Market Insights for Week Ending June 2, 2017

Better Returns with a Different Kind of Diversification

For decades, investors have described portfolio diversification in terms of sectors such as financial stocks, industrial stocks, technology stocks, etc. While that is still a valid way to think about a portfolio's allocation, it is also equally important to tactically diversify among "equity style factors".

Equity style factors represent broad, persistent qualities that tend to be correlated with different phases of the economic cycle such as expansion, slowdown, recovery and contraction. In other words, certain security characteristics tend to do better during different phases of the economic cycle. HCM believes weighting our portfolios in favor of certain factors during distinct economic phases will enhance returns, reduce volatility or both. Style factors tend to have the following characteristics:

- ***Size*** factor observations suggest that smaller companies tend to outperform larger companies during economic recoveries.
- ***Momentum*** securities with improving sentiment tend to outperform during economic expansions.
- ***Minimum Volatility*** securities tend to do better during economic slowdowns and contractions.
- ***Value*** (inexpensive) securities tend to do better during the recovery phase of the economic cycle.
- ***Quality*** companies with stable and high-quality earnings tend to do relatively well during slowdowns and contractions similar to minimum volatility securities.

HCM's current reflationary theme recognizes that the current global economy is expanding, and favors the Momentum factor. However, that could change as our overall reflation theme, while based on rising interest rates, rising oil, and a rebound in capital expenditures also presumes that the economy will continue to broaden out beyond the consumer-centric economy we have experienced since 2008.

While these themes provided enough fuel in the tank for the Fed to get started raising rates and oil rebounding off its 2016 low, it will also depend on Administration-led stimulus to sustain it. Currently, as hopes of seeing any new legislation in 2017 begin to fade, we are losing our conviction with regard to the reflation trade. As a result we may adjust our "tilt" one step back to the Value factor if our analysis of relative strength suggests the move would be prudent.

Weekly Focus – Think About It

"Know what you own, and know why you own it." - Peter Lynch

Market Activity

Performance last week for the four major asset classes were:

- U.S. Stocks – Russell 3000 (IWV) – Gain of 1.10%
- Developed Foreign Markets (EFA) – Gain of 1.71%
- Emerging Markets (EEM) – Loss of 0.14%
- Fixed Income (AGG) – Gain of 0.49%

(Note: performance is based on the change in net asset value.)

Last Week's Headlines

- The employment sector has been volatile the past few months. While March's hirings were weak, April proved positive for job gains. However, employment in May has slowed again. There were 138,000 new jobs added for the month, compared to 174,000 new hires in April, which was revised down from 211,000. The unemployment rate dropped 0.1 percentage point to 4.3% — a 16-year low. The number of unemployed persons decreased from 7.1 million in April to 6.9 million in May. Since January, the unemployment rate has declined by 0.5 percentage point and the number of unemployed has decreased by 774,000.

- Personal income and consumer spending increased in April, according to the latest report from the Bureau of Economic Analysis. Personal income increased $58.4 billion, or 0.4%, for the month while disposable personal (after-tax) income increased $56.5 billion, or 0.4%. Personal consumption expenditures also climbed 0.4% to $53.2 billion in April following a 0.3% gain in March, revised. Core PCE (excluding food and energy) rose 0.2% after falling 0.1% in March. For the 12 months ended in April, the PCE price index is up 1.7%.

- The final report on the goods and services trade deficit for April was released last week by the Census Bureau. The deficit increased by $2.3 billion from $45.3 billion in March to $47.6 billion in April. April exports were $191.0 billion, $0.5 billion less than March exports. April imports were $238.6 billion, $1.9 billion more than March imports. Year-to-date, the goods and services deficit increased $22.1 billion, or 13.4%, from the same period in 2016. Overall, this information highlights the increased U.S. demand for foreign goods and services, while the foreign demand for U.S. products has declined.

- Consumer confidence, which fell in April, declined further in May, according to The Conference Board Consumer Confidence Index®. The index came in at 117.9, down from 119.4 in April. The Present Situation Index increased slightly to 140.7 in May from 140.3 in April. The Expectations Index declined from 105.4 in April to 102.6 in May.

- In the week ended May 27, the advance figure for seasonally adjusted initial claims for unemployment was 248,000, an increase of 13,000 from the previous week's revised level. The advance seasonally adjusted insured unemployment rate remained at 1.4% for the seventh consecutive week.

Eye on the Week Ahead

While this week is very light for economic news at home, the focus of attention will be on Great Britain's national election at the end of the week. A win for the country's Conservative Party would seem to cement the UK's exit from the European Union.

• • •