn**, for lying to the FBI about his conversations with Russia officials post the Trump election, is **more than a speed bump** that could **derail the Christmas stock market rally**. Market strategists believe that the Flynn is another **temporary political distraction**, not the first of the Trump administration, and **markets are being driven by strong economic growth**, solid corporate earnings and the potential for tax cuts.

The **Senate early Saturday passed the Republican-sponsored tax reform** proposal along the party lines, paving the way for lower corporate taxes and the repeal of Obamacare's individual-insurance mandate among other changes. The vote will be viewed as a crucial victory for Trump who had promised sweeping tax reforms as part of his pro-business agenda. The **proposed cut in corporate tax rates could add approximately $8.00 per share to the S&P 500** in 2018, driving estimated earning growth to the mid-teens range. This would give the present market an **additional upside close to 7.0%.**

Lastly, we are already amid a **favorable season for equities**. **December** has always been **a strong month** for equities. The **Dow Jones Industrial Average** has **gained 74% of the time** over the past 100 years in December for an **average return of 1.6%,** according to Bespoke Investment Group.

In turning to **next week's economic calendar**, **Friday's employment report will be the focus** and solid strength is the call, a return to normalcy after the disruptions of the hurricane season. November's consensus is expected to **post a strong 185,000 gain**. The unemployment rate never showed much effect from the hurricanes, dropping a tenth in October to 4.1% where it is expected to hold in November. **Moderate strength** is expected for **average hourly earnings**, at a consensus 0.3% monthly gain for an improving **2.6% year-on-year rate**.

On Monday we get a look at the durables economy which appears to be building momentum. Factory orders for aircraft and capital goods, which had been very strong in prior months, fell back in October and set up what is expected to be a 0.4% decline for the month's factory orders. But outside these factors, **factory orders are likely to show strength** and confirm expectations for **fourth-quarter manufacturing strength**.

Service sector updates, which are usually strong, will also be posted **Tuesday. ISM non-manufacturing** posted its **best composite score** of the expansion **in October, at 60.1** for a peak last matched at the height of the prior expansion in 2004. New orders including export orders are unusually strong. Backlogs have been building and employment is at a 6-month high. Only limited slowing, to 59.0 from 60.1, is the Street consensus for November.

**ADP on Wednesday** and jobless claims will offer last looks at the labor market going into November's employment report on Friday. ADP made a good call back in October, looking for sharp, but still limited bounce back for payrolls which were depressed by hurricanes in September. The consensus for **ADP's November** call is **192,000 versus ADP's October call of 235,000**.