



Equity Market Summary

October 18, 2018

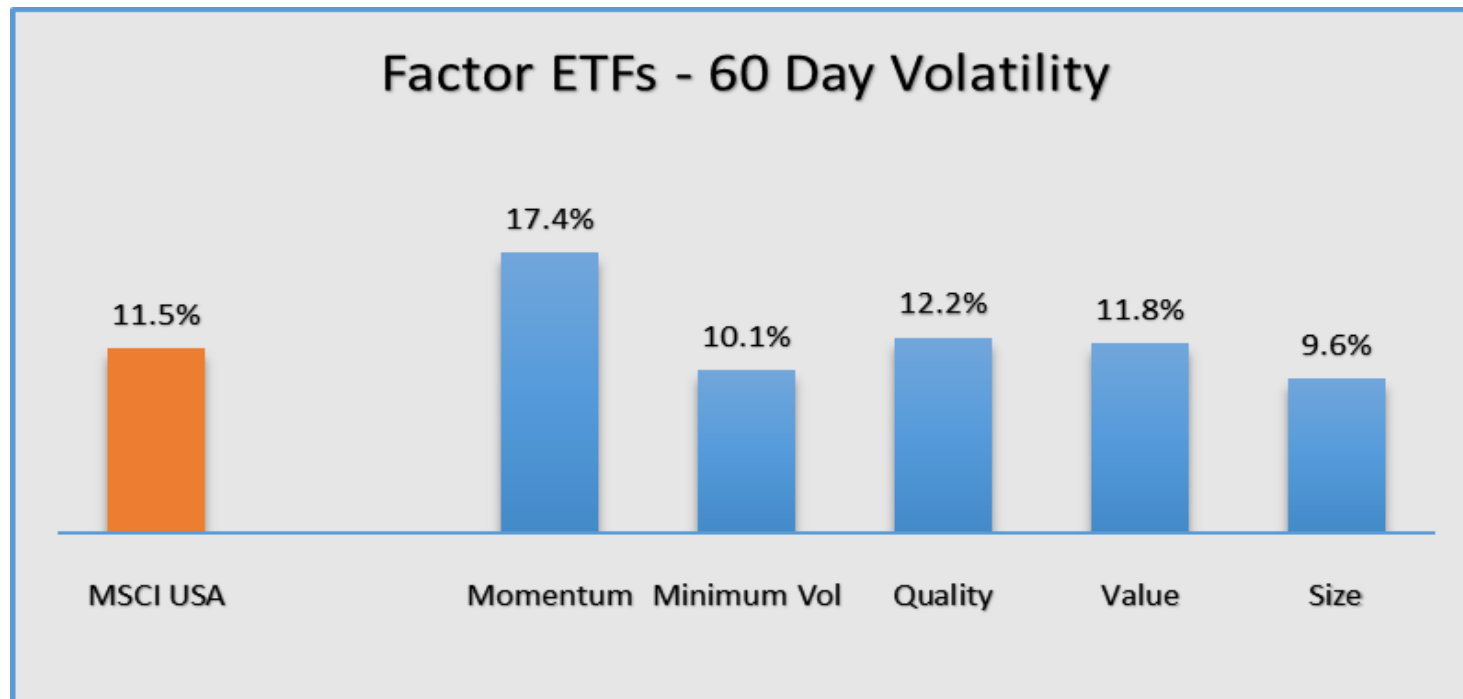
Investment Factor Returns



Source: Bloomberg, III Capital Management

Momentum (iShares MTUM) has been the best performing investment factor over the last year, with returns of 16.1% compared to 7.9% for the MSCI USA Index. Size (small cap stocks) has been the underperformer.

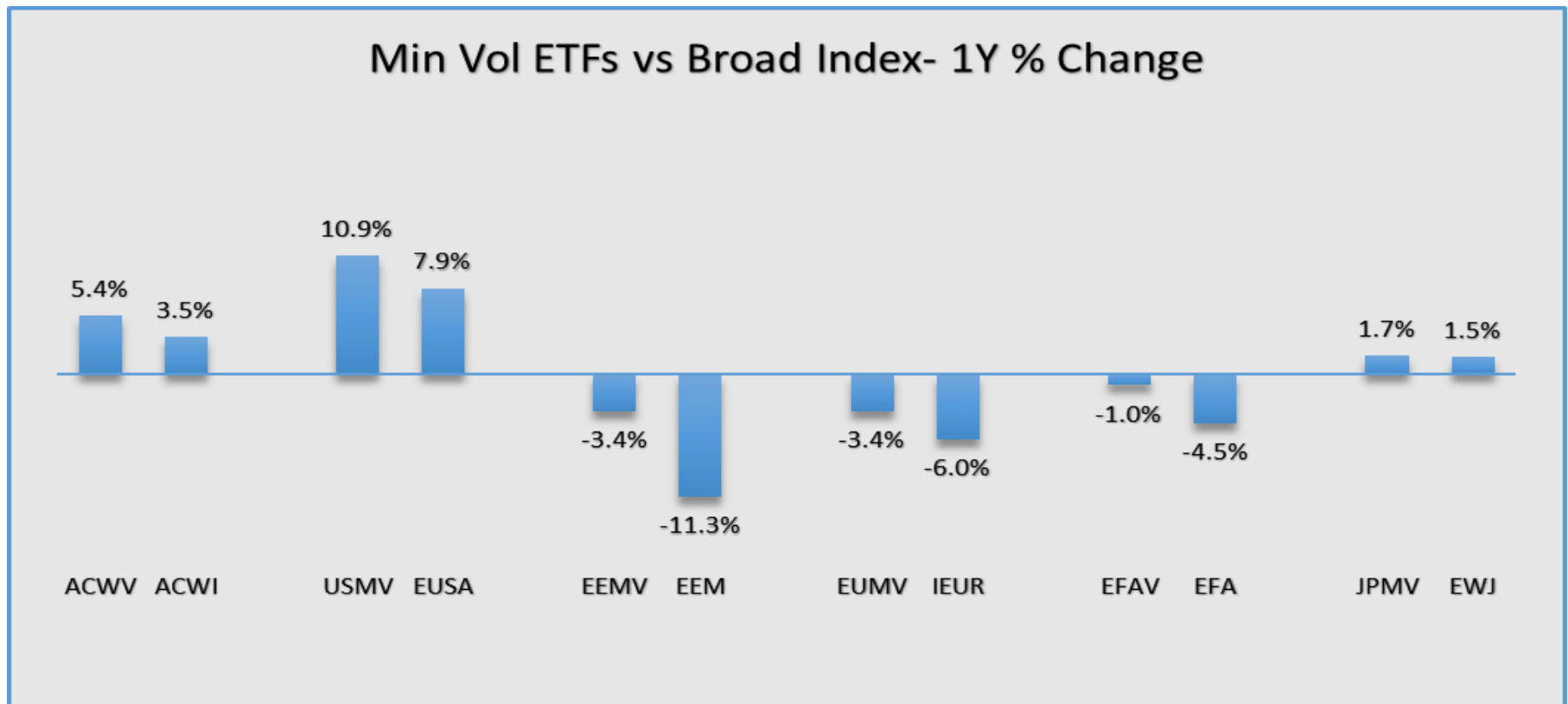
Factor Volatility



Source: Bloomberg, III Capital Management

Momentum has had the highest realized volatility over the last 60 days compared to other investment factors. It has been almost twice as volatile as the Size factor.

Minimum Volatility Factor



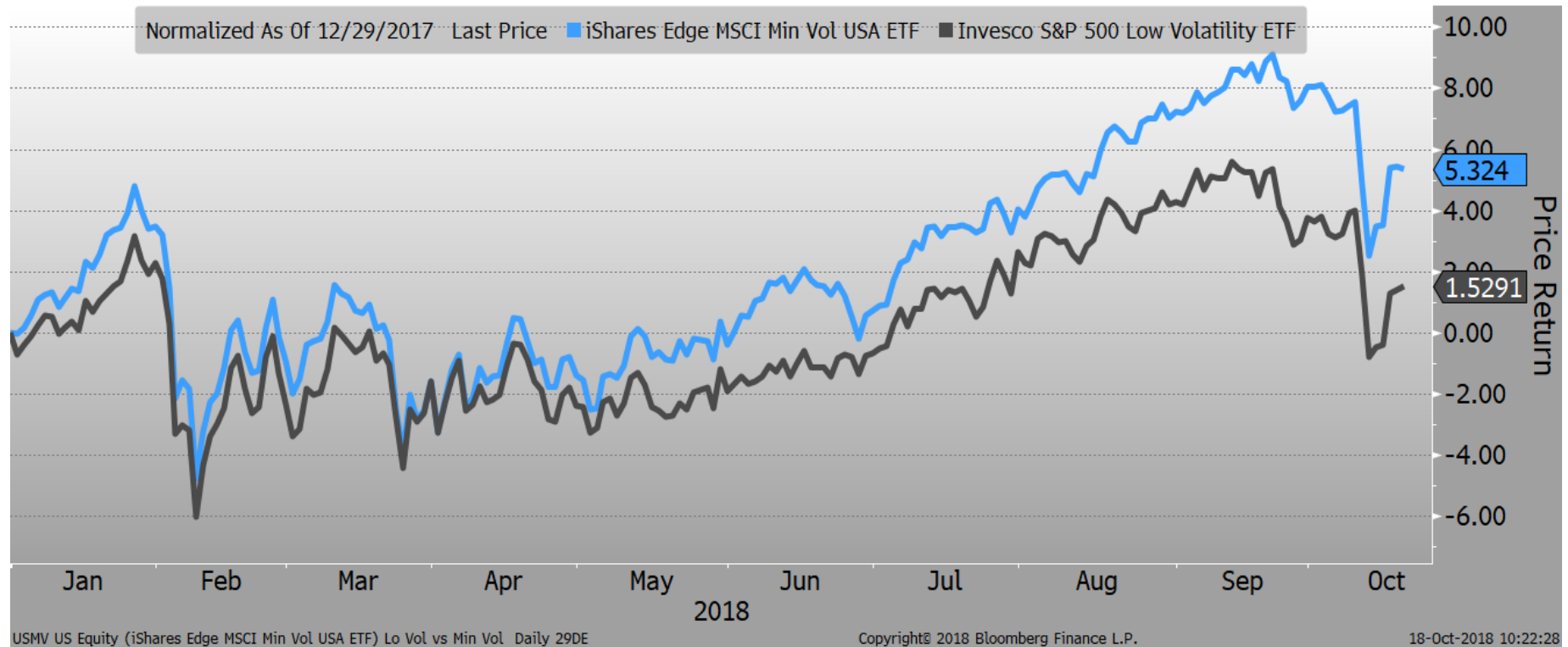
Source: Bloomberg LP, III Capital Management

“Min Vol” ETFs have outperformed the broader indices over the last year.

Low Vol vs Min Vol: Performance

Low Vol vs Min Vol

(SPLV vs USMV)



Source: Bloomberg LP, III Capital Management

Minimum volatility, which looks at reducing portfolio variance, has outperformed low volatility, which carves off a percentage of the lowest volatility individual stocks. Minimum volatility has outperformed low volatility YTD.

Low Vol vs Min Vol: Allocations

Low Vol (SPLV)

Top Industry Group Allocation	
Electric	21.92%
REITS	16.44%
Insurance	12.02%
Software	5.73%
Commercial Services	3.97%
Electronics	3.73%
Beverages	3.48%
Pharmaceuticals	3.18%
Retail	2.86%
Diversified Finan Serv	2.80%

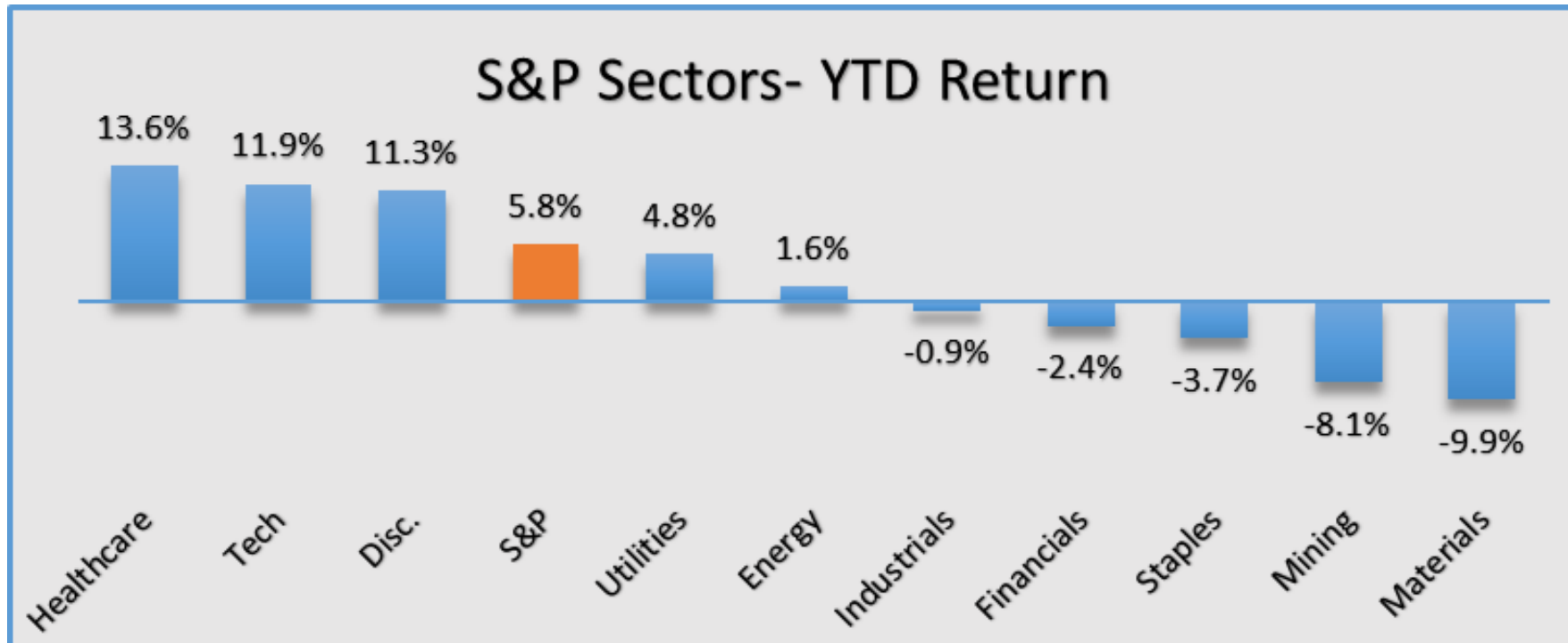
Min Vol (USMV)

Top Industry Group Allocation	
REITS	9.24%
Software	8.30%
Insurance	7.92%
Electric	7.83%
Retail	7.39%
Healthcare-Products	5.77%
Pharmaceuticals	5.58%
Aerospace/Defense	5.47%
Telecommunications	4.89%
Healthcare-Services	4.19%

Source: Bloomberg LP, III Capital Management

Low Vol has a much higher allocation to electric utilities and REITS than Min Vol; neither tend to do well in a rising rate environment. Overall, Min Vol looks more balanced in terms of sector allocation.

Sector Returns



Source: Bloomberg LP, III Capital Management

Healthcare and Tech are the best performing sectors in the S&P 500 YTD; the Materials and Mining sectors are the worst. Surprisingly, the Utilities sector has weathered the move to higher rates quite well so far.

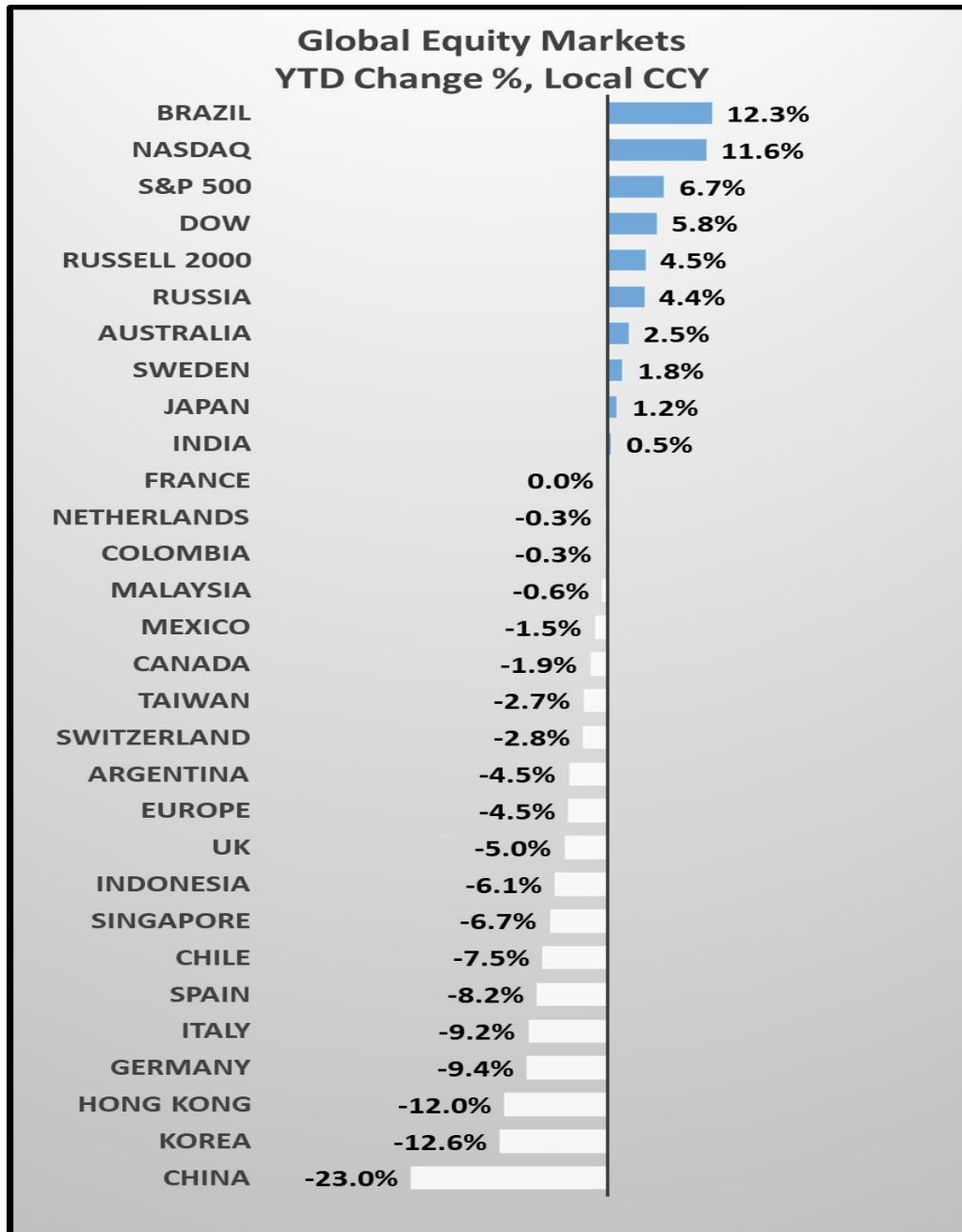
Sector Valuations

	Financials	Materials	Real Estate	Industrials	Cons. Discr.	Technology	Energy	Comm. Services*	Health Care	Cons. Staples	Utilities	S&P 500 Index	
S&P weight	13.3%	2.4%	2.7%	9.7%	10.3%	21.0%	6.0%	10.0%	15.0%	6.7%	2.8%	100.0%	Weight
Russell Growth weight	4.2%	1.7%	2.0%	12.0%	15.4%	32.6%	0.9%	12.0%	13.8%	5.4%	0.0%	100.0%	
Russell Value weight	22.8%	3.9%	4.6%	8.1%	5.3%	9.8%	10.8%	6.8%	15.2%	7.2%	5.6%	100.0%	
QTD	4.4	0.4	0.9	10.0	8.2	8.8	0.6	9.9	14.5	5.7	2.4	7.7	Return (%)
YTD	0.1	-2.7	1.7	4.8	20.6	20.6	7.5	0.8	16.6	-3.3	2.7	10.6	
Since market peak (October 2007)	18.8	71.9	70.2	124.0	273.7	260.7	25.0	55.6	223.9	161.6	96.2	135.5	
Since market low (March 2009)	548.8	309.4	531.1	515.7	765.1	655.8	128.8	197.2	422.2	266.8	243.3	426.3	
Beta to S&P 500	1.42	1.32	1.29	1.22	1.11	1.07	1.01	0.96*	0.76	0.59	0.42	1.00	β
Correl. to Treas. yields	0.64	0.34	-0.62	0.39	0.22	-0.25	0.48	-0.05	0.00	-0.35	-0.54	0.17	ρ
Foreign % of sales	31.2	52.7	-	44.6	34.1	56.9	54.1	-	38.2	32.5	41.3	43.6	%
NTM Earnings Growth	25.2%	24.0%	4.0%	19.8%	13.2%	31.1%	93.6%	14.7%	15.5%	7.2%	7.1%	22.2%	EPS
20-yr avg.	5.6%	9.3%	2.9%**	6.7%	9.6%	10.3%	12.8%	9.6%*	9.2%	5.7%	2.7%	6.4%	
Forward P/E ratio	12.2x	15.0x	17.3x	16.6x	22.4x	18.2x	16.9x	18.2x	16.7x	17.9x	16.5x	16.8x	P/E
20-yr avg.	12.8x	14.0x	15.2x	16.2x	18.0x	20.7x	17.6x	18.3x*	17.0x	16.9x	14.2x	15.9x	
Trailing P/E ratio	13.8x	20.0x	36.1x	19.8x	28.5x	27.0x	18.1x	15.7x	32.7x	21.0x	16.4x	21.3x	Div
20-yr avg.	15.5x	18.6x	36.1x	19.8x	18.8x	24.9x	17.4x	21.8x*	24.1x	20.7x	15.8x	19.4x	
Dividend yield	2.2%	2.1%	3.6%	2.0%	1.3%	1.5%	2.9%	1.4%	1.6%	3.2%	3.6%	2.0%	Div
20-yr avg.	2.3%	2.6%	4.4%	2.1%	1.4%	0.9%	2.3%	1.7%*	1.8%	2.7%	4.0%	2.0%	

Source: JPM Asset Management

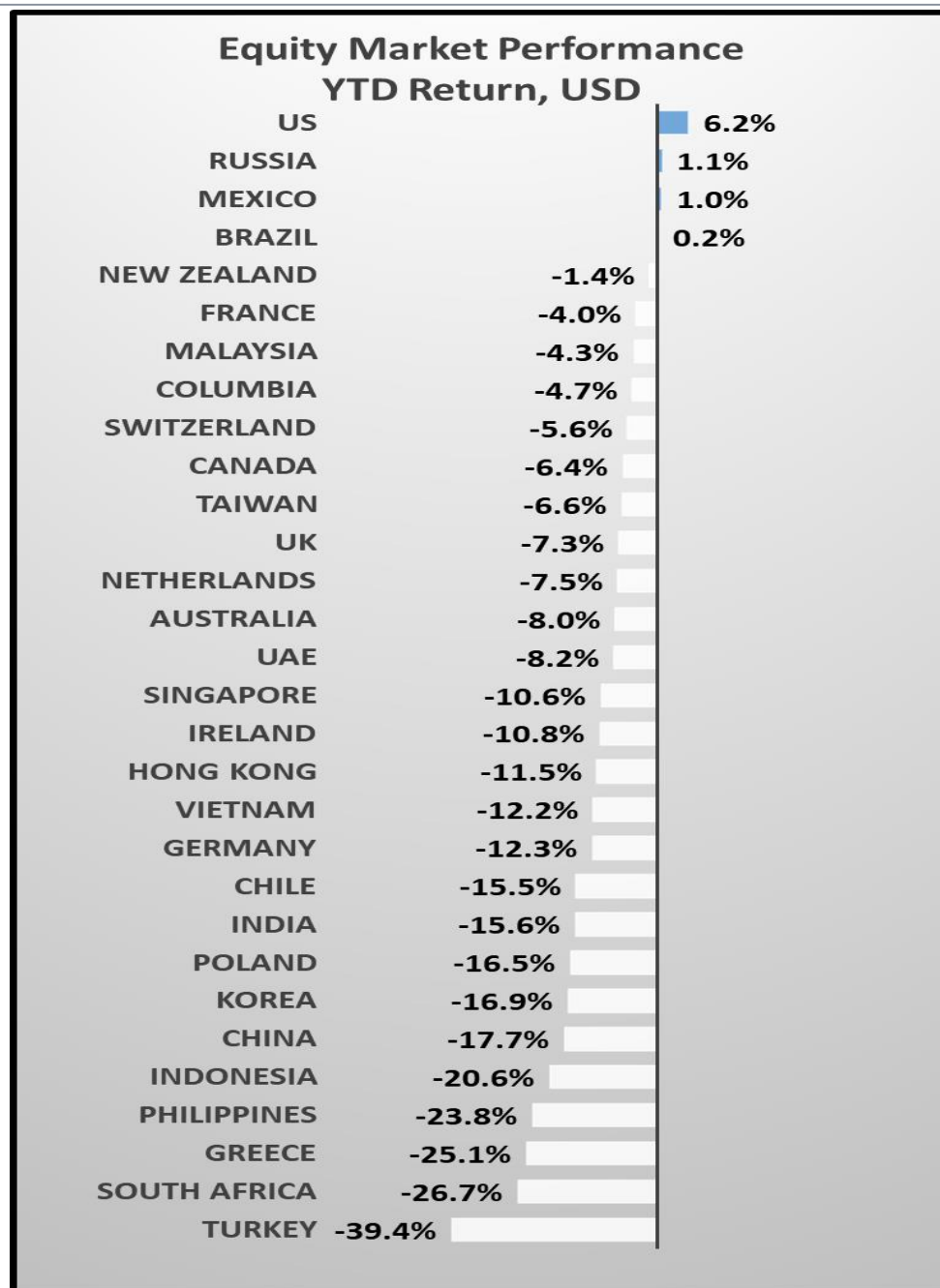
Consumer Staples and Utilities have the lowest beta to the S&P 500, but have a negative correlation to bond yields. They are also trading rich compared to their 20 year history on a 1 year forward P/E basis.

Global Equities Performance



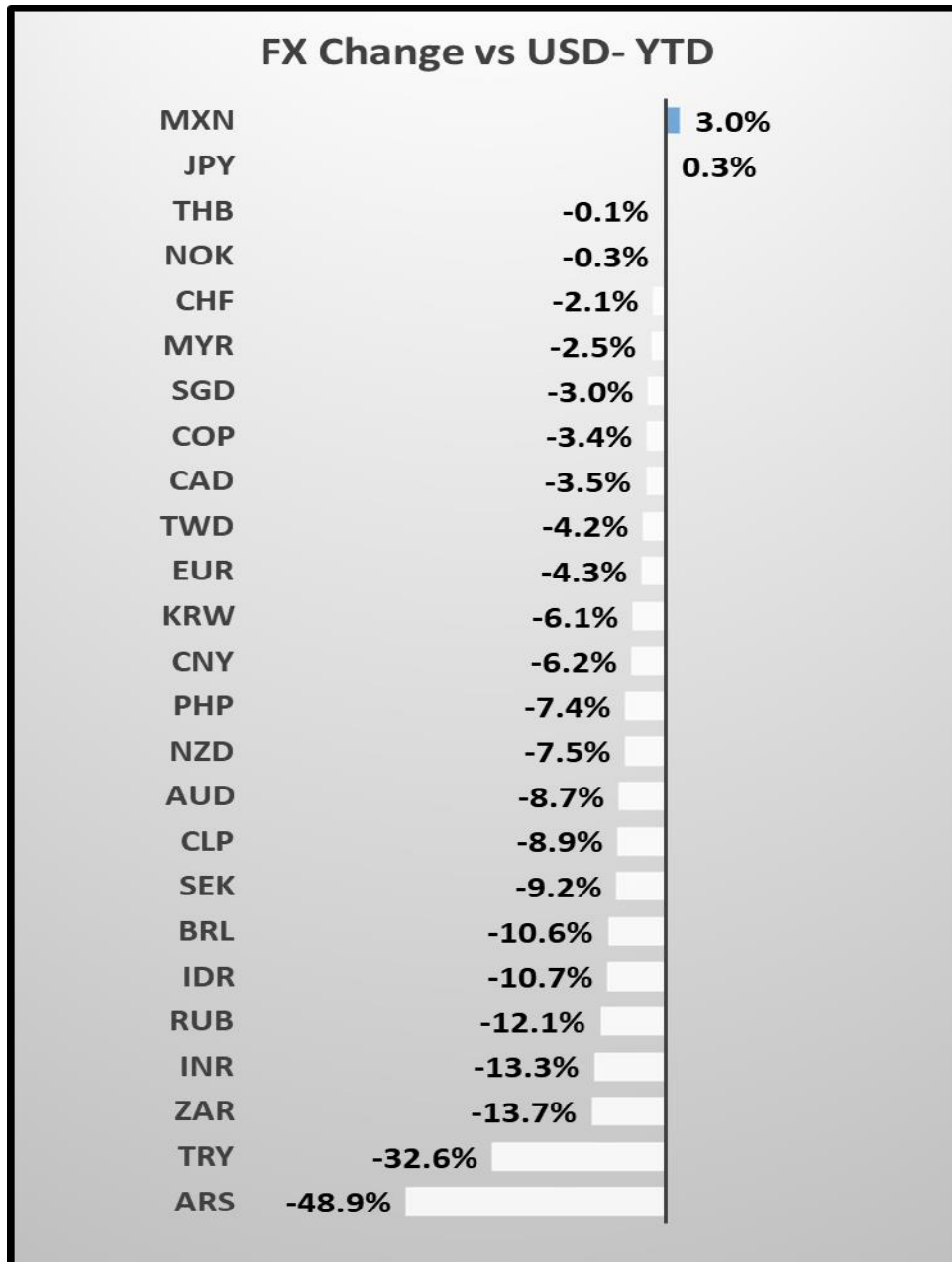
Brazil has been the top performing equity market YTD; China has been the worst. These returns, however, are in local currencies. The picture looks different when you translating returns back to USD (see next slide).

Global Equities Performance (in USD)



Using the price return of various country ETFs (which provide their return in USD), the US equity market stands out as the clear outperformer YTD. The ACWI ETF is down 0.3% so far this year; without the US, it would be much more negative. Bottom line: international allocations for US investors have been painful recently.

FX Returns



USD strength has been a major theme this year. Of all the major countries, only Mexico has seen its currency outperform the USD. Many emerging market currencies have depreciated by more than 10% relative to the USD. Asset appreciation in these countries has largely been offset by weaker currencies.

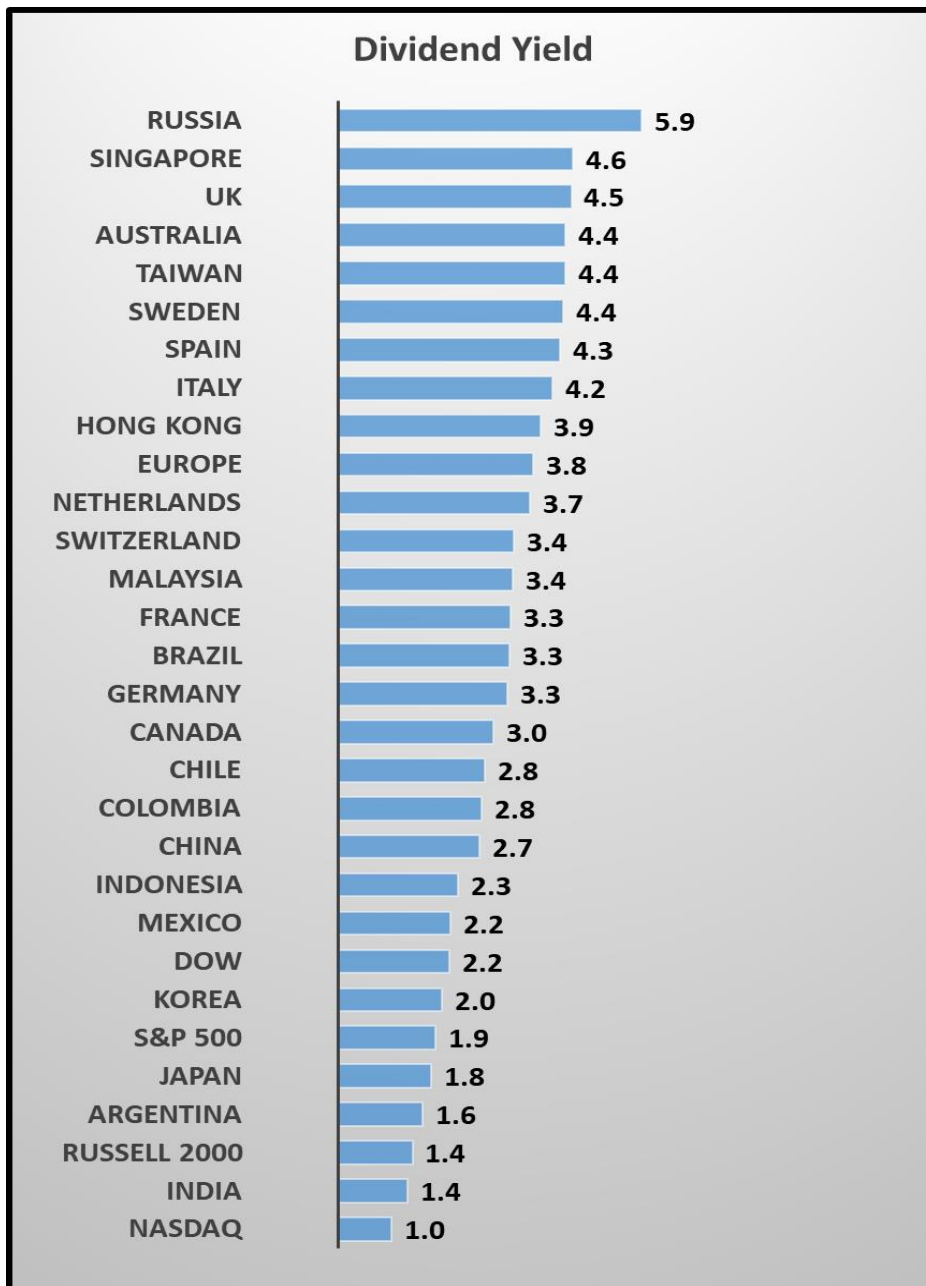
Global Equity Valuation Metrics

Region	YTD TRR	1M TRR	PE RATIO	1Y FWD PE	P/B	EARN YLD	Div Yld	DVD P/O	90D Vol
Asia Pacific	-6.0%	-4.6%	14.8	13.6	1.67	7.3	3.1	45	15.3
Australia	2.5%	-3.5%	16.4	15.0	1.95	6.1	4.4	77	9.9
Japan	1.2%	-2.7%	16.3	15.9	1.80	6.1	1.8	29	15.6
India	0.5%	-7.3%	21.4	18.1	2.86	4.7	1.4	30	13.6
Malaysia	-0.6%	-2.4%	18.4	16.8	1.83	5.4	3.4	61	10.3
Taiwan	-2.7%	-7.5%	13.0	12.8	1.56	7.7	4.4	56	17.0
Indonesia	-6.1%	0.7%	19.7	15.3	2.22	5.1	2.3	48	18.6
Singapore	-6.7%	-2.2%	11.0	12.4	1.07	9.1	4.6	47	12.7
Hong Kong	-12.0%	-5.9%	9.7	10.6	1.20	10.3	3.9	39	18.4
Korea	-12.6%	-7.0%	10.3	8.7	0.89	9.7	2.0	21	14.4
China	-23.0%	-7.9%	11.7	10.2	1.33	8.6	2.7	35	22.6
Europe	-3.3%	-3.3%	14.5	12.5	1.60	7.8	4.1	51	14.0
Russia	4.4%	2.9%	5.8	5.5	0.81	17.3	5.9	35	21.2
Sweden	1.8%	-4.7%	15.7	15.1	2.07	6.4	4.4	50	12.8
France	0.0%	-3.5%	16.5	13.8	1.58	6.1	3.3	51	13.1
Netherlands	-0.3%	-2.9%	14.3	14.2	1.78	7.0	3.7	45	12.2
Switzerland	-2.8%	-1.1%	23.5	15.4	2.42	4.2	3.4	79	12.5
Europe	-4.5%	-3.3%	15.3	13.4	1.61	6.5	3.8	53	12.5
UK	-5.0%	-3.1%	15.7	12.6	1.69	6.4	4.5	54	12.3
Spain	-8.2%	-5.1%	13.1	11.7	1.33	7.6	4.3	57	11.7
Italy	-9.2%	-8.7%	11.1	10.6	1.06	9.0	4.2	50	17.9
Germany	-9.4%	-3.7%	13.8	12.7	1.64	7.3	3.3	40	14.1
Latin America	0.0%	-1.7%	16.6	12.7	1.62	6.1	2.6	49	23.9
Brazil	12.3%	9.5%	20.0	12.9	1.88	5.0	3.3	55	23.4
Colombia	-0.3%	-1.8%	14.9	13.3	1.33	6.7	2.8	43	11.0
Argentina	-4.5%	-10.5%	14.3	8.8	1.53	7.0	1.6		50.0
Chile	-7.5%	-3.9%	17.2	15.8	1.75	5.8	2.8		11.1
North America	4.2%	-3.9%	28.7	18.9	3.08	4.3	1.9	51	12.1
NASDAQ	11.6%	-3.9%	46.3	22.4	4.60	2.2	1.0	48	15.3
S&P 500	6.7%	-3.2%	20.2	17.2	3.38	5.0	1.9	49	11.0
Dow	5.8%	-2.0%	18.0	16.2	4.04	5.6	2.2	48	11.6
Russell 2000	4.5%	-7.0%	52.3	25.9	2.27	1.9	1.4	68	13.4
Mexico	-1.5%	-3.6%	18.5	16.3	2.44	5.4	2.2	44	12.6
Canada	-1.9%	-3.9%	17.1	15.1	1.73	5.9	3.0	51	8.8

Source: Bloomberg LP, III Capital Management

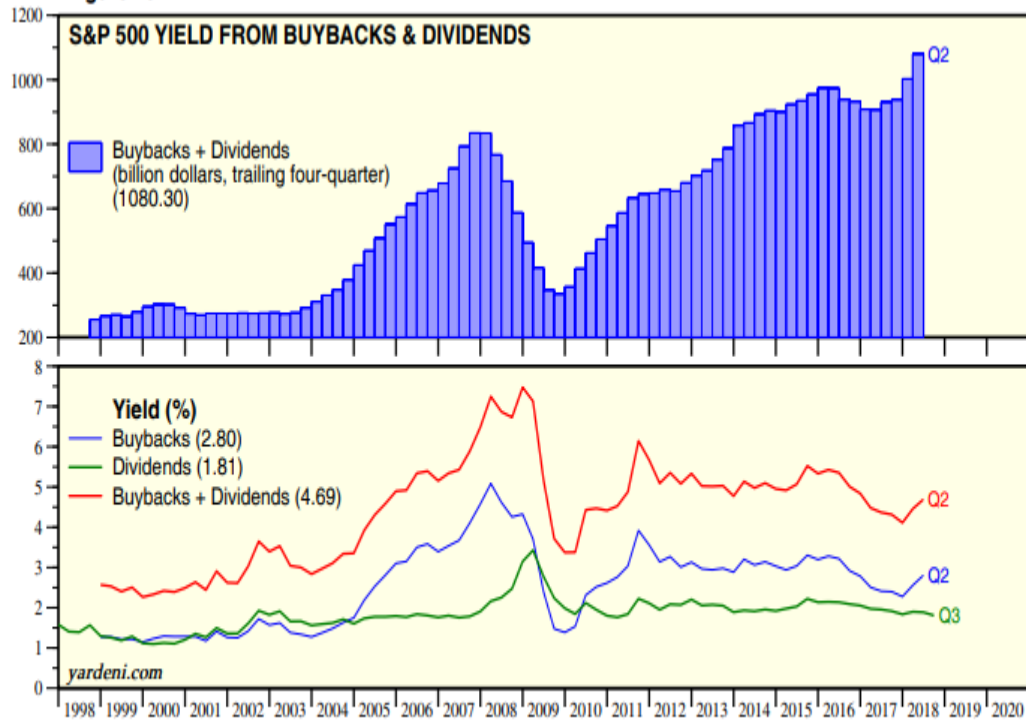
Europe has the highest dividend yields and the lowest average P/E ratios; US markets have the opposite. Russia has the lowest 1-year forward P/E ratio and P/B ratio, followed by Korea. India stands out in Asia as rich on a P/E basis.

Global Dividend Yields



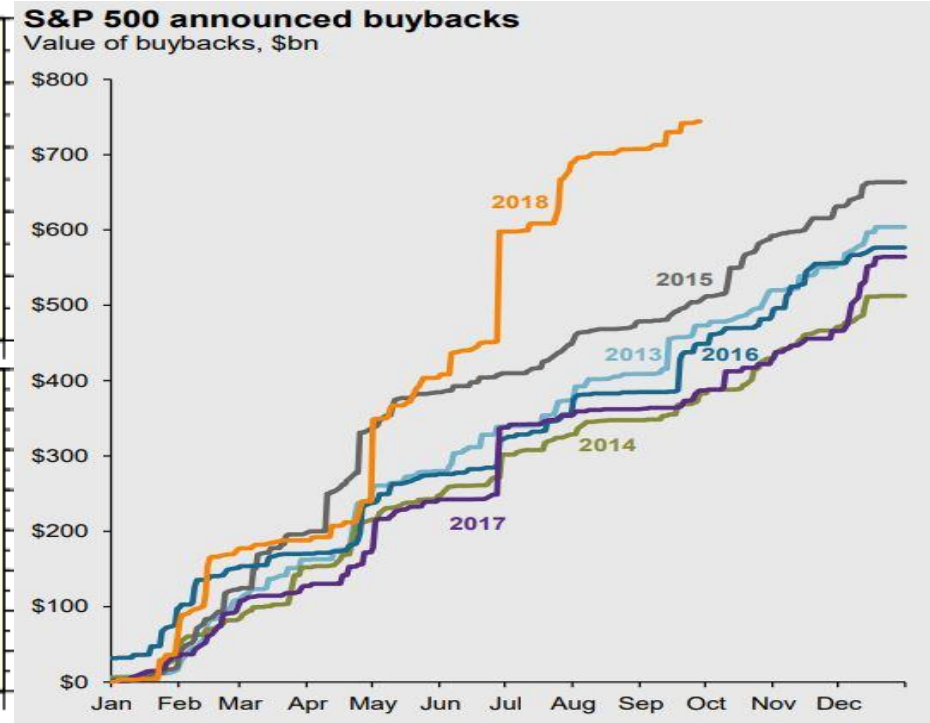
Russian equities provide the highest dividend yield (5.9%) of all the major markets we track. US equities pay only 1.9%. It's important to note, however, that the US market gets extra benefits from share buybacks which are projected to be more than an estimated \$800 billion in 2019.

Stock Buybacks



Source: Standard & Poor's Corporation.

Source: Yardeni Research

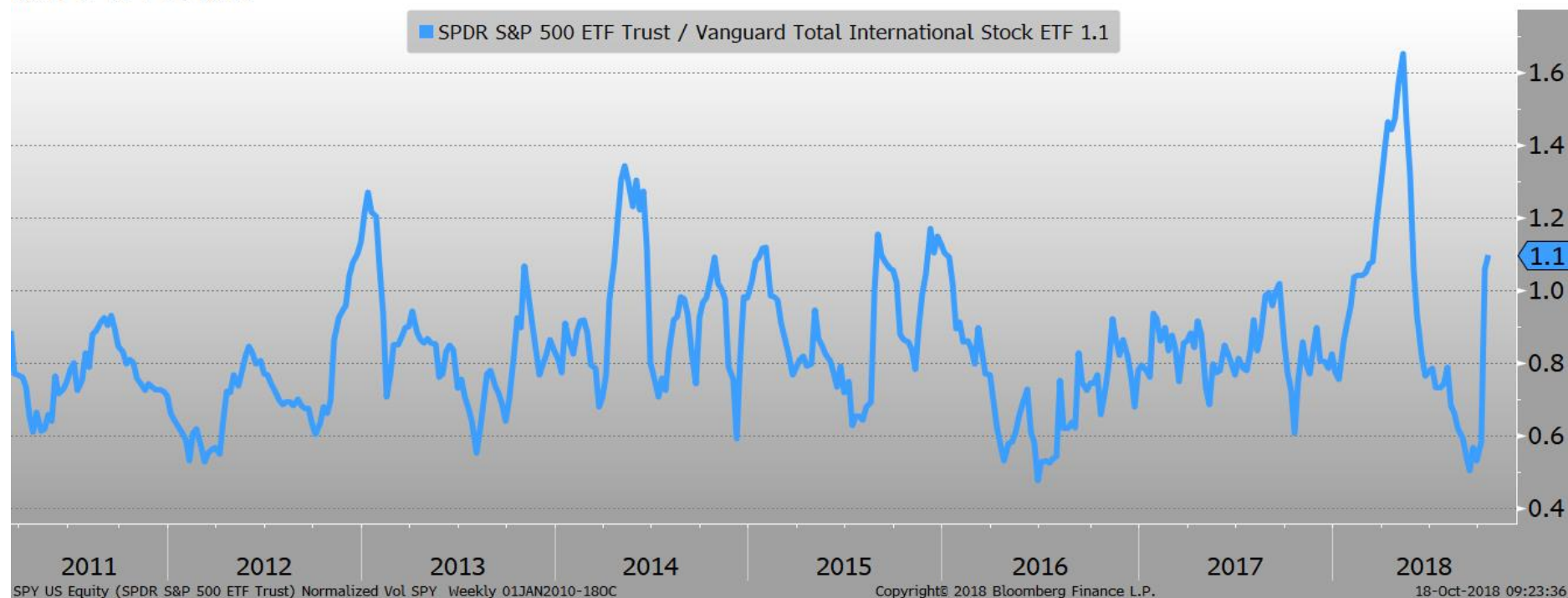


Source: JPM Asset Mgmt

Accounting for buybacks, the “yield” of the S&P jumps to 4.7%. Buybacks appear to be a larger source of yield than dividends.

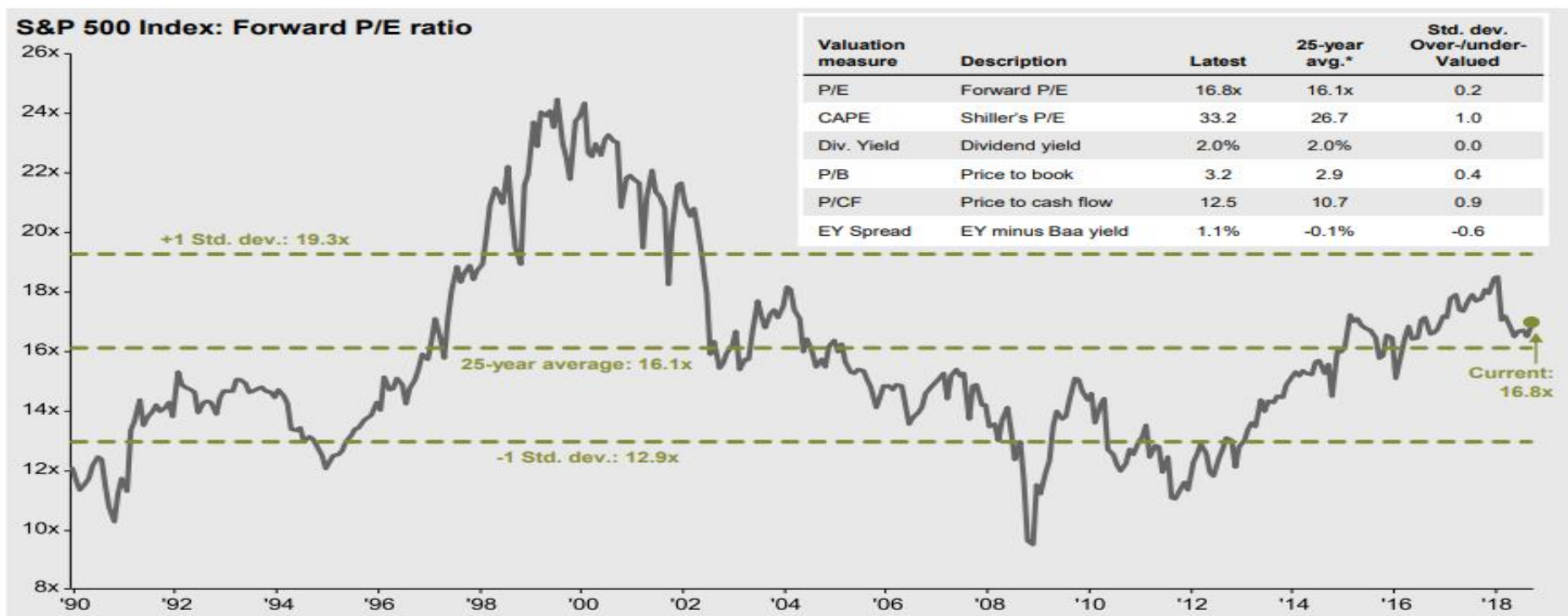
Realized Volatility: US vs Rest of World

30-Day Realized Equity Volatility Ratio of SPY vs VXUS



Equity volatility in the US compared to the rest of the world started the year around average levels, spiked in Q1 with the VIX debacle, and collapsed in Q2 and Q3 as international markets sold off. Q4 may see the return of higher US equity volatility compared to other DM countries.

Historical S&P 500 Valuations



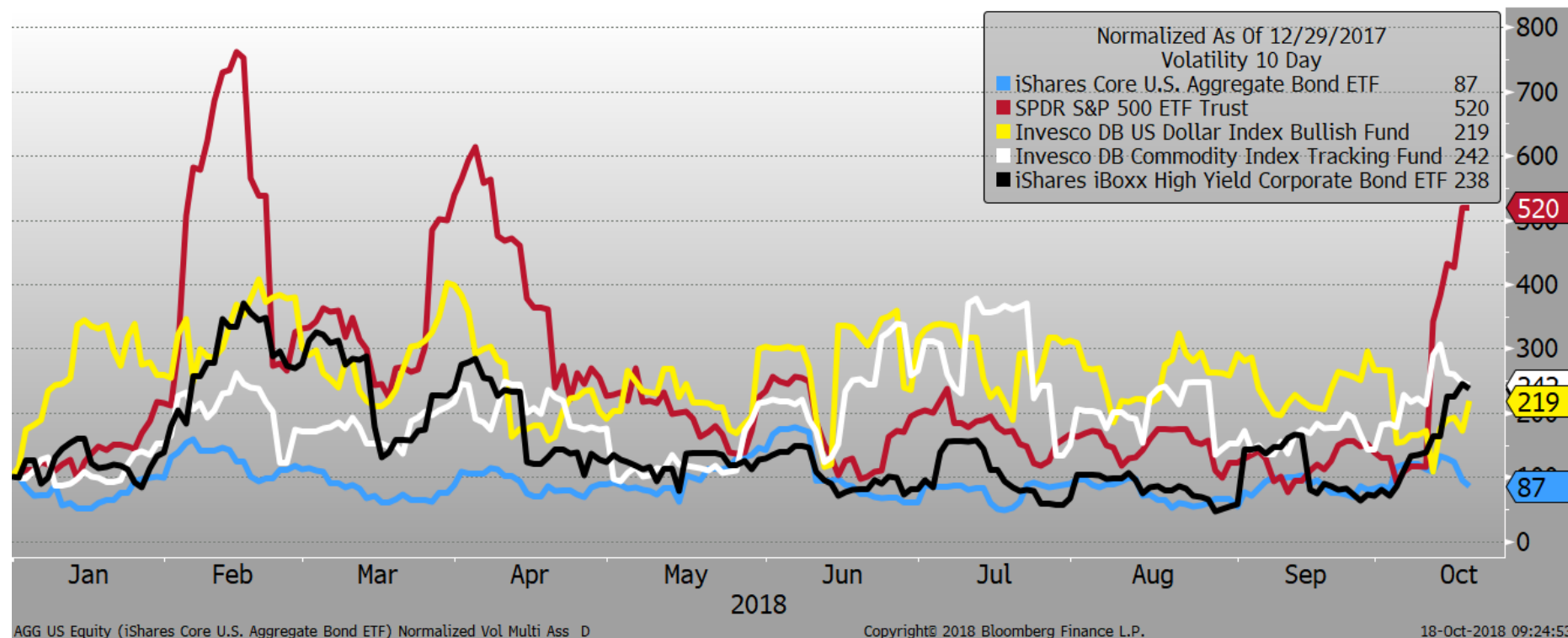
Source: JPM Asset Management

The S&P may be trading expensive according to the CAPE valuation metric, but thanks to 20%+ earnings growth this year, P/E ratios have fallen back close to their 25-year averages. The S&P still appears to be marginally cheap relative to corporate bond yields.

Cross Market Volatility

Normalized Vol Across Asset Classes

(Equity, HY, Rates, Comm, FX)

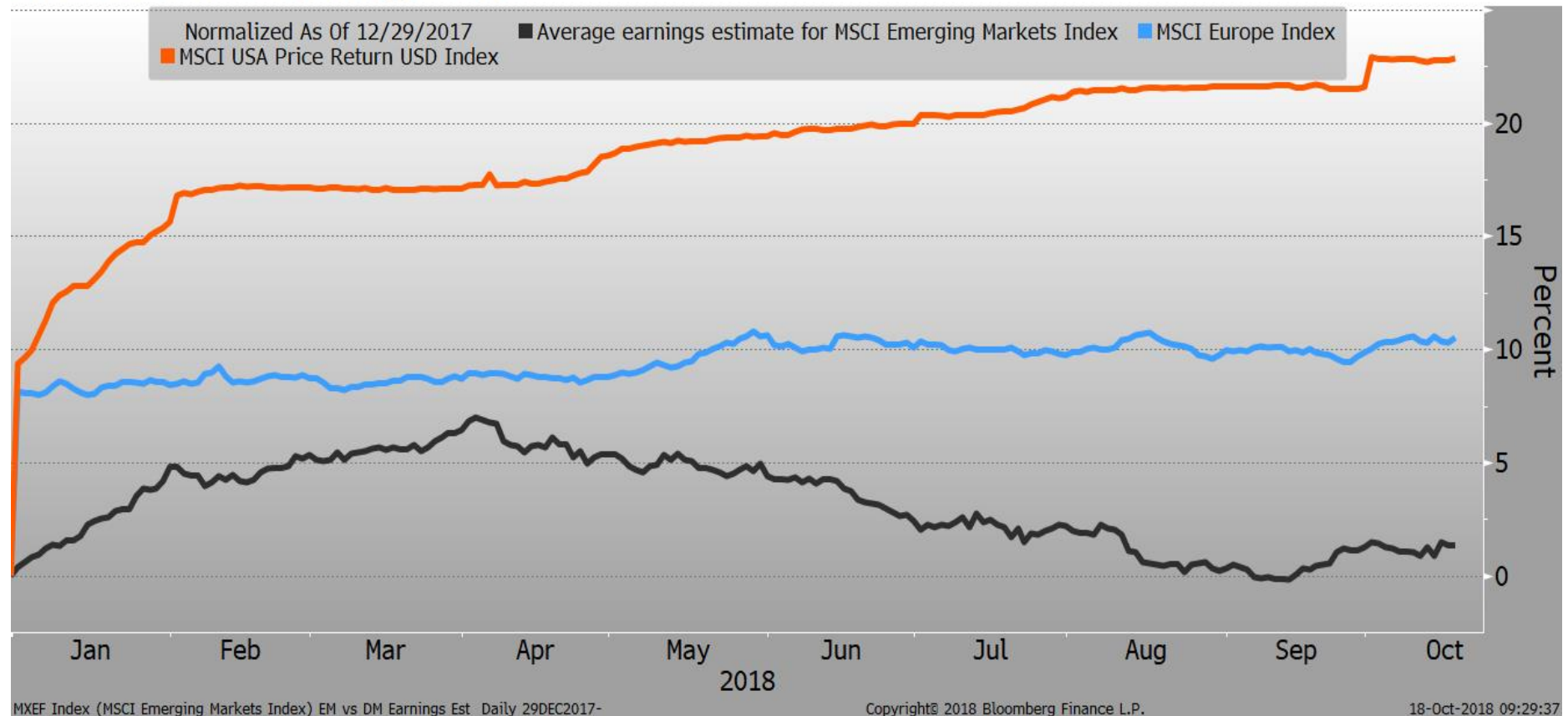


Source: Bloomberg LP; III Capital Management

Equity volatility has had a 3 spikes so far in 2019. Volatility in other asset classes remains contained, especially in fixed income.

Earnings Estimates

EM vs DM Earnings Est

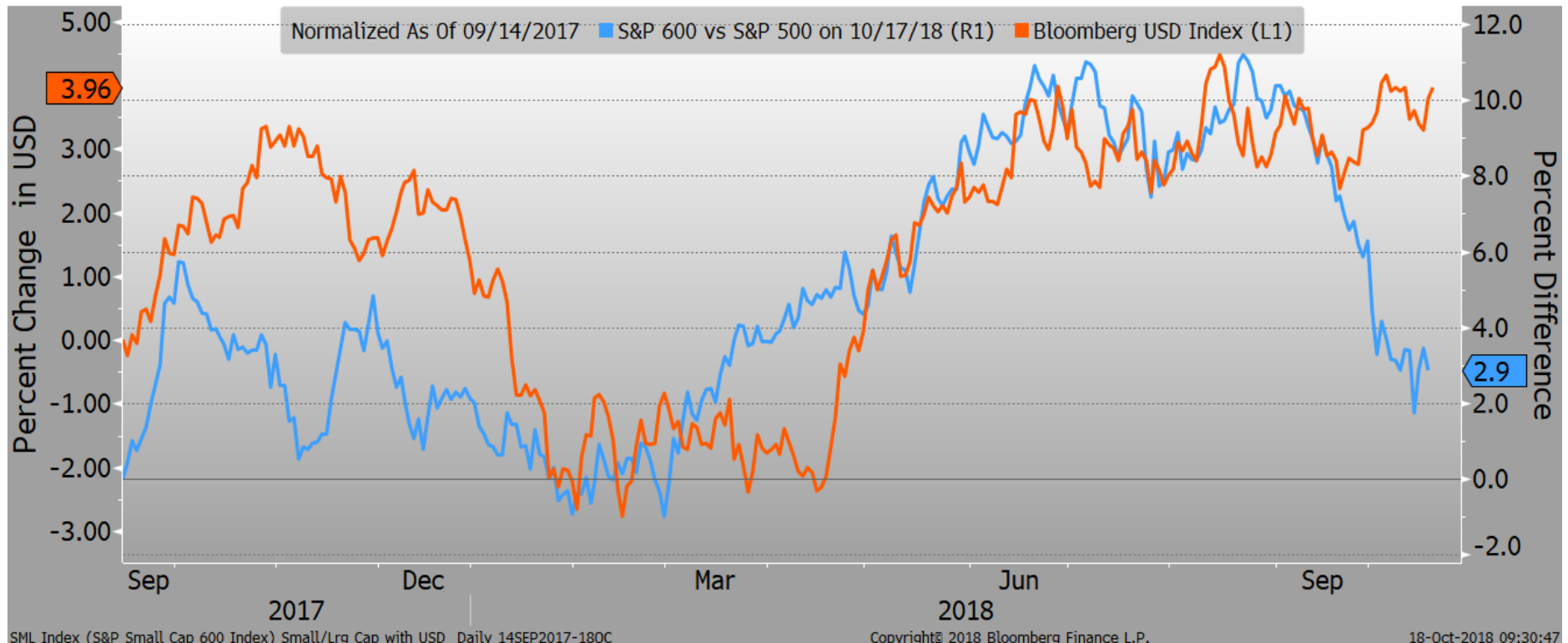


US earnings are almost 25% higher on the year. European earnings are roughly 10% higher. Earnings in EM are up a modest 2%. This helps explain some of the 2019 EM underperformance.

Small Caps

Small Cap vs Large Cap

(S&P Small Cap 600 vs S&P 500)

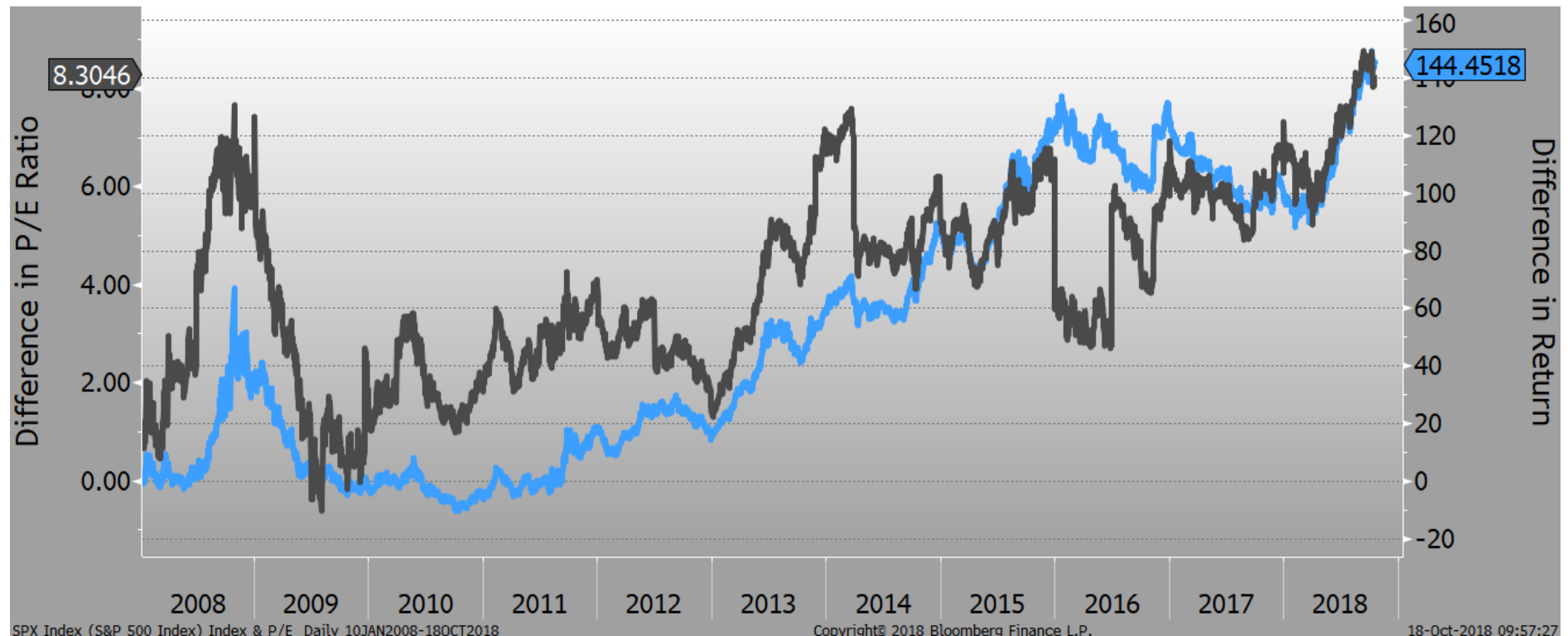


Source: Bloomberg LP; III Capital Management

Small cap stocks did great in Q2 and Q3 when investors were concerned over trade and the USD peaked. Small caps have given back much of their outperformance and have decoupled from the USD.

EM Equity Valuation

S&P 500 vs EM (Returns & P/E Differentials)

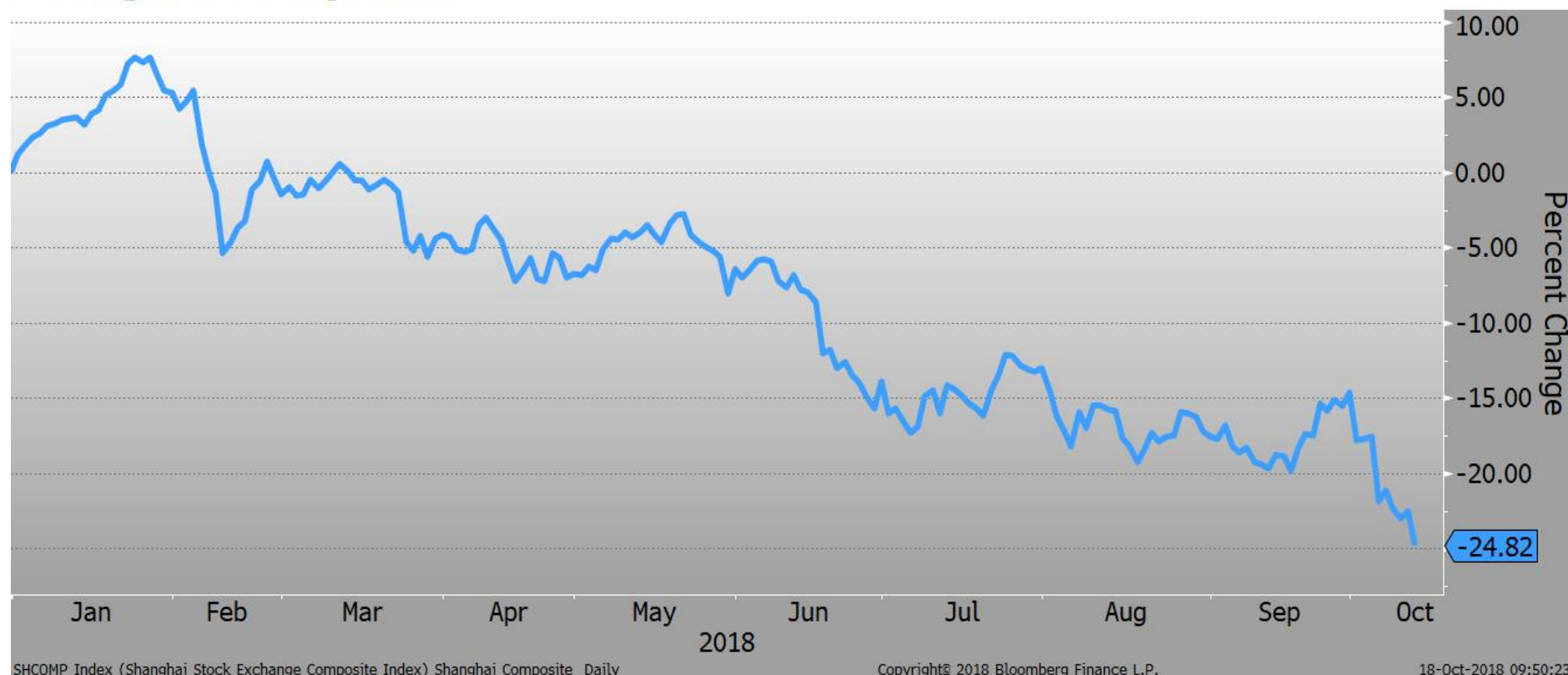


Source: Bloomberg LP; III Capital Management

The difference in P/E ratio of 8X between the MSCI EM Index and the S&P 500 is the highest it has been going back to the financial crisis. Over that time period, the S&P has outperformed EM by 144%.

China Equity Market

Shanghai Composite

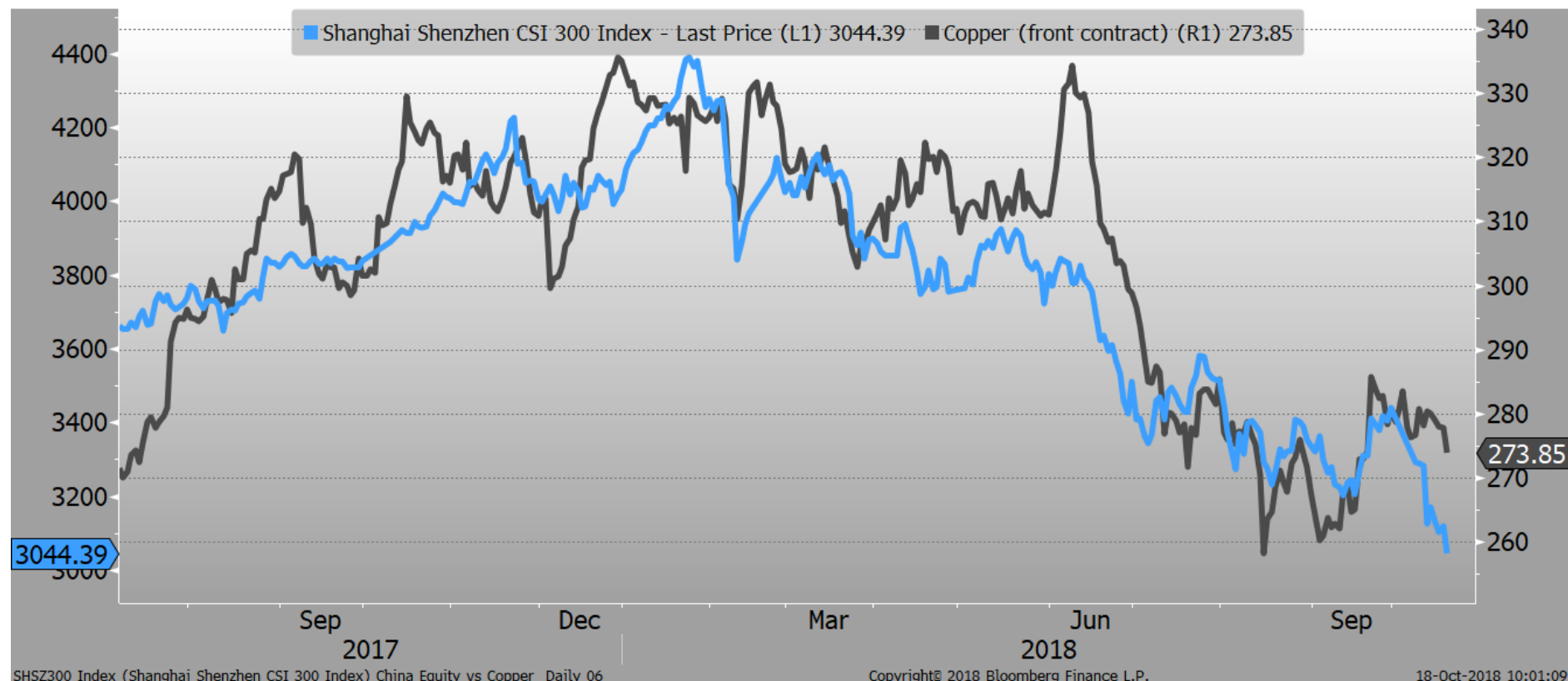


Source: Bloomberg LP; III Capital Management

The Shanghai Composite is 25% lower YTD, clearly in bear market territory. The large China weight in most EM indices is hurting investors with passive EM exposure.

Chinese Equities and Copper

Chinese Equities & Copper



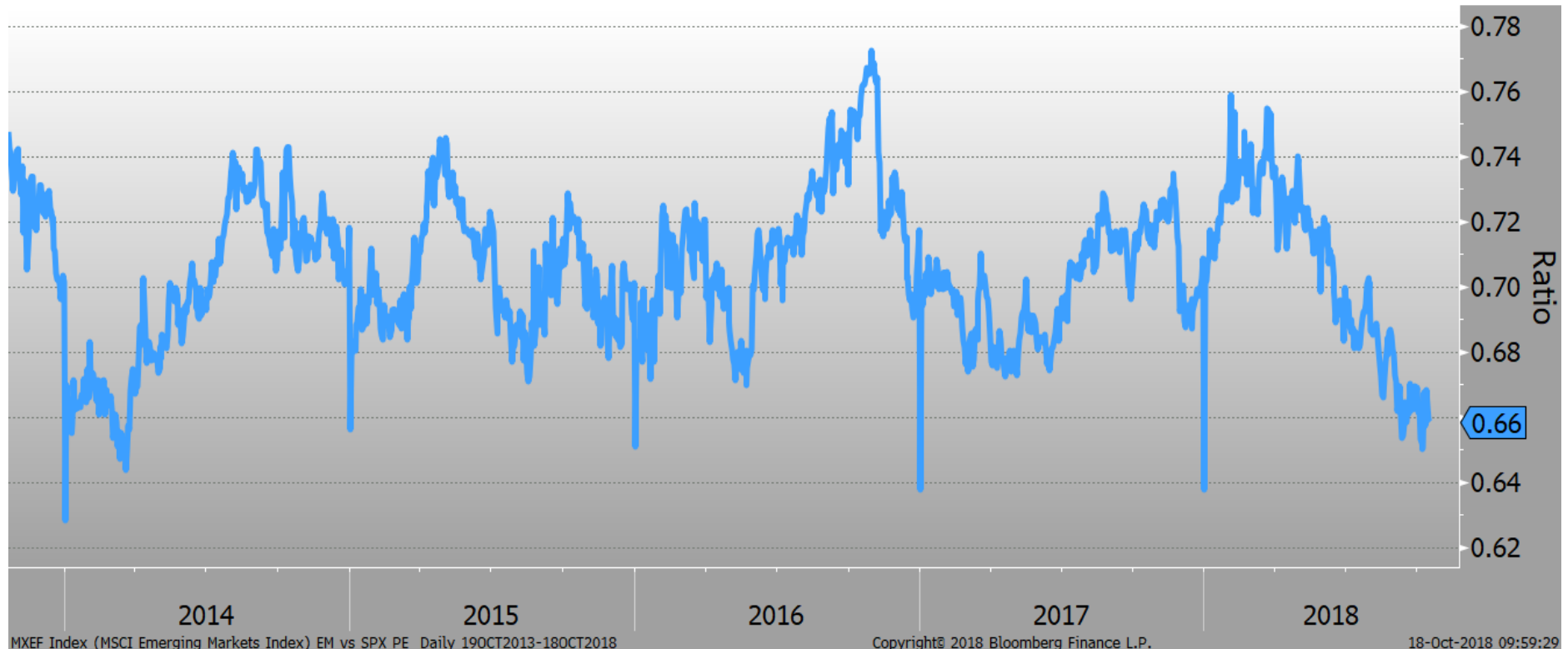
Source: Bloomberg LP; III Capital Management

The link between Chinese equities and industrial metals like copper appears to be intact.

EM vs S&P: P/E Ratio Comparison

MSCI Emerging Markets vs SPX

(Ratio of 1Y Forward PE)



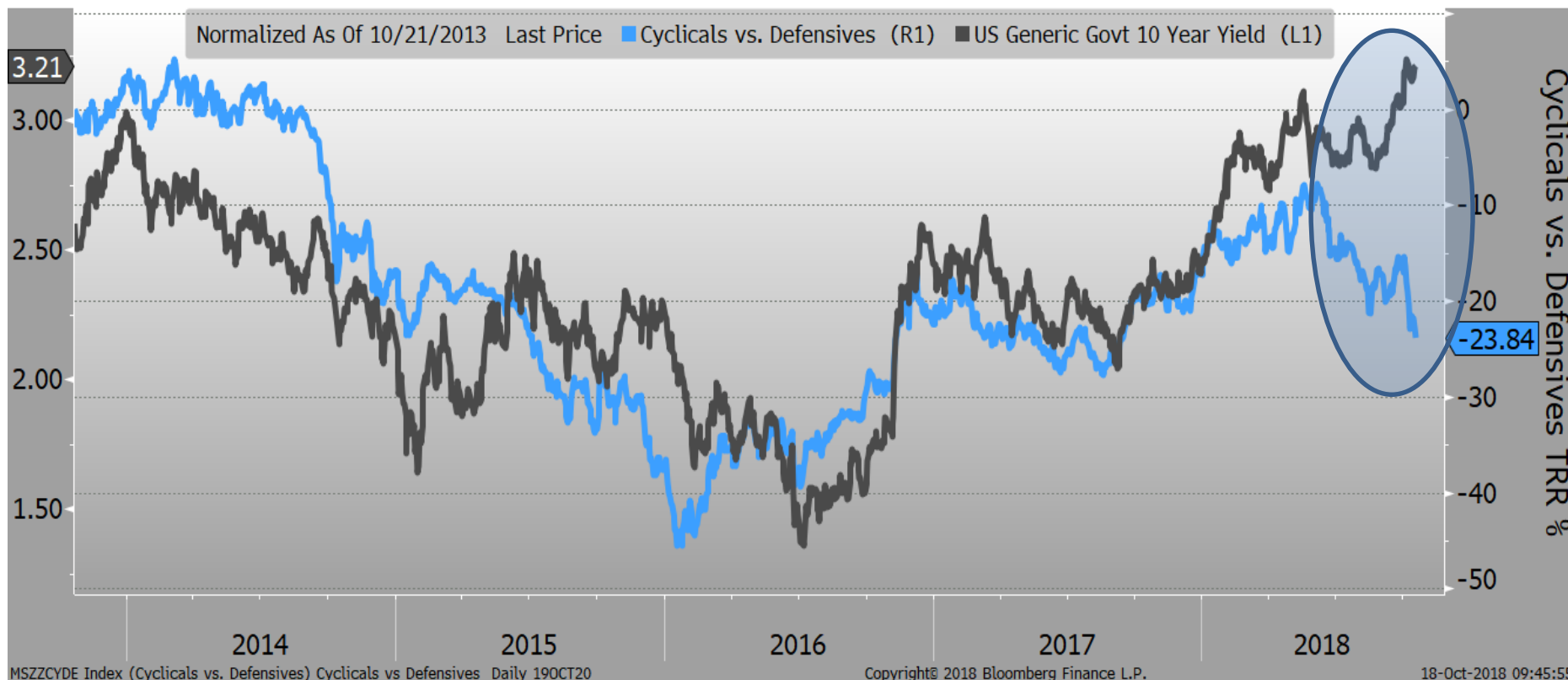
Source: Bloomberg LP; III Capital Management

This chart tells the same story: the ratio of 1-year forward P/E multiples of the MSCI EM Index compared to the S&P 500 is at a multi-year low.

Defensives vs Cyclical

Cyclicals vs Defensives

(compared to 10Y note yield)



Source: Bloomberg LP; III Capital Management

The performance of cyclical stocks (blue line) rolled over in the middle of the year compared to defensive stocks. Historically, there has been a strong link between cyclical outperformance and higher bond yields. That link appears to have broken.

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