# Monthly Scorecard

November 8, 2018 | Portfolio Advisory Group – U.S. Equities

## Performance (Total return % change)

| Index | 10/31/18 | 1 mo. | 3 mos. | YTD | 1 yr. | 2 yrs. |
|---|---|---|---|---|---|---|
| Dow (DJIA) | 25,115.76 | -4.98 | -0.64 | 3.41 | 9.87 | 45.10 |
| S&P 500 | 2,711.74 | -6.84 | -3.25 | 3.00 | 7.34 | 32.69 |
| NASDAQ | 7,305.90 | -9.16 | -4.52 | 6.73 | 9.77 | 44.05 |
| Russell 2000 | 1,511.41 | -10.86 | -9.26 | -0.60 | 1.85 | 30.18 |
| Russell 3000 | 1,597.71 | -7.36 | -3.95 | 2.43 | 6.59 | 32.13 |
| S&P 500 Equal Wgt. | 4,012.68 | -7.20 | -5.22 | -0.45 | 4.58 | 25.91 |
| MSCI AC World | 484.57 | -7.47 | -6.26 | -3.54 | 0.01 | 23.91 |
| MSCI Europe | 122.26 | -7.81 | -10.09 | -9.75 | -8.04 | 17.40 |
| MSCI EAFE | 1,815.17 | -7.95 | -8.89 | -8.85 | -6.37 | 16.22 |
| MSCI Asia-Pacific | 149.49 | -9.56 | -9.76 | -11.87 | -8.51 | 13.71 |
| MSCI Emerg. Mkts. | 955.92 | -8.70 | -11.60 | -15.51 | -12.21 | 11.40 |
| 60/40 Allocation[1] | N/A | -4.42 | -2.27 | 0.85 | 3.58 | 19.15 |
| **S&P 500 Sector** | **10/31/18** | **1 mo.** | **3 mos.** | **YTD** | **1 yr.** | **2 yrs.** |
| Consumer Disc. | 831.97 | -11.27 | -5.74 | 7.02 | 15.14 | 37.88 |
| Consumer Staples | 566.68 | 2.31 | 3.90 | -1.12 | 6.80 | 10.82 |
| Energy | 497.37 | -11.26 | -11.97 | -4.64 | 1.77 | 4.30 |
| Financials | 435.85 | -4.73 | -5.56 | -4.65 | 0.59 | 37.82 |
| Health Care | 1,026.70 | -6.69 | 0.24 | 8.83 | 11.28 | 36.44 |
| Industrials | 587.50 | -10.81 | -8.59 | -6.50 | -1.06 | 23.78 |
| Information Tech. | 1,215.67 | -7.97 | -1.92 | 11.02 | 12.30 | 56.05 |
| Materials | 328.69 | -9.47 | -11.76 | -11.95 | -9.35 | 16.67 |
| Real Estate | 198.36 | -1.67 | -1.89 | -0.03 | 2.42 | 12.09 |
| Telecom. | 150.88 | -5.75 | 1.26 | -5.04 | 6.50 | 5.05 |
| Utilities | 272.38 | 1.95 | 2.48 | 4.72 | 1.00 | 16.55 |
| **FI, FX, & Commod.** | **10/31/18** | **1 mo.** | **3 mos.** | **YTD** | **1 yr.** | **2 yrs.** |
| U.S. Treasuries[2] | 3.14% | -0.48 | -0.65 | -2.14 | -1.97 | -2.65 |
| Invest-Grade Credit[3] | 4.28% | -1.46 | -1.33 | -3.76 | -3.02 | 0.34 |
| High-Yield Credit[3] | 6.86% | -1.60 | -0.32 | 0.93 | 0.97 | 9.98 |
| WTI Crude Oil[4] | $65.31 | -10.84 | -5.02 | 8.09 | 20.10 | 39.37 |
| Dollar Index[4] | $97.13 | 2.10 | 2.72 | 5.43 | 2.72 | -1.34 |
| Gold[4] | $1,214.76 | 1.87 | -0.76 | -6.78 | -4.43 | -4.90 |

[1] 60% S&P 500 and 40% Bloomberg Barclays U.S. Aggregate; [2] Yield reflects 10-year U.S. Treasury, total returns reflect Bloomberg Barclays U.S. Treasury Index; [3] Yield and total returns reflect that of the respective Bloomberg Barclays Index; [4] Spot prices and price returns.
Source - Bloomberg, RBC Wealth Management

Priced (in USD) as of October 31, 2018, market close (unless otherwise stated).

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# Spooked markets: Taking stock

Investors should not be sorry to see October fade into the background, as equities struggled in a month that has historically been the most volatile of the year. The best-performing index in the U.S., the Dow Jones Industrial Average, declined 5.0% on a total return basis while the worst U.S. index, the Russell 2000, saw small caps lose 10.9%. The S&P 500 declined 9.3% at its worst before rallying over the final two trading days to end the month down 6.8%. The NASDAQ experienced similar trends, only magnified, as seen in the trough decline of 12.4% and subsequent rally to finish 9.2% lower than it had begun the month.

International markets fared as poorly as their U.S. peers. The MSCI All Country World Index declined 7.5% with the Asia-Pacific region losing 9.6%. Hong Kong and China led the regional decliners, losing 10.1% and 7.8%, respectively, on trade war concerns and slowing economic growth. Europe shed 7.8% and emerging markets dropped 8.7%. Ongoing strength in the U.S. dollar helped hold back international returns, as the 2.1% climb in the greenback brought its appreciation to 5.4% for the year. Remember, a stronger dollar makes it harder for international companies that borrow in dollars to pay their debt when the local currency declines.

## U.S. selloff post-mortem

Autumn's 9.9% peak-to-trough selloff on the S&P 500 has many investors asking how equity markets arrived at this point. From a high level, it starts with markets' efforts to digest decelerating earnings growth as well as concerns that margins have peaked, input costs and wage inflation are starting to pressure profitability levels, and U.S. economic growth is likely unsustainable at its current

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level. This is to say nothing of the midterm elections that are now in the rear-view mirror, or of geopolitical tensions that show little sign of easing.

With this backdrop in mind, it makes sense that stocks levered to economic output and those that provided early-2018 leadership could falter. Consumer Discretionary was the hardest-hit sector, and Internet Retail was the worst industry within the sector. Amazon.com ended the month down more than 20% while Home Depot and Lowe's were both down more than 15%. Exacerbating the problem, Tech dropped nearly 8% with the Semiconductors industry down 12% and Software declining more than 8%.

Other economically sensitive sectors—such as Industrials, Materials, and Energy—all posted double-digit losses. Capital Goods, Oilfield Services, and Exploration & Production stocks all experienced painful losses in excess of 15%.

Stocks that outperformed through the recent spike in volatility were the ones that would be expected to perform well in a challenging environment, namely those in defensive sectors. Consumer Staples and Utilities both delivered positive monthly returns as investors fled high-beta stocks for lower-risk alternatives. Food and Staples retailing was the best industry here, as companies such as Walmart and Walgreens helped stabilize the market. Hormel Foods was one of four stocks to deliver double-digit returns in October, the others being Twitter, CBOE Global Markets, and Red Hat.

Only 30% of the S&P 500 remains above correction territory.

### 52-week highs and the S&P 500

| Distance below 52-week high | Number of firms | Percent of S&P 500 |
|---|---|---|
| Less than 5% | 55 | 11.0% |
| >5% and <10% | 94 | 18.7% |
| >10% and <15% | 78 | 15.5% |
| >15% and <20% | 80 | 15.9% |
| >20% and <25% | 62 | 12.4% |
| >25% and <30% | 54 | 10.8% |
| Greater than 30% | 79 | 15.7% |

Source - RBC Wealth Management, FactSet; data through 10/31/18

Further highlighting the investor experience of recent weeks is the surprising breadth of the current selloff. By that, we mean the number of stocks trading a meaningful distance below their 52-week highs is exceedingly large. More than 70% of the S&P 500 has declined by 10% or more, and nearly 40% of S&P 500 companies are down more than 20%. These steep declines (on an unweighted basis) illustrate the lack of broad leadership in the S&P 500.

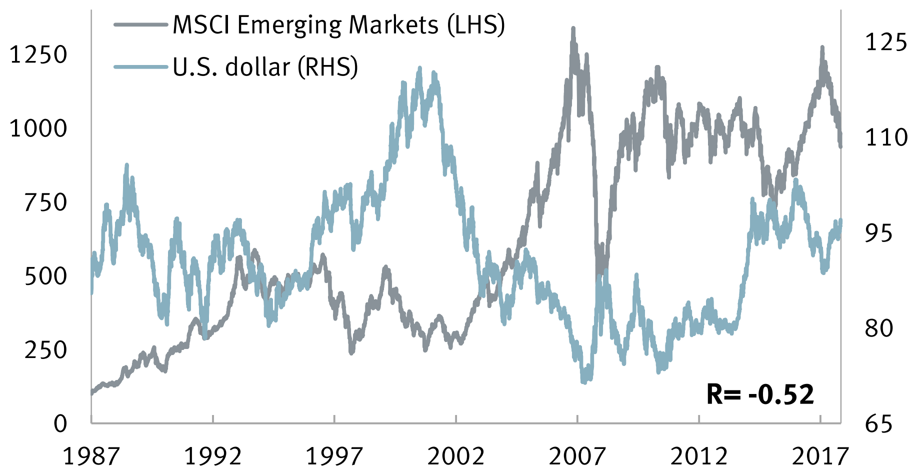
Finally, earnings season has delivered a mixed bag of results so far. To be sure, we're still on track for earnings growth greater than 20%. However, management teams are beginning to see rising input costs and wage inflation affect their bottom lines. Labor shortages, elevated transportation costs, end-of-cycle fears, and weaker-than-hoped-for loan growth have all been consistent challenges that corporate executives have been addressing on quarterly earnings calls.

However, the news is not all bad. The midterm elections resolved themselves as expected, with the Democrats taking the House and Republicans holding the Senate, and equity markets rallied on the removal of this overhang. Furthermore, the economy continues to work and grind higher while U.S. consumers, who account for 60% of the country's economic output, remain the backbone of this expansion. Consumer balance sheets continue to exhibit low debt levels and below-average delinquency rates, while unemployment is also extremely low. Finally, while earnings growth is clearly slowing, we do not believe that earnings will decelerate so abruptly as to actually decline in the immediate future. In our view, a recession does not appear to be on the horizon in the next 12–18 months and as long as that's the case, investors should continue to give equities the benefit of the doubt and exercise patience through this bout of volatility.

## Quick hit: Strong dollar and emerging markets

Another factor underlying global market returns in 2018 is the surprising strength of the U.S. dollar, which is up 5.4% year to date. The currency's strength has been catalyzed by the one-two economic punch of U.S. output leading the developed world and global growth materializing at levels below consensus expectations. Further strengthening in the currency is a result of the IMF reducing its economic growth forecasts.

### The U.S. dollar and emerging markets move in opposite directions




Source - RBC Wealth Management, FactSet; data through 10/31/18

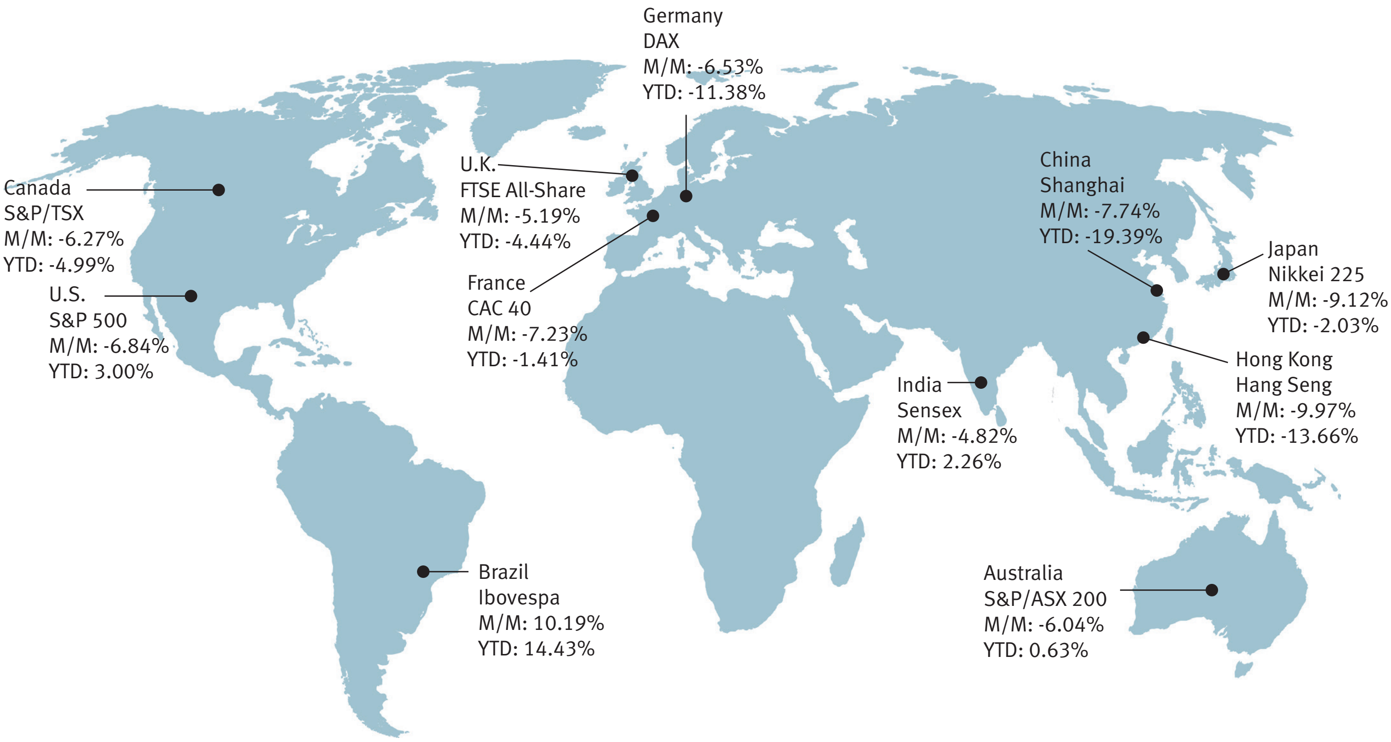
Sharp declines in the U.S. dollar have historically provided good entry points to emerging markets.

One specific asset class feeling reverberations from the move in the dollar is emerging markets. This equity exposure has declined more than 15% in 2018 and dropped nearly 9% in October. The strong dollar is a headwind for emerging market economies, and October's double-digit decline in oil prices did not help either. However, focusing on the relationship between the U.S. dollar and emerging markets suggests an important question: When is the right time to step back into emerging markets, based on what the U.S. dollar tells us?

We have found that sharp declines in the U.S. dollar have historically provided good entry points. When the dollar declines by more than 5.0% in a single month or 12.3% in six months, emerging market returns in the following 12 months are better than average 67% and 72% of the time, respectively. Stretch the U.S. dollar decline to 16.2% over the course of 12 months, and emerging markets deliver better-than-average returns 95% of the time. Given that emerging markets' average 12-month returns are 11.2%, and a 16.2% decline in the U.S. dollar indicates you beat that average 95% of the time, the takeaway is clear. There's no need to get ahead of this trade before the U.S. dollar reverses course, in our view. We believe waiting for the dollar to weaken prior to moving into emerging markets should shift the risk-to-reward ratio in your favor.

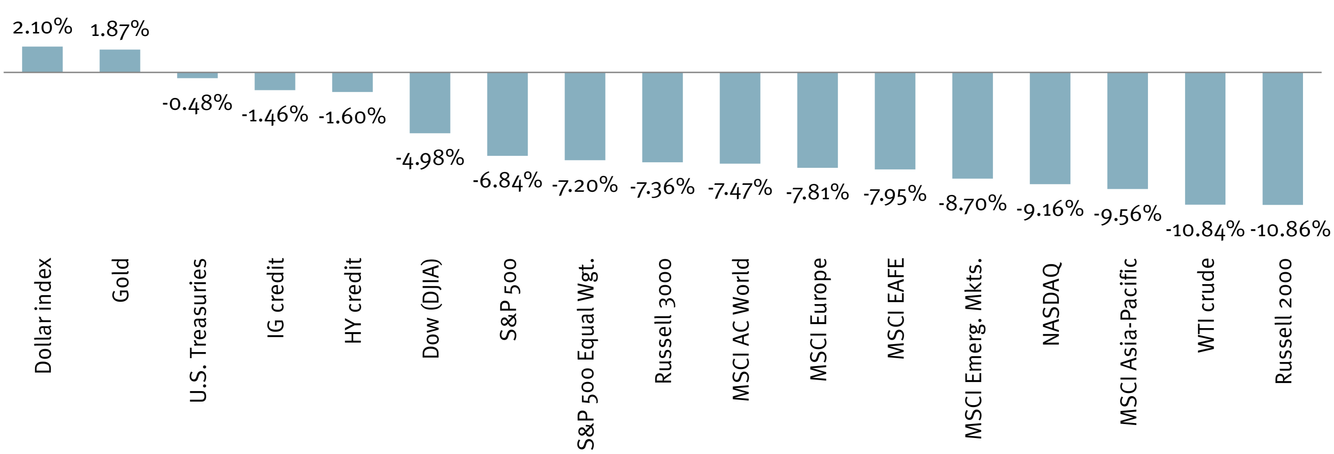
# World markets

## October month-over-month and year-to-date total return




Source - Bloomberg; priced in local currency

## Total monthly returns for select indexes – October 2018




Source - Bloomberg

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|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent |
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| Hold [Sector Perform] | 646 | 40.86 | 125 | 19.35 |
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