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INVESTMENT COMMITTEE MARKET COMMENTARY

FEBRUARY 12, 2018 www.clearbrookglobal.com

U.S. EQUITIES

U.S. equity markets experienced their worse weekly performance in more than two years, as bond yields surged amidst inflation concerns, prompting already nervous investors to sell.

a) **Dow Jones -5.08%, MTD -7.35%, YTD -1.90%** b) **S&P 500 -5.10%, MTD -7.15%, YTD -1.84%**
c) **Russell 2000 -4.47%, MTD -6.14%, YTD -3.69%**

Drivers: I) **US major market equity indexes** suffered their **worse weekly decline since Q1 of 2016**, prompted by rising bond yields due to worries over rising inflation. Selling by investors were exacerbated by the unwinding of short volatility positions, selling by Risk Parity, Volatility Targeted programs and retail investors. **Retail investors who recently flowed an estimated $100 billion into S&P 500 Index ETFs in Q4, sold a rumored $25 billion.**

II) At the **market's nadir seen on Thursday afternoon**, **96 of the S&P 500's components were in a bear market** according to FactSet. In short, these equities were trading at least **20% below their 52-week high**, with more than a dozen of those components crossing the 20% threshold with their Thursday drops. Leading the carnage are **energy names** such as Range Resources Corp -62.0%, Chesapeake Energy -57.0% and Baker Hughes -56.0%.

III) Within the **S&P 500**, on a sector basis **eight of 11 primary industry groups are in correction territory**, **led by utilities**, which have plunged more than 16% from their recent peak. This group along with other fixed income proxies, have been pressured by the recent rise in bond yields, which makes the sector less attractive to income-seeking investors. Other high yielding sectors that have dropped include REITs and Telecom.

IV) The **performance of service-oriented companies** such as hotels, restaurants and banks surged in January to a **13-year high of 59.9, as reported by the Institute for Supply Management**. Employment activity set a record. An index that measures current staffing and future hiring plans rose to an all-time high of 61.6 from 56.3 in the prior month. That is the highest level since the ISM services index began in 1997.

V) **Equities in February are lower with Small-Cap, Value, Utilities and Healthcare leading equity price performance. The laggards for the month are Large-Cap, Growth, Energy and Industrials.**

Capitalization: **Large Caps -7.10%** (YTD -2.00%), Mid-Caps -6.83% (YTD -3.32%) and **Small Caps -6.14%** (YTD -3.69). **Style: Value -6.50%** (YTD -5.23%) and **Growth -6.51%** (YTD -2.67%). **Industry Groups (Leaders):** Consumer Discretionary -6.43% (YTD +2.29%). **(Laggards):** Technology -7.08% (YTD -0.50%), Info. Tech -7.22% (YTD -0.29%), **Healthcare -6.80%** (YTD -0.62%), Financials -6.87% (YTD -0.86%), **Industrials -7.46%** (YTD -2.35%), Materials -7.22% (YTD -3.44%), Consumer Staples -7.09% (YTD -5.53%), Telecom -7.37% (YTD -6.17%), **Energy -10.95%** (YTD -7.62%), **Utilities -4.87%** (YTD -7.77%) and REITs -6.86% (YTD -8.61%).

EUROPEAN EQUITIES

The MSCI Europe index was lower last week falling -6.49% due to concerns over rising inflation, which could lead to further rate increases from the Federal Reserve and other central banks.

Drivers: I) In **Germany, December manufacturing orders rebounded** from a smaller revised 0.1% monthly drop in November orders to 3.8%, their second strongest increase since July 2014. The year-end rise was built upon capital goods orders which were up 5.7% on the month. Intermediates (2.4%) also fared well but consumer goods (down 5.1%) had a poor month albeit after a solid November (2.8%).

II) **Euro-zone December retail sales volumes** (excluding autos) **dropped a monthly 1.1% but were 1.9% higher on the year**. The data followed a sharply stronger revised 2.0% monthly surge in November and an increase of 3.9% on the year. Monthly non-food sales excluding auto fuel declined 1.2%, their second decline in excess of 1.0% since September. Textiles, clothing and footwear were down 3.3% and electrical goods and furniture was down 1.5%.

III) **Performance of European Indexes for the week, month-to-date and year-to-date. The MSCI Europe Index was lower by -6.49% for the week (MTD -8.41%, YTD -3.46%).**

ASIAN EQUITIES

Asian markets tumbled for the week, closing sharply lower Friday on renewed worries about rising inflation and higher interest rates after the yield on the 10-year U.S. Treasury note neared its highest levels in four years and the Bank of England hinted at somewhat earlier and more frequent interest rate increases. The Dow Jones Asia Index dropped by -6.82% for the week, (MTD -7.36%, YTD -1.36%).

Drivers: I) **Chinese shares led regional losses for the week** as **liquidity conditions tightened** before the Chinese New Year break that begins on Friday (February 16). The People's Bank of China said it has released temporary liquidity of almost 2 trillion yuan to meet cash demand before the long Lunar New Year holidays. The Shanghai Composite and Hang Seng led regional declines with drops of 9.6% and 9.5% respectively, on a local currency basis. Some selling pressure came from **investors lightening their positions ahead of the holidays.**

II) **China's January consumer price index was up 1.5%** on the year after increasing 1.8% in December, the **lowest level of inflation since July** and the seventh consecutive month in which the direction of inflation has reversed from the previous month. On the month, the CPI was up 0.6% after an increase of 0.3% the month before.

III) **Performance of Asian Indexes for the week, month-to-date and year-to-date. The Nikkei was lower by -8.31% (MTD -7.43%, YTD -6.06%), the Hang Seng Index fell by -6.71% (MTD -7.60%, YTD +1.78%) and the Shanghai Composite was down by -5.36% (MTD -5.91%, YTD -1.36%).**

FIXED INCOME

The Treasury market led by the 10-year yield stayed close to a four-year high on several concerns raging from rising inflation expectations, expansionary fiscal spending and rising bond issuance.

Performance: I) **The 10-year Treasury yield was higher last week ending at 2.854 up from 2.842%. The 30-year yield rose last week climbing from 3.088 to 3.157%.**

II) **Performance for the week, month-to-date and year-to-date. The Bloomberg Barclays US Aggregate Bond Index dropped by -0.10% last week, MTD -0.77% and YTD -1.92%. The Bloomberg Barclays US MBS TR was up +0.02% last week, MTD -0.59% and YTD -1.75%. The Bloomberg Barclay's US Corporate HY Index fell by -1.43%, MTD -1.84% and YTD -1.25%.**

COMMODITIES

The DJ Commodity Index was lower by -4.14 last week and is down month to date -4.82% (YTD -2.32%), as oil plunged due to the rise in US production levels and industrial metals dropped on concerns over the potential of a second half slowdown in China's economic growth.

Performance: I) The **price of oil plunged last week by -9.24%** down to $59.05 and is lower month to date in February -8.77% (YTD -1.75%). Oil prices fell for a sixth straight session on Friday, notching its biggest weekly loss in more than a year due to the **rise in US oil production and rigs count**.

II) The **ICE USD Index**, a gauge of the U.S dollar's movement against six other major currencies, **rose +1.26%** from 89.19 to 90.32 for the week (MTD +1.33%, YTD -2.14%). The U.S. dollar got a safe-haven bid, as the selloff in equities sent jitters throughout financial markets propelling the USD to its best weekly performance in 2018.

III) **Gold declined on Friday** to suffer from their **largest weekly loss in two months**, as investors were concerned about volatility in global stocks and a **rising dollar index** which aimed for its best weekly performance in more than a year. Gold was down by -1.28% last week, falling from $1335.2 to $1318.1 (MTD -1.86%, YTD +0.99%).

HEDGE FUNDS

Hedge fund returns for February are down for the month, with core strategies Equity Hedge, Event Driven, Distressed, Macro and Relative Value all lower.

Performance:

I) The HFRX Global Hedge Fund Index is lower at -2.21% MTD and +0.18% YTD.
II) Equity Hedge is down -2.60% MTD and is up +0.73% YTD.
III) Event Driven has declined MTD -2.25% and is lower YTD -0.53%.
IV) Distressed Debt is lower by -0.45% MTD and is positive YTD +1.06%
V) Macro/CTA has declined by -3.61% MTD and is up +0.05% YTD.
VI) Relative Value Arbitrage has dropped by -0.71% and is higher by +0.38% YTD.

ECONOMIC DATA WATCH AND MARKET OUTLOOK

As we look ahead to **next week's trading session**, investors may be shell shocked by the **plunge of equity market indexes into correction territory last week**, due to concerns over inflation and rising bond yields. **Market strategist** believe that the **market correction was a normal reaction** to a bull run that had lasted more than eight years, amidst record low volatility and extended valuations. **Market corrections of -10.0% typically occur once every eighteen months**. The recent meltdown has left us at present with an **S&P 500 trading at 16.5X forward earnings**, and a current yield that is finally above 2.0% again.

Despite the magnitude of the **equity market decline** last week, investor **flight to quality has yet to occur**. In a market correction, investors typically flee to mega cap, defensive and high-quality stocks. This has not happened as large caps, utilities and REITs have been some of the market's worse performers. The quandary confronting investors is the determination of whether interest rates are rising due to inflationary forces, or due to the positive response to accelerating economic growth.

In turning to **next week's economic calendar**, a week filled with **inflation data** starts on **Wednesday** with the consumer price report where any unexpected **pressure in the core rate** could **re-ignite rate-hike concerns**. Inflation may be under new scrutiny, but one area it has **not been found is in consumer prices**. And not much price traction is expected to appear in January's report with the core rate (less food and energy) seen up a modest 0.2% with the **year-on-year expected to fall 1 tenth to 1.7%.** The consensus for the headline CPI is a gain of 0.3% for a yearly rate that is also down 1 tenth, at 2.0%.

Wednesday also sees **January retail sales** and though a **softer number is expected**, a **seventh straight month** of **solid strength** is expected for the ex-auto reading. **Unit auto sales proved very weak** which is expected to hold down January's **retail sales gain to a moderate 0.3%.** When excluding autos, however, sales are expected to show a seventh month of solid strength, at a consensus gain of 0.5%. When excluding autos and gasoline, where higher prices are a positive for the month, sales are expected to rise 0.4%. When also excluding food services and building materials, sales are expected to come in at a 0.4% gain.

Producer prices, which have shown pressure in recent months, will **open Thursday's data** followed by the **industrial production report** where manufacturing has been showing surprisingly little lift. Producer prices did rise toward the end of last year, but not in December, when they fell an unexpected 0.1% at the headline level on a pullback in service costs. Forecasters are looking for a snap back in **January to a gain of 0.4%. Less food and energy are seen up 0.2% with less food**, energy and trade services also expected to rise 0.2%.

On **Friday** we will see the **Consumer Sentiment index** which recovered from a preliminary January slump to end the month at 95.7 and about where it was in December. This **report has been flat,** unlike the consumer confidence index where readings have been much higher. Street consensus for the preliminary **February consumer sentiment index is 95.5** in a result that would point to **no measurable panic tied to the stock market.**