GREYCOURT

Capital Market Flash Report

February 2020 As the coronavirus spread geographically, expectations of disrupted global supply chains and rapidly slowing growth were exacerbated by a pandemic of fear that pummeled stocks, pushed bond yields to record lows, and skyrocketed the VIX to 49. With Chinese PMIs collapsing, markets are pricing a deflationary shock, interest rate cuts, and persistent low inflation. Ongoing policy and market uncertainties make it difficult to determine if the negative economic effects are fully priced in just yet and lower stock valuations justified.

US EQUITY

The S&P 500 fell nearly 13% from a record high on the 19th of February until month end. This percentage free fall was the fifth largest since 1928 and saw the forward P/E contract from 19x to 16.5x. Led by the FAANGM stocks, the biggest winners on the way up were also the biggest losers on the way down. And though all sectors were down, energy, financials, technology, and materials predictably experienced the largest losses. Measures of investor sentiment such as breadth tanked as well, moving rapidly from overbought to oversold.

	Month (%)	YTD (%)
S&P 500	-8.2	-8.3
Russell 1000	-8.2	-8.1
Russell 1000 Value	-9.7	-11.6
Russell 1000 Growth	-6.8	-4.7
Russell 2000	-8.4	-11.4
Russell 2000 Value	-9.7	-14.6
Russell 2000 Growth	-7.2	-8.2

NON-US EQUITY

Non-US stocks experienced sharp losses on a US dollar basis. In local currency terms, however, they outperformed US stocks, because non-US valuations were lower. Stocks in Europe were hit hard because of coronavirus cases in Italy and fear of spread into Europe. Japan also suffered over concerns the virus would disproportionately impact its aged workforce. Chinese retail investors pushed the MSCI China Index up 1.2% by betting on companies expected to rebound most when the economy stabilizes after the viral outbreak.

	Month (%)	YTD (%)
MSCI All-Country World ex-US	-7.9	-10.4
MSCI EAFE	-9.0	-10.9
MSCI Europe	-9.3	-11.5
MSCI Japan	-9.1	-10.4
MSCI Emerging Markets	-5.3	-9.7
MSCI BRIC Index	-3.4	-7.6

FIXED INCOME

Bond markets revealed significant doubts about growth and profits, pricing in a deflationary shock with falling rates and inflation. The yield on the 10-year US Treasury fell to 1.1% while the Long Bond posted spectacular monthly and year-to-date returns. Investment-grade corporates benefitted from falling rates, while the increase in risk spread to almost 550 basis points hurt high yield debt. Benchmark municipal yields fell across the curve as investors continued to pour into tax-exempt debt for safety and after-tax yield.

	Month (%)	YTD (%)
U.S. Intermediate Treasuries	1.7	3.1
U.S. Long Treasuries	6.7	14.0
U.S. TIPS	1.4	3.5
Corporate IG Bonds	1.2	3.4
High-Yield Bonds	-1.4	-1.4
Tax-Exempt Bonds	1.3	3.1

CURRENCIES

Although the US dollar strengthened over this volatile period, the Swiss franc seemed close to displacing it as the safe-haven currency. That rotation is occurring because of falling US yields and expectations of additional rate cuts. The euro traded off given concerns about stock outflows, while the yen struggled to hold on to its safe-haven status. With volatility increasing, there was significant, defensive unwinding of currency carry trades. Flight to safety outflows caused EM currencies to decline broadly.

	Month (%)	YTD (%)
US Dollar	0.8	1.8
Euro	-0.6	-1.7
Yen	0.2	0.5
Emerging Markets[1]	-1.5	-2.6

REAL ASSETS

Commodity prices that had been clawing their way back up after January were scuttled late in the month. Much like the bond markets, commodity investors focused on negative outcomes involving no China growth and a global deflationary shock. Copper and oil remain susceptible to further declines even after energy and MLPs were particularly hard hit. Gold had appreciated by almost 7% during the month but fell rapidly in the last four days of the month as crisis fears led investors to seek out more liquid investments.

	Month (%)	YTD (%)
Commodities[2]	-5.0	-12.0
Energy	-11.6	-24.7
Industrial Metals	-2.6	-9.7
Gold	-1.2	2.7
Master Limited Partnerships[3]	-14.0	-18.9
Real Estate Investment Trusts[4]	-8.0	-6.9

HEDGE STRATEGIES

Across the board, hedge strategies performed well. Directional equity strategies, especially systematic long/short funds, benefitted from lower net exposures and timely sector rotations that mitigated losses to approximately one-third of those in full market beta investments. Gross and net leverage declined as expected in a volatile environment, while relative value managers took advantage of volatility and dispersion. Global macro managers navigated rapidly changing flows well but not well enough to post positive absolute returns.

	Month (%)	YTD (%)
Equity Hedge	-2.8	-3.1
Equity Market Neutral	-0.4	-2.0
Event Driven	0.2	0.7
Relative Value Arbitrage	0.1	0.8
Macro	-0.3	0.5

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 a one-day lag. For complete Index Descriptions, see http://www.greycourt.com/indices.html