

Viewpoints

A technical take on this summer's correction



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Whenever markets undergo sharp corrections of 10% or more, as they did in August 2015, investors will inevitably wonder whether the weakness represents a temporary setback or the start of a new bear market. Right now, the evidence from global equity markets suggests that, despite the recent spike in market volatility, the bull trend is still unbroken. While it's too early to rule out the possibility of a nascent bear market, we find it encouraging that all the major trends that have characterized the bull market since the global financial crisis, including the continued leadership of growth sectors, have so far remained intact.

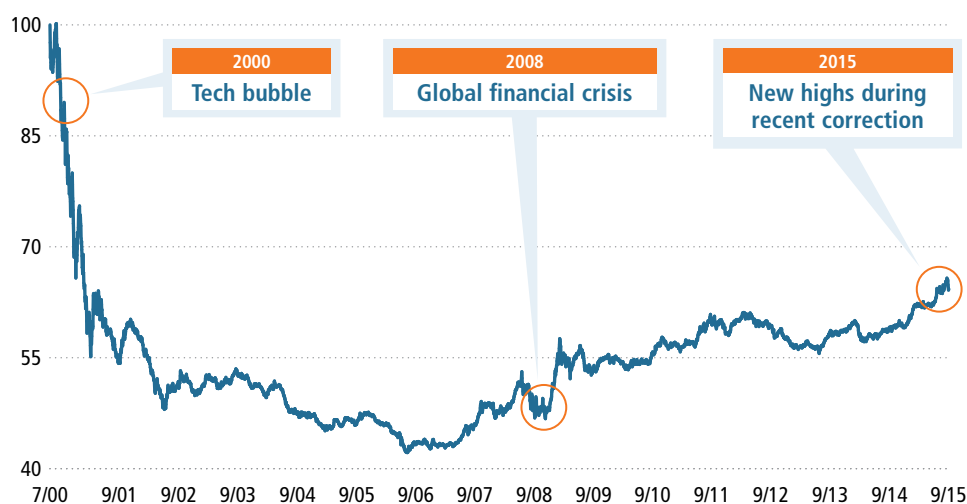
Leading growth sectors still leading

For some time, one of the major themes driving the relative performance of various sectors and asset classes globally has been low growth. A clear growth premium has been in place, so investors can gain even more perspective by analyzing how growth assets reacted during the recent decline. Has there been a reversal of fortune, indicating a market rotation, or is this theme still in the driver's seat?

Encouragingly, the past market leaders continue to lead. After the popping of the tech bubble in the early 2000s, growth (as measured by the Russell 3000 Growth Index relative

Growth has been in an uptrend relative to value since before the 2008 financial crisis

Russell 3000 Growth Index relative to the Russell 3000 Value Index



Source: FactSet, 9/30/15.

to the Russell 3000 Value Index) underwent a prolonged period of underperformance. But growth began to outperform value before the global financial crisis in 2008, and it has continued outperforming ever since. During the recent correction, we would have expected growth-related sectors, after their strong performance, to sell off the most, but that didn't happen. In fact, growth broke to a new high. That gives us confidence that the market still senses a low-growth environment globally and therefore puts a premium on sectors that offer the potential for at least *some* growth.

Regional markets

In euro terms, the relative downtrend in European equities, which has been in place for over a decade, has been broken; however, when viewed in dollar terms, it remains intact. Consequently, we are waiting for greater evidence of the sustainability of strength in Europe before deciding whether to turn more positive on the region.

The picture is a little more upbeat in Japan. The relative downtrend there, which had persisted for over two decades, was finally broken earlier this year, and it has been among the strongest-performing markets so far in 2015, measured in both Japanese yen and U.S. dollars. Given this recent strength, investors may wonder if it's too late to enter the Japanese market. We think not. In U.S. dollars, the relative downtrend is only just starting to break. Should this new relative uptrend remain in place and gain traction, we would expect it to last for several years.

As for emerging markets, which have been in a downtrend for five years, there is a widespread perception that a turnaround must be near. However, emerging markets' underperformance relative to developed markets shows no evidence of changing, and the weakness is mirrored by continued malaise in the commodity markets. However, emerging markets are not a monolithic asset class, and we draw some clear lines, most obviously between Asian countries (largely commodity importers) and those in Latin America (largely commodity exporters). Within Asia, we believe that China's equity market bubble burst some years ago. In a postbubble phase, it's not uncommon to see large mean-reversion rallies after years of significant underperformance. In our view, the Chinese advance that began in late 2014 was just such a rally, rather than a sustained, multi-year trend.

Investment implications

While short-term shifts happen continually, we see no evidence of a clear rotation of market leadership; therefore, we are taking a cautious, gradualist approach to any adjustments to exposure at this point. For us to turn more bearish, we would need to see defensive sectors such as utilities and consumer staples leading. So far, even though they have been outperforming over the short term, they have not broken any relative trends. If they did, that would be one signal of the onset of a bear market. When the technical structure of the market is constructive and the majority of trends are healthy, a stock that demonstrates some technical weakness can end up being more of a buy opportunity than a sell.

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