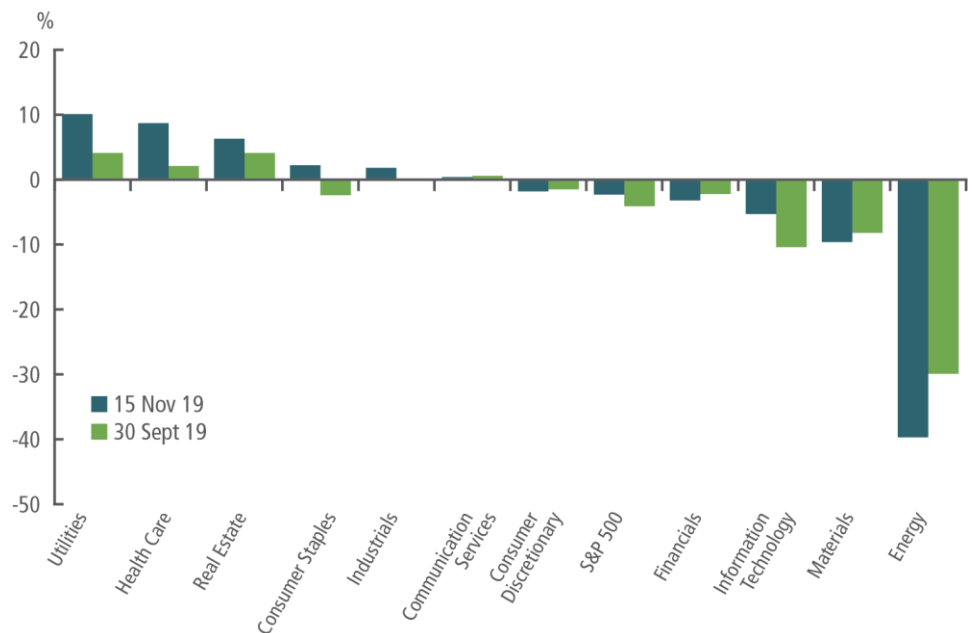


# What Bad News? Finding Opportunity Amidst Complacency

The last time we saw the “short” VIX trade like this was in January 2018, and by February 2018 the S&P 500 index had sunk 10% from its January peak, in one of its swiftest market corrections in US history.

The “Risk On” trade is back, once again! The S&P 500 Index has seen 24 record highs this year despite elevated economic policy uncertainty and geopolitical risk, and amid accommodative monetary policy which has sent global yields lower. Technology stocks are racing towards their best year since 2009, up over 43% year to date, despite posting some of the steepest declines in Q2 and Q3 2019 earnings growth.<sup>1</sup>

## Q3 2019 S&P 500 EARNINGS GROWTH



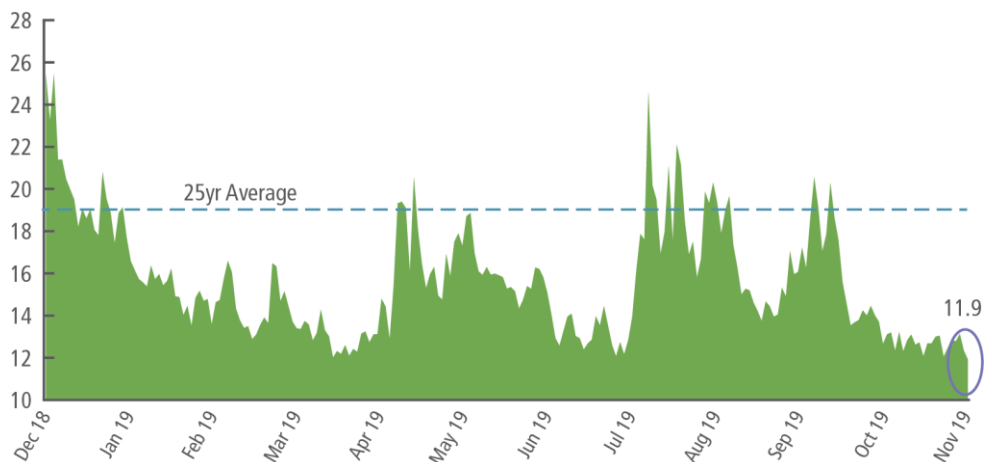
Source: FactSet as of November 15, 2019. Based on GICS sector classifications.

Apple and Microsoft, have single handedly helped buoy the Information Technology sector and market index broadly to new highs.<sup>1</sup> The two tech giants are up over 47% and 66%, respectively, this year alone; are twice as large as the entire S&P 500 Energy Sector; and are eclipsing the whole Consumer Staples, Materials and Utilities sectors.

<sup>1</sup> Source: FactSet.

The VIX has slumped to 11.9,<sup>2</sup> its lowest level of the year and well below its 25-year average of 19. The market is confident the tranquility will continue as hedge funds have gone “short” the VIX in a 204,000 record futures contracts tied to the index (US Commodity Futures Trading Committee announced last week). The last time we saw the “short” VIX trade like this was in January 2018 and by February 2018, the S&P 500 index had sunk 10% from its January peak, in one of its swiftest market corrections in US history.

### CBOE VOLATILITY INDEX (VIX)



Source: Bloomberg, daily CBOE Volatility Index Last Price. December 31, 2018 – November 25, 2019.

Now is the time, amidst record low volatility and high flying growth/momentum returns, for investors to prudently trim back market beta and overall risk exposure. Defensive equities with a tilt towards dividend generation can allow for market participation with a focus on drawdown mitigation.

Investors continue to shrug off weak data and trade snags, including the largest drop in US industrial production in nearly a year and a half as well as reports that the US and China are unlikely to reach a trade deal before year-end. While corporate earnings have been better than expected for the last two quarters, they continue to shrink overall. The Atlanta Fed GDP Indicator is pointing to 0.4% growth for the US economy in the fourth quarter, down from a forecast of 1% earlier this month.

While recessionary fears have abated, further economic growth and recovery is expected to be muted. Now is the time, amidst record low volatility and high flying growth/momentum returns, for investors to prudently trim back market beta and overall risk exposure. Defensive equities with a tilt towards dividend generation can allow for market participation with a focus on drawdown mitigation. At this point in the market cycle, it is important to be cognizant of the differences between dividend growth and dividend yielding strategies in terms of exposure to cyclicals, relative dividend yield and market beta. Dividend yielding strategies tend to offer higher than market level dividend yields, a more muted risk/return profile and greater exposure to non-cyclical, defensive sectors such as Utilities and Consumer Staples while their dividend growth counterparts tend to offer both a higher upside and downside capture profile given the nature of their composition skewing towards cyclical sectors.

<sup>2</sup> Source: Bloomberg, as of November 25, 2019.

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