GREYCOURT

# Capital Market Flash Report

**December 2018** Global markets are discounting slower, more modest growth and increasing risk premiums because of tightening financial conditions and increasing political risks. Markets are also reflecting the need for renewed monetary stimulus to keep growth on track. Current pricing implies the US will outperform across stocks, bonds, and most currencies. Relative pricing for US assets, however, is too optimistic while non-US pricing is overly pessimistic. US stock markets have not found a bottom as valuations remain above long-term averages.

## US EQUITY

Accelerating volatility spiked in December as a four-session selloff beat down stocks. Despite positive economic data, and strong holiday sales, markets slashed prices over fears of slower growth and possible recession. Predictably, large cap stocks outperformed small cap stocks as the small cap *premium* reached a record negative level. Defensive factors and strategies provided some cushion. A stellar month-end rebound led by the consumer-discretionary and technology sectors rescued markets from near-bear-market losses.

| | Month (%) | YTD (%) |
|---|---|---|
| S&P 500 | -9.0 | -4.4 |
| Russell 1000 | -9.1 | -4.8 |
| Russell 1000 Value | -9.6 | -8.3 |
| Russell 1000 Growth | -8.6 | -1.5 |
| Russell 2000 | -11.9 | -11.0 |
| Russell 2000 Value | -12.1 | -12.9 |
| Russell 2000 Growth | -11.7 | -9.3 |

## NON-US EQUITY

Abysmal growth projections for Europe and political turmoil around Italy and Brexit battered developed market stocks. With China struggling to maintain growth and reduce corporate debt, its stock market was the worst performer in 2018. Nonetheless, EM stocks outperformed developed stocks in December because of the weaker US dollar, falling oil prices helping major oil importers, and the fact that much gloom and doom was already priced in, as evidenced by lower volatility than the US for the second time in five years.

| | Month (%) | YTD (%) |
|---|---|---|
| MSCI All-Country World ex-US | -4.5 | -13.8 |
| MSCI EAFE | -4.8 | -13.4 |
| MSCI Europe | -4.6 | -14.3 |
| MSCI Japan | -6.7 | -12.6 |
| MSCI Emerging Markets | -2.6 | -14.2 |
| MSCI BRIC Index | -4.2 | -13.2 |

## FIXED INCOME

Investors sought shelter from volatility and stock losses in US Treasuries as December was 2018's best month for global bonds. The Fed's announcement that only two rate increases might be needed in 2019 signaled to investors that growth and inflation might be lower than previously anticipated. As a result, long Treasuries soared as the yield curve flattened. This flight to quality hurt junk bonds which saw record outflows. Confirming what has been a very unusual investing period, cash outperformed stocks and bonds in 2018.

| | Month (%) | YTD (%) |
|---|---|---|
| U.S. Intermediate Treasuries | 1.5 | 1.4 |
| U.S. Long Treasuries | 5.5 | -1.8 |
| U.S. TIPS | 0.5 | -1.3 |
| Corporate IG Bonds | 1.1 | -5.0 |
| High-Yield Bonds | -2.1 | -2.1 |
| Tax-Exempt Bonds | 1.2 | 1.3 |

## CURRENCIES

Notwithstanding a December rate-hike, the US dollar fell. Investors adjusted their expectations anticipating less-strict Fed rate and QT policies in 2019. Tempered trade optimism with China also weakened the US dollar. Analysts continue to predict additional weakening in 2019, while traders are positioning for a possible surprise rally. The yen continued as a flight-to-safety currency as investors in Japan dumped foreign stocks and bought the yen. EM currencies continued to rebound from cyclical lows.

| | Month (%) | YTD (%) |
|---|---|---|
| US Dollar | -1.1 | 4.4 |
| Euro | 1.3 | -4.5 |
| Yen | 3.5 | 2.8 |
| Emerging Markets[1] | 0.4 | -3.8 |

## REAL ASSETS

Gold appreciated significantly, reaching its highest level since June, given extreme volatility, the weaker dollar, and evolving Fed policies. Commodity returns overall were dragged down by weakening demand expectations and trade tensions that hit industrial metals, building materials, and especially energy and oil. OPEC's failed efforts to curb supply exacerbated the plunge in oil prices. MLPs traded down as demand and oil price forecasts were also cut. In the short-term, REITS traded with stocks as rate views reset.

| | Month (%) | YTD (%) |
|---|---|---|
| Commodities[2] | -6.9 | -11.2 |
| Energy | -18.7 | -12.7 |
| Industrial Metals | -5.1 | -19.5 |
| Gold | 4.7 | -2.8 |
| Master Limited Partnerships[3] | -9.4 | -12.4 |
| Real Estate Investment Trusts[4] | -8.2 | -4.6 |

## HEDGE STRATEGIES

Although falling generally, hedge funds fared much better in December, significantly outperforming markets as fourth quarter deleveraging protected them from the extreme fluctuations across global equity markets. Unsurprisingly, neutral strategies performed well owing to their avoidance of equity market exposure. Macro strategies for the most part avoided the significant losses among stocks, taking advantage of currency movements and rates through effective trading to realize positive returns for the month.

| | Month (%) | YTD (%) |
|---|---|---|
| Equity Hedge | -4.6 | -9.7 |
| Equity Market Neutral | -0.8 | -3.5 |
| Event Driven | -2.1 | -12.5 |
| Distressed | -1.7 | -9.7 |
| Macro | 0.8 | -3.2 |

Data Source: Bloomberg. MSCI returns are gross USD. Currency returns are Simple Price Appreciation (SPA) USD basis. Fixed Income reported on Bloomberg Barclays Indices. [1]MSCI Emerging Markets Currency Index. [2]Bloomberg Commodity Indices. [3]Alerian MLP Index. [4]FTSE NAREIT Equity REIT Index. Hedge Strategies reported on HFRX Indices SPA with one-day lag. For complete Index Descriptions, see http://www.greycourt.com/indices.html