

Advancing Risky Asset Prices: the Second Phase

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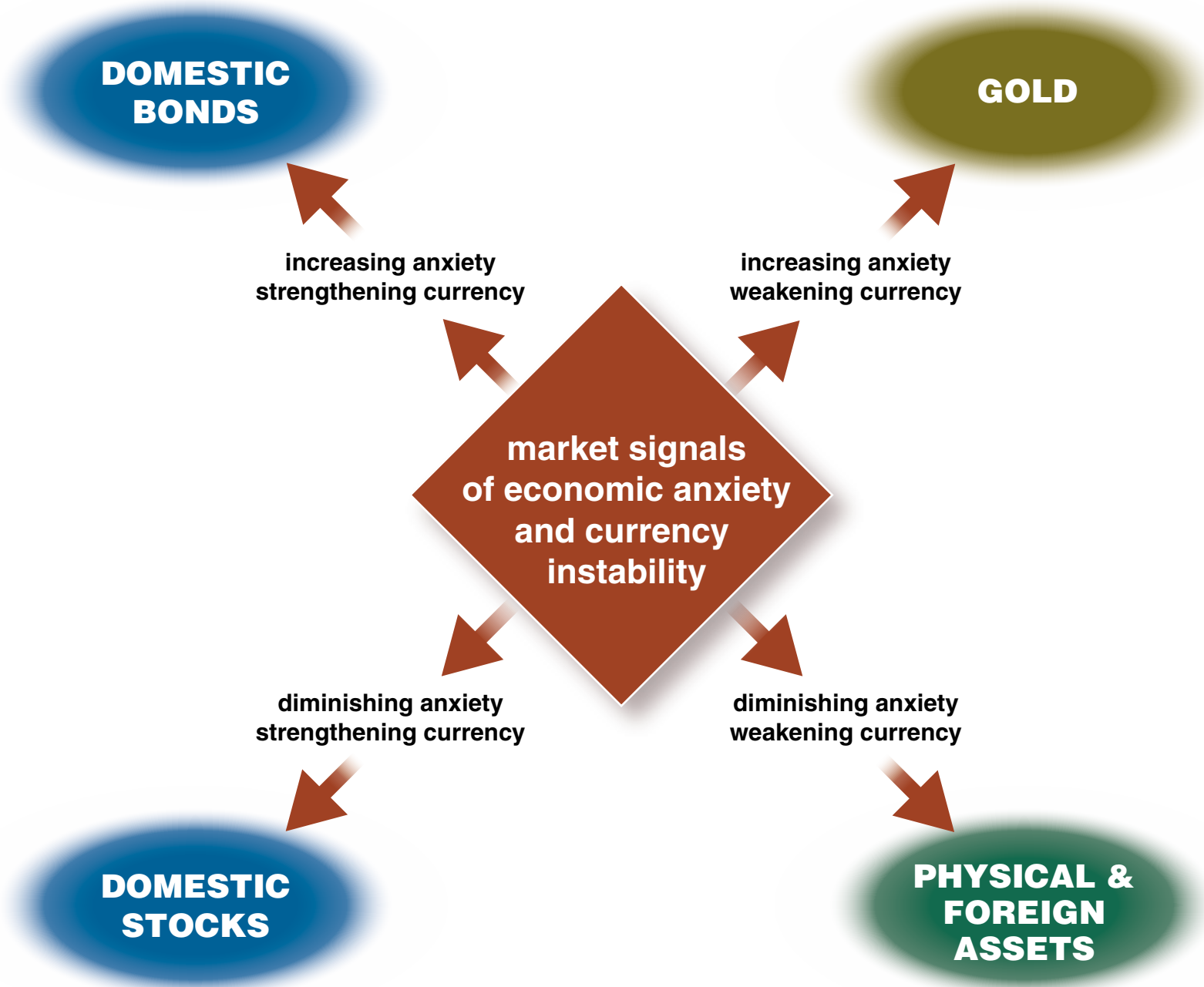
Prepared for the CFA Society of Texas – Austin

September 29, 2017

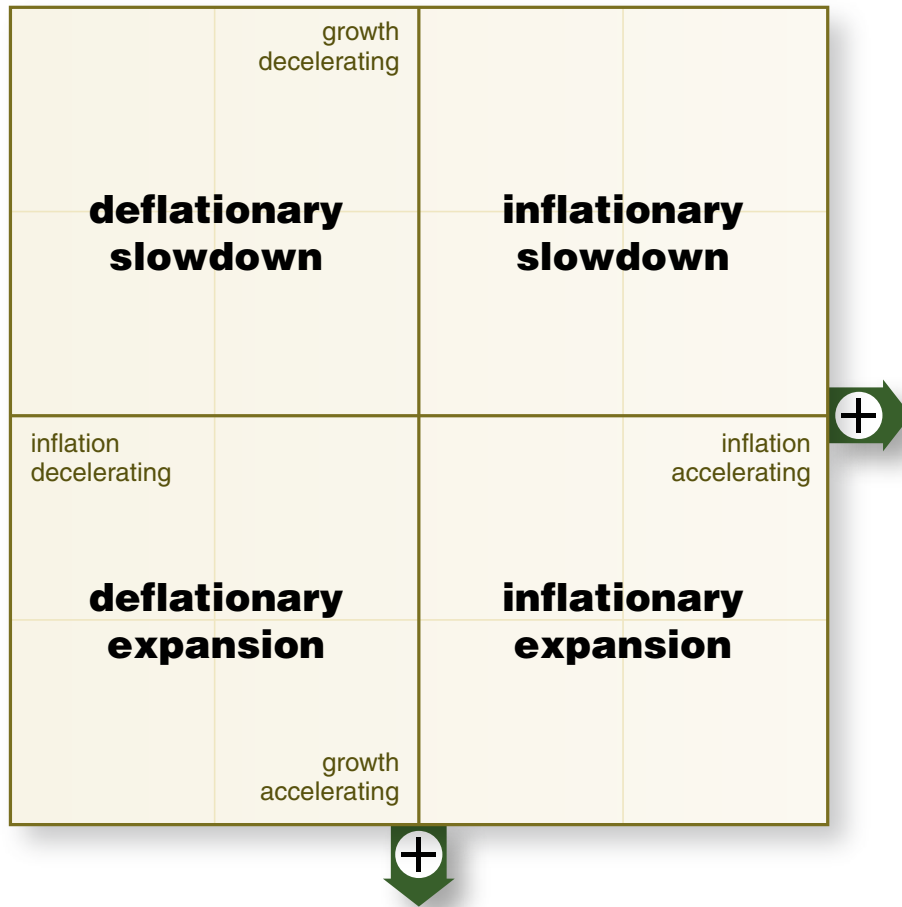


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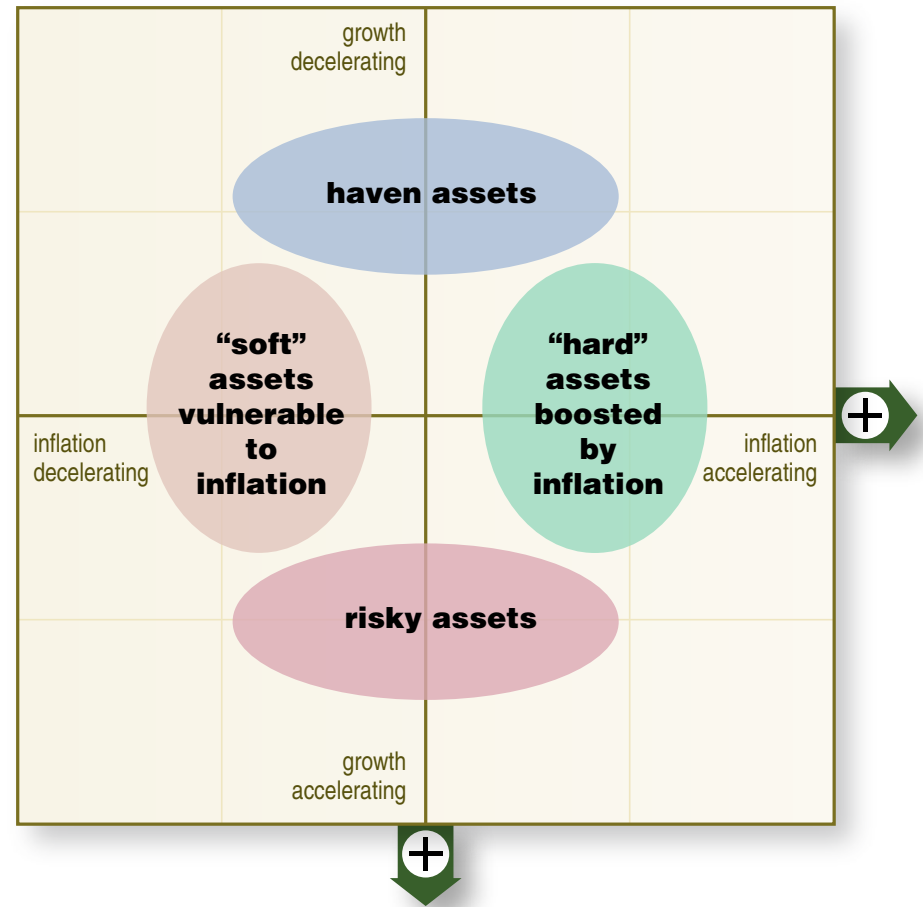
Two Market Signals and Four Primary Asset Classes



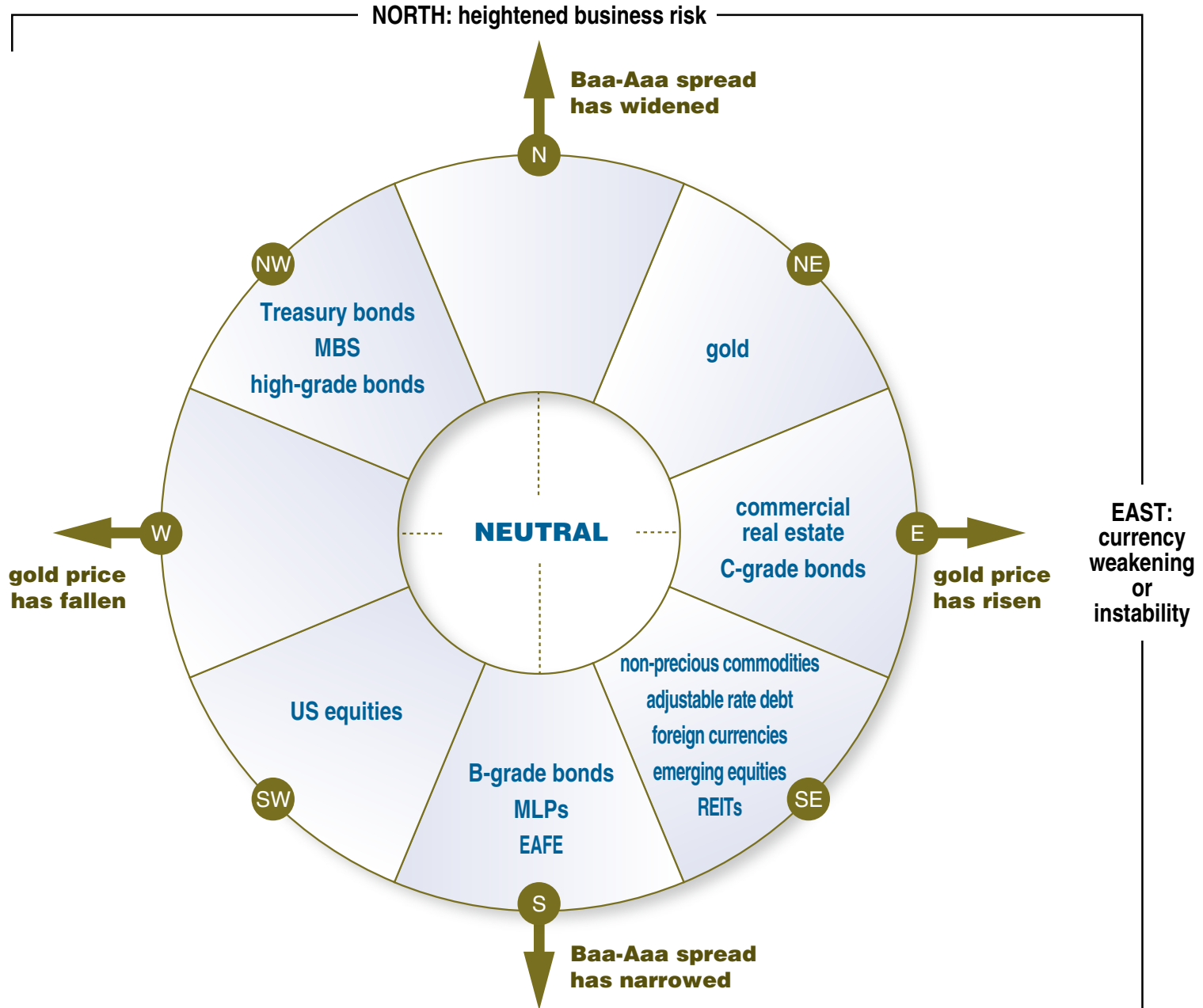
Four Primary Economic Scenarios



Using Scenarios to Classify Assets

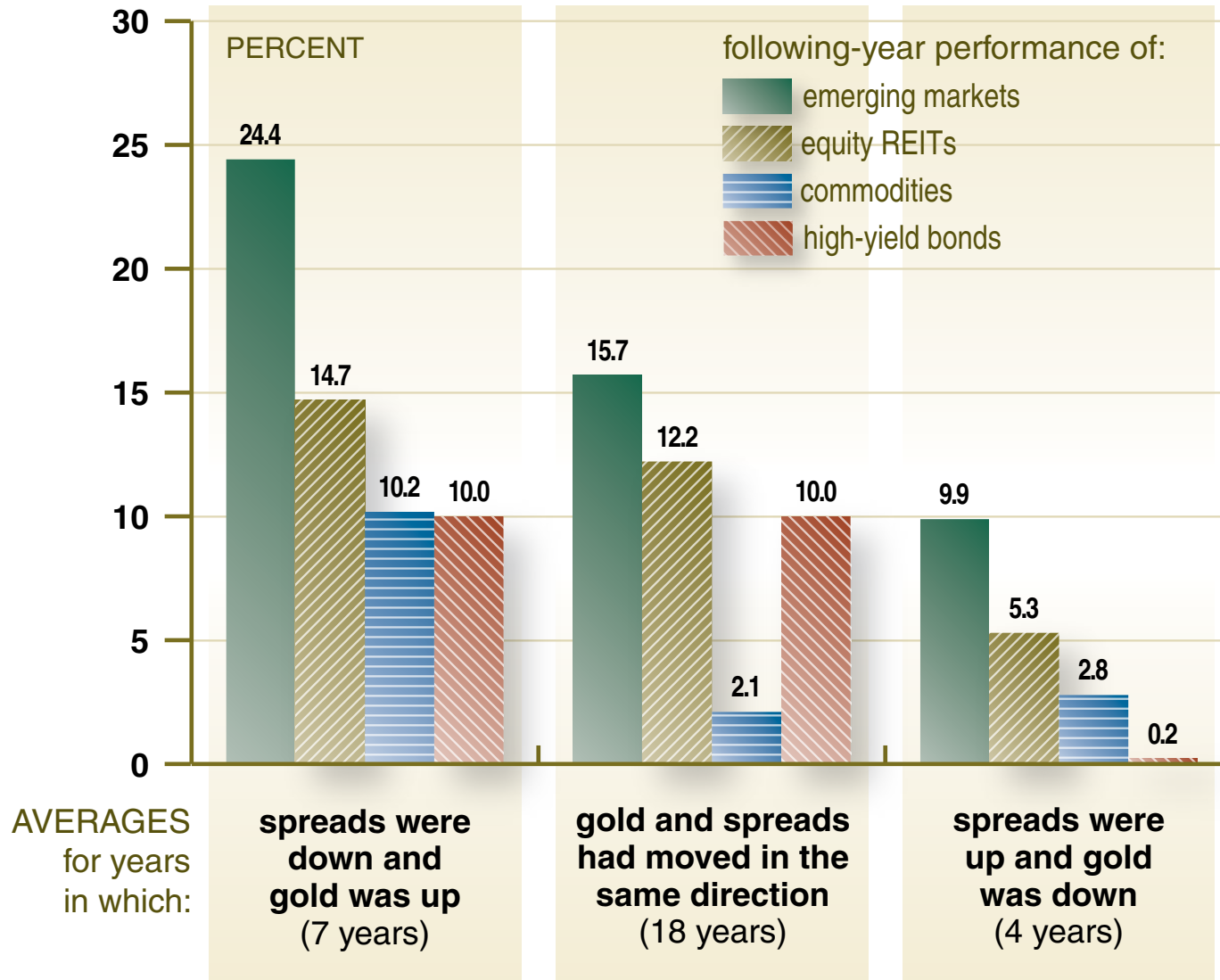


An Asset-Allocation “Compass”



Response of Risky-Hard Assets to Market Signals from Credit Spreads and Gold

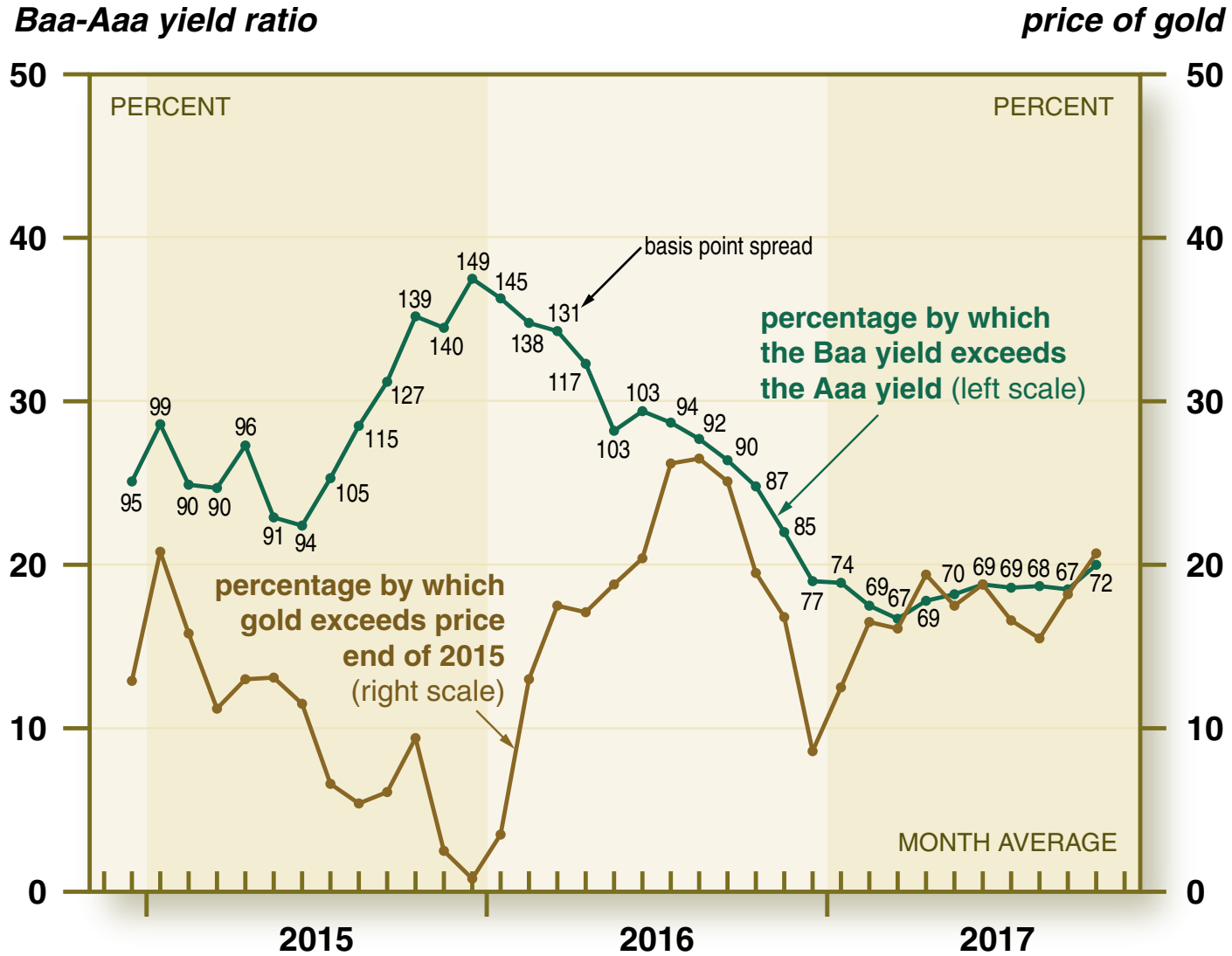
calendar-year average data from 1987



Data: monthly returns from high-yield bonds (Bank of America Merrill Lynch), US all-equity REITs (FTSE NAREIT) and unweighted indices of commodity groups (Thomson Reuters Commodity Research Bureau) and emerging equity markets (Morgan Stanley Capital International).

A Rare Double Turning Point in Market Signals from Spreads and Gold

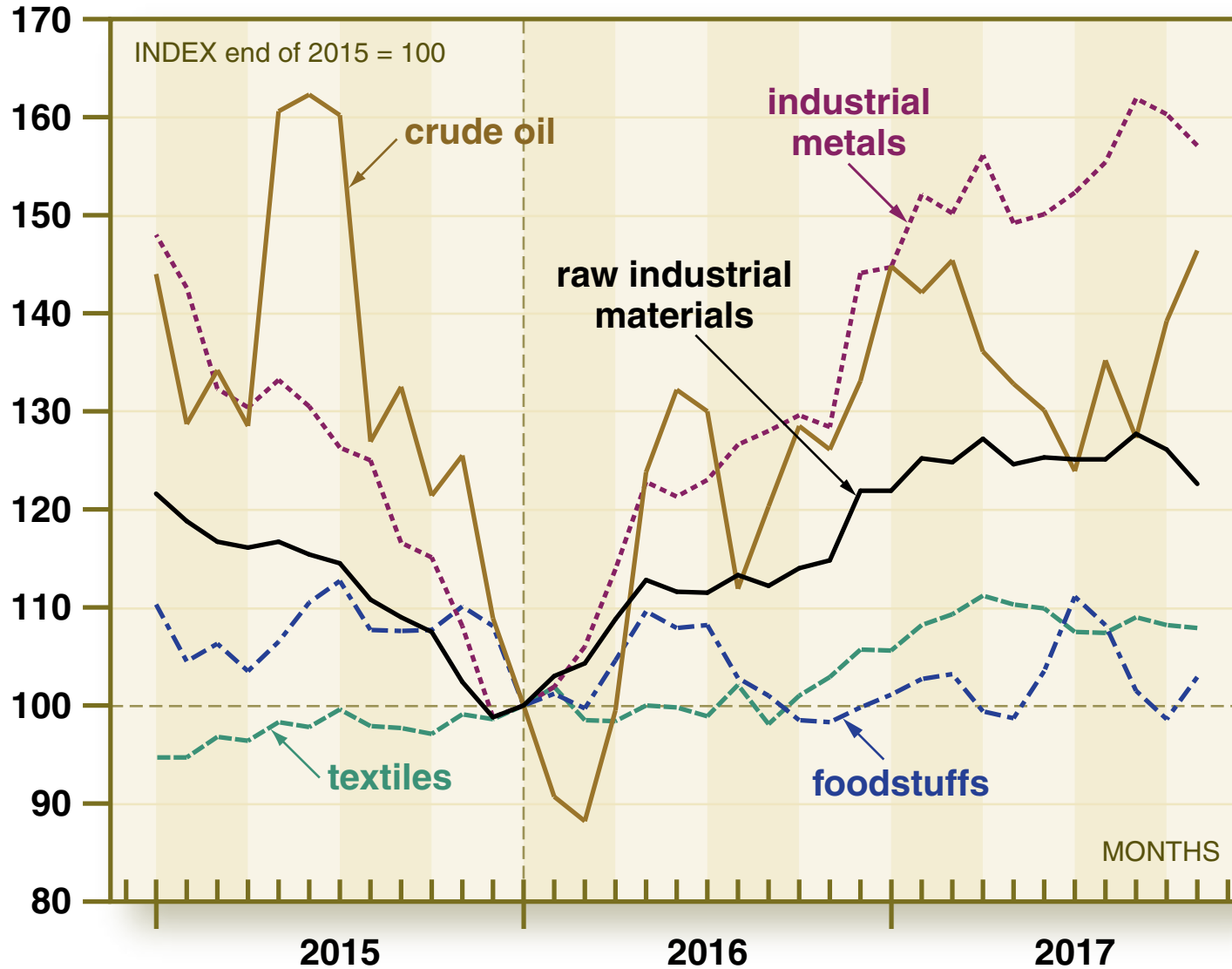
month-average data from the beginning of 2015



Data: Month-average yields on Baa and Aaa corporate bonds (Moody's/Federal Reserve Board) and month-average spot prices for gold (Metals Week).

The Turnaround in Commodity Prices

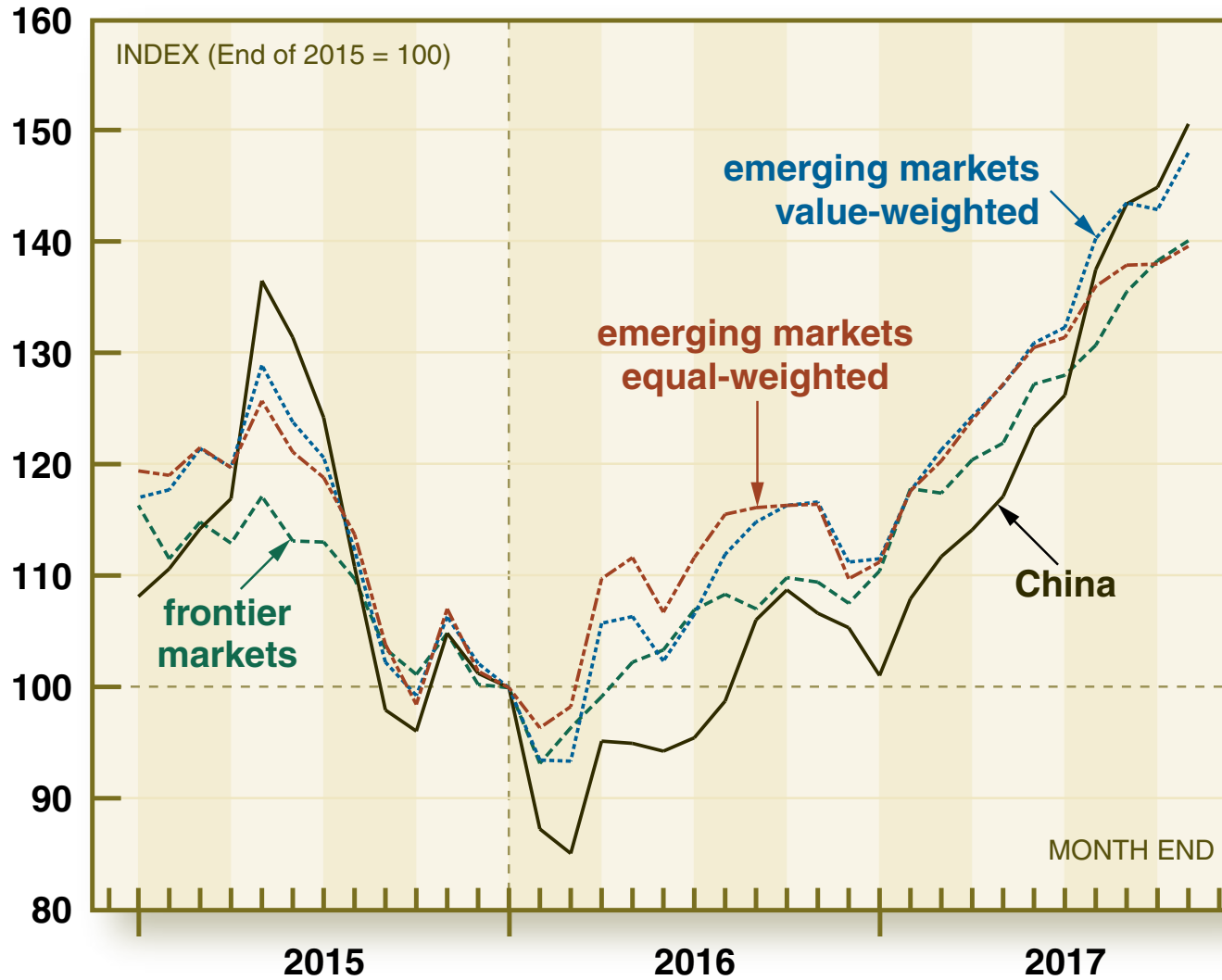
month-end price data from the beginning of 2015



Data: Reuters Bridge Commodity Research Bureau.

The Outlook for the Emerging World Re-Awakens

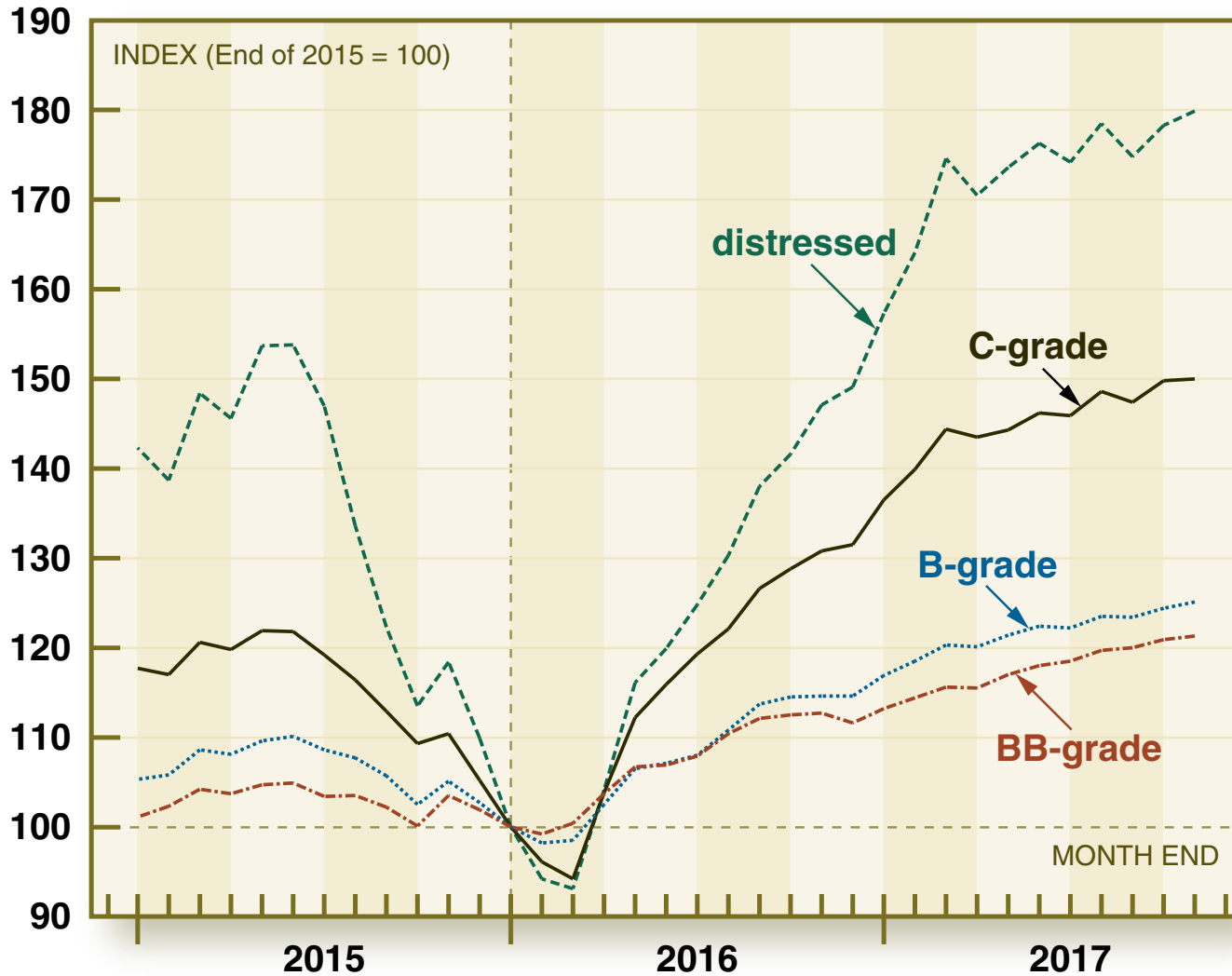
month-end data from the end of 2014



Data: Monthly total returns from emerging markets (Morgan Stanley Capital International/HCWE & Co.).

The Turnaround in the High-Yield Market

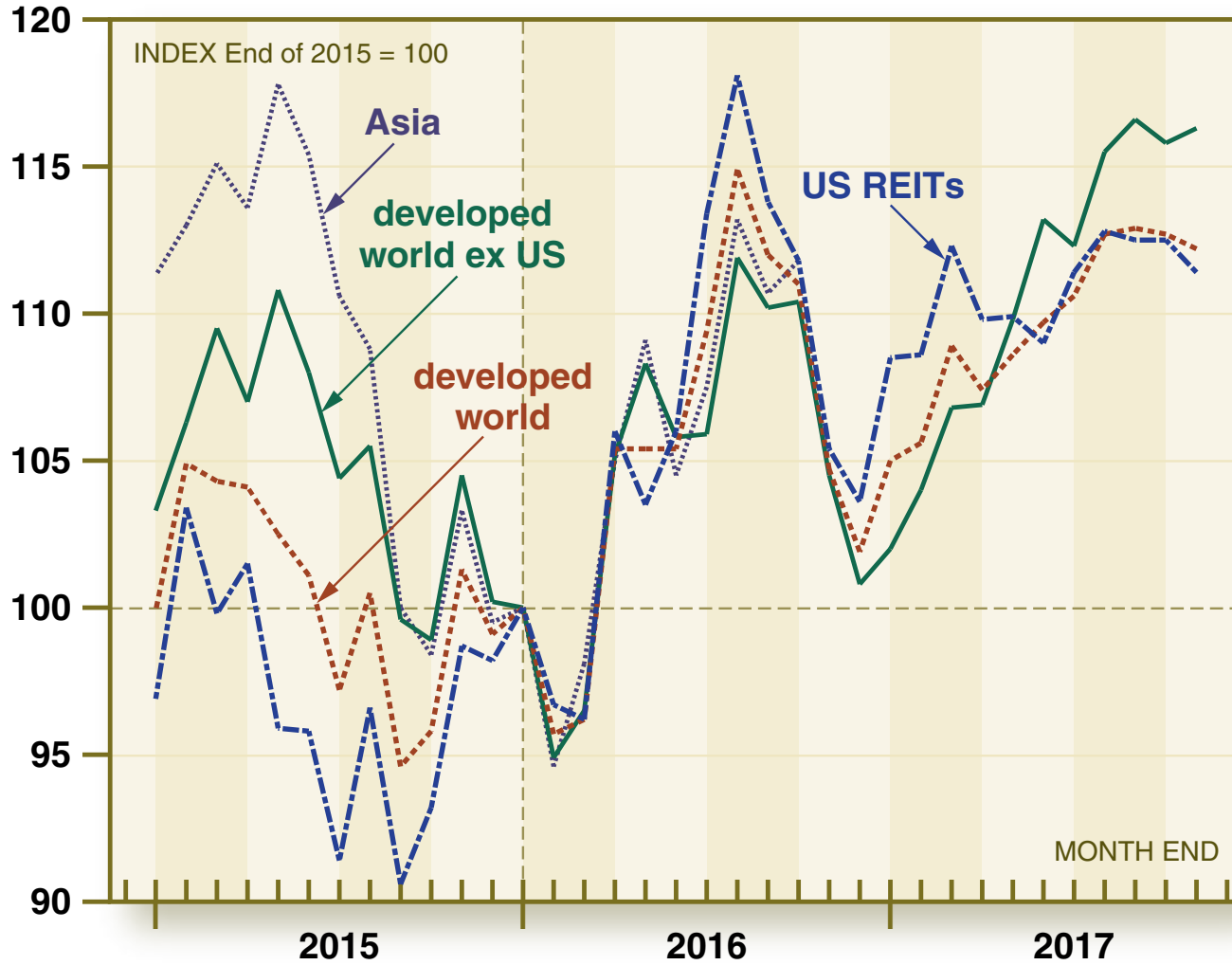
month-end data from the beginning of 2015



Data: Month-end yields for Baa and Aaa corporate bonds (Moody's/Federal Reserve Board) and total-return indices for BB-grade, B-grade and C-grade corporate bonds (Bank of America Merrill Lynch) and SPUSDHYT, an index of distressed corporate debt (Standard & Poor's).

The Roller-Coaster Advance in Equity REITs

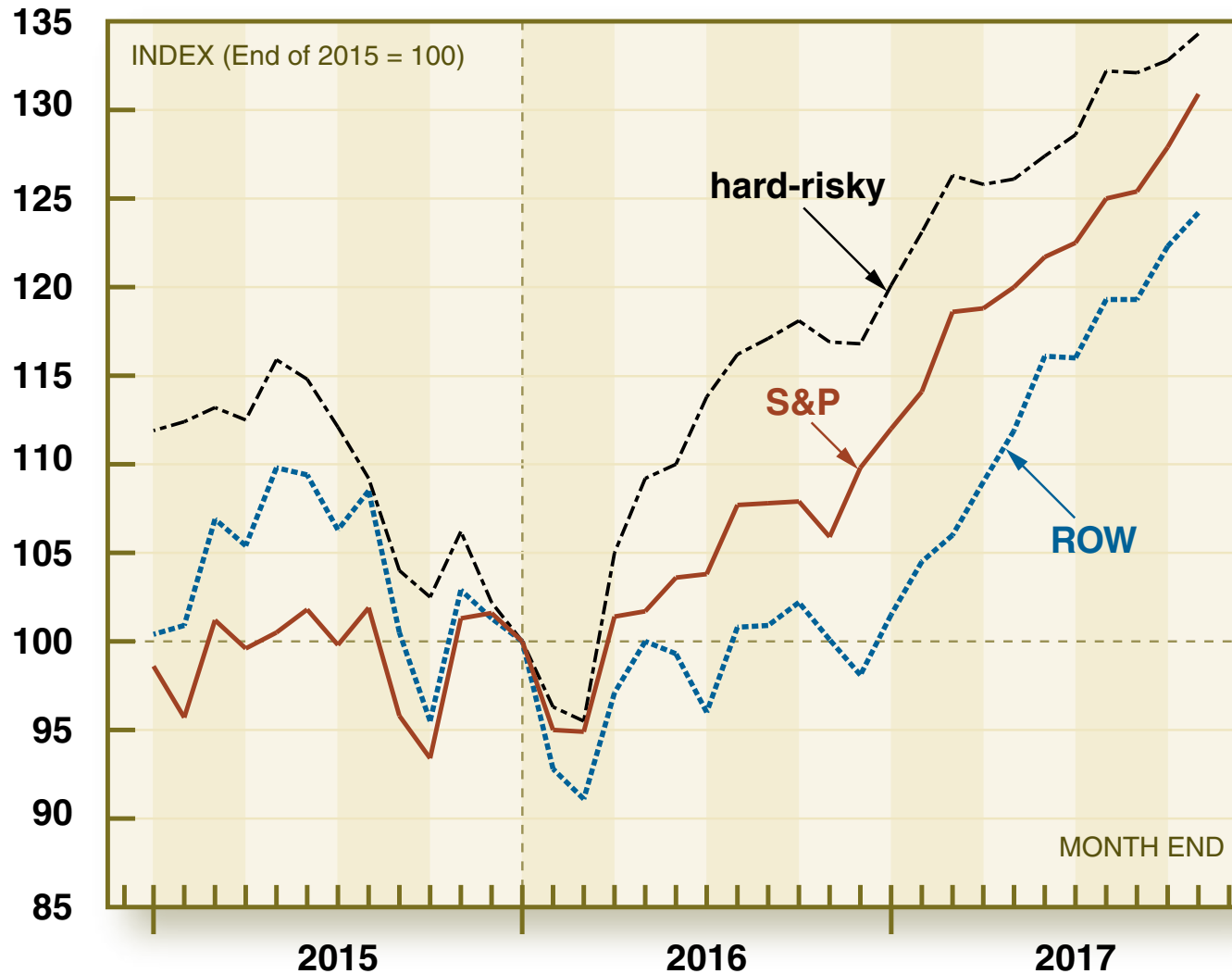
monthly data since the beginning of 2015



Data: Month-end total-return indices of US and international real estate investment trusts (National Association of Real Estate Investment Trusts/FTSE/Bloomberg).

The Comparative Performance of Stocks and Hard-Risky Assets

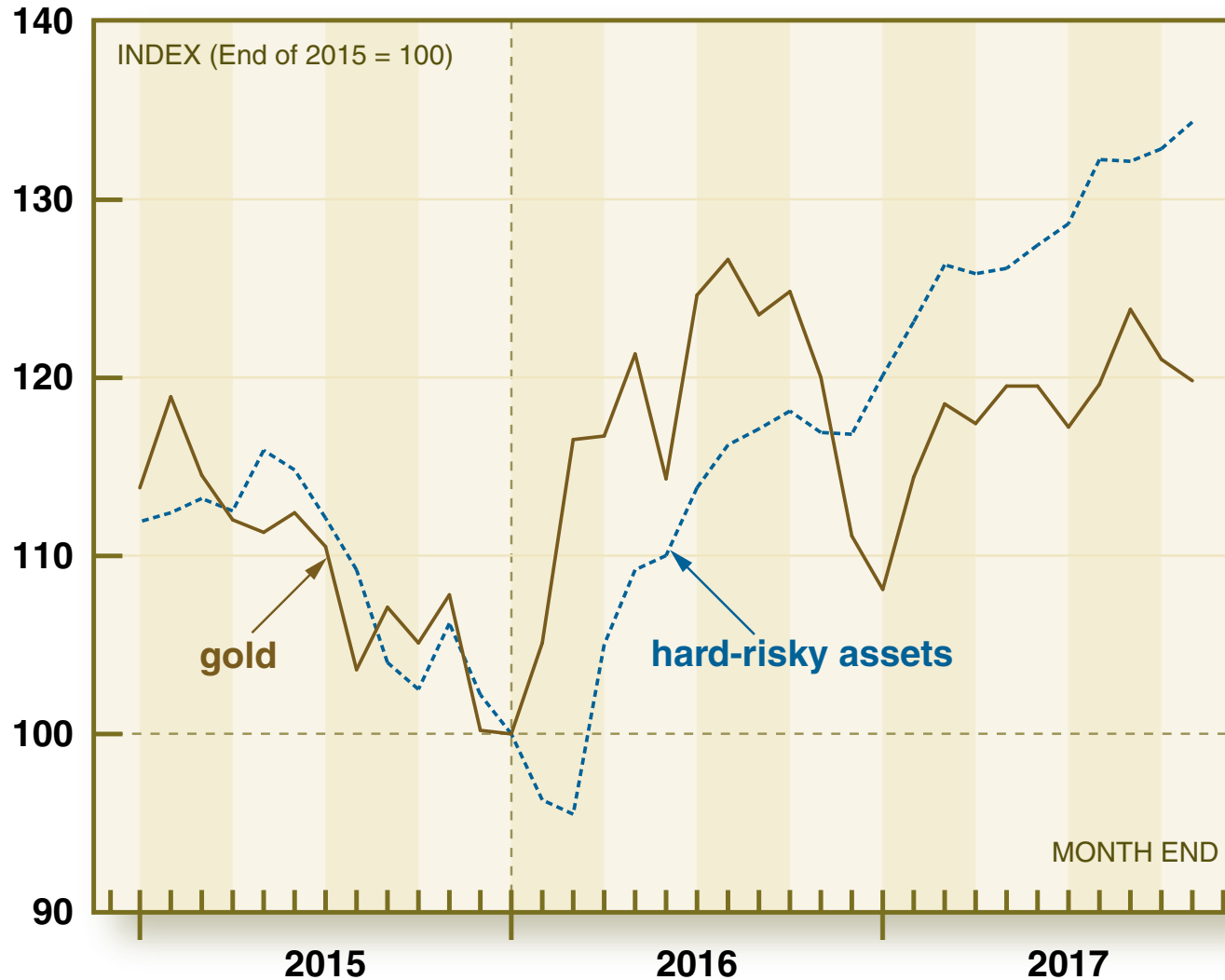
month-end total-return data from the beginning of 2015



Data: Month-end total-return indices for the S&P 500 (University of Chicago/Dimensional Fund Advisors), the EAFE index (Morgan Stanley Capital International) and an equal mix of four hard-risky assets: emerging-market equities (MSCI), diversified spot commodities (Thomson Reuters Commodity Research Bureau/HCWE & Co.), and US equity REITs (National Association of Real Estate Investment Trusts). The commodity index gives equal weight to crude oil, industrial metals, foodstuffs and textiles and is rebalanced monthly.

How Gold Led the Turnaround in Hard-Risky Assets

month-end price data from the beginning of 2015

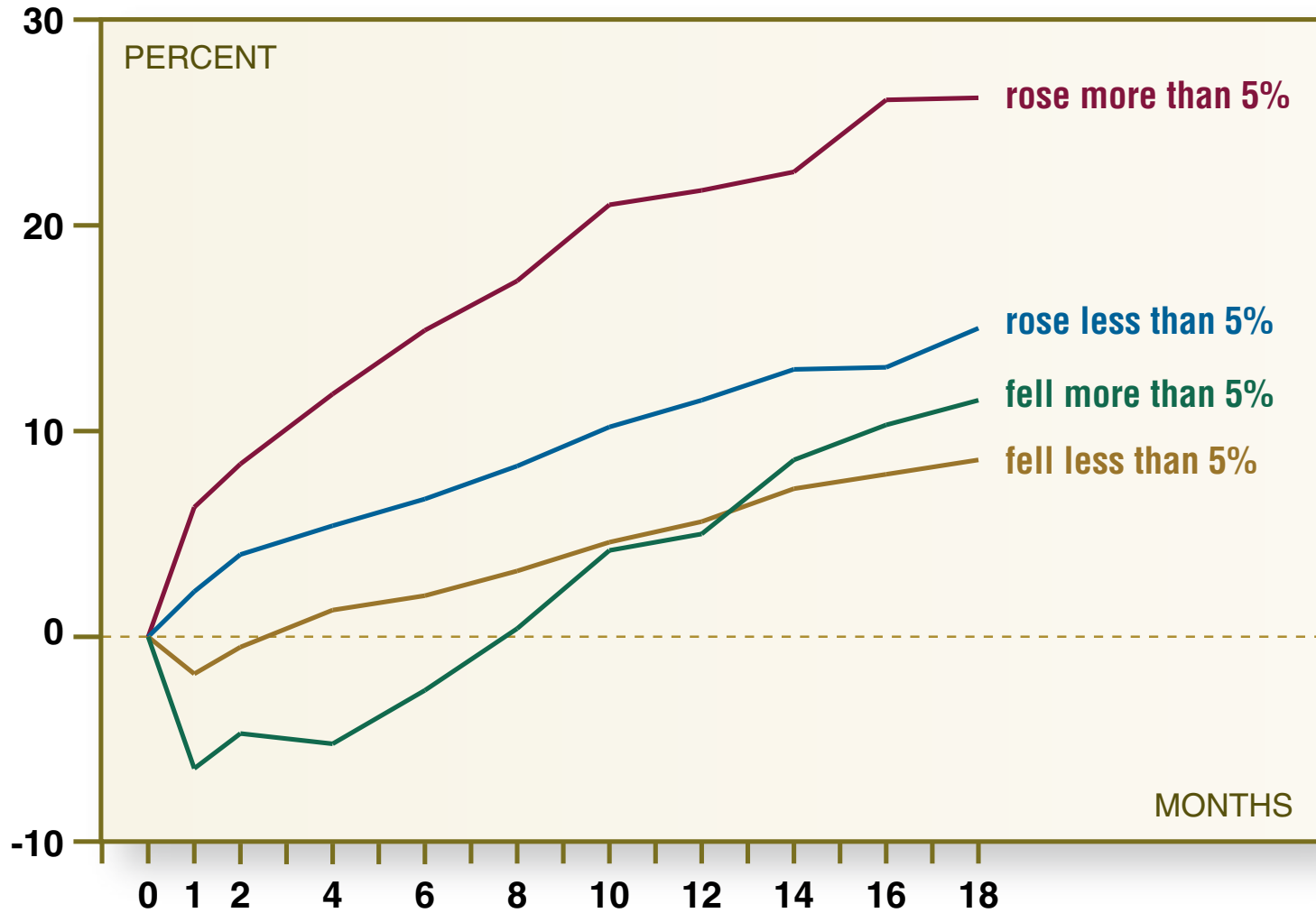


Data: Month-end total-return indices for spot gold (*Metals Week*), C-grade high-yield bonds (Bank of America Merrill Lynch), US equity REITs (National Association of Real Estate Investment Trusts), emerging market equities (Morgan Stanley Capital International), and diversified spot commodities (Thomson Reuters Commodity Research Bureau/HCWE & Co.). The commodity index gives equal weight to crude oil, industrial metals, foodstuffs, and textiles, and is rebalanced monthly.

Stock-market Plunges Tend to Reverse, but Advances Tend to Persist

monthly price changes since 1949

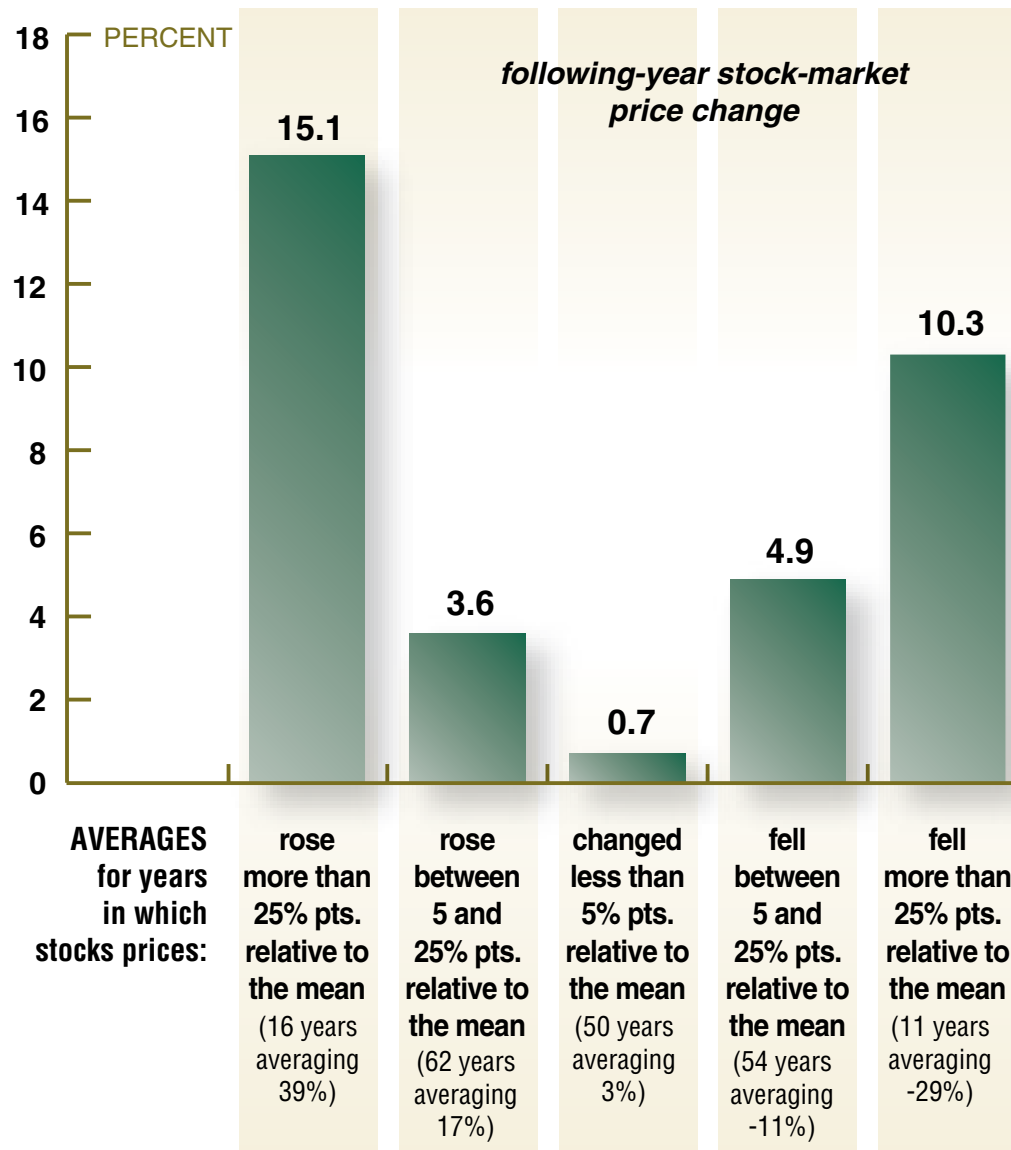
median cumulative price change following months that the market:



Data: Year-end prices for US large-cap stocks (1814-1925 Ibbotson Associates/Morningstar; and 1925-2008 University of Chicago/Dimensional Fund Advisors).

Persistence and Reversal in Annual Changes in US Stock Prices

from 1814



Data: Year-end prices for US large-cap stocks (1814-1925, Ibbotson Associates/Morning Star; 1925-2008, University of Chicago/Dimensional Fund Advisors).

What Are We to Conclude?

- **Commodities and many other risky asset classes are often volatile, but they have a marked tendency to climb or to drop back together**
- **Domestic equities fall into a separate, “soft,” category of risky assets – favored by a dollar that is strong/stable rather than weak/unstable**
- **The contrast between a rising and declining hard-risky market could hardly be more dramatic than the experience of the past two or three years**
- **Assets in this category include energy and non-energy commodities, emerging equity markets, high-yield and floating rate bonds, and real-estate investment trusts**
- **All of these assets bottomed simultaneously in February of 2016**
- **Month to month, a simple mix of these would have scarcely missed a beat as they advanced from the bottom to produce a cumulative return of 40 percent**
- **At any given time, a stock-market advance is much likely to persist rather than be reversed**
- **Contrary to popular wisdom, the residual life expectancy of a bull market does not decline with age**
- **The second phase of the risky-hard asset advance is likely to be slower and could be more volatile**
- **It will continue to be pockmarked by temporary cross currents such as this year’s drop in the energy sector**

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