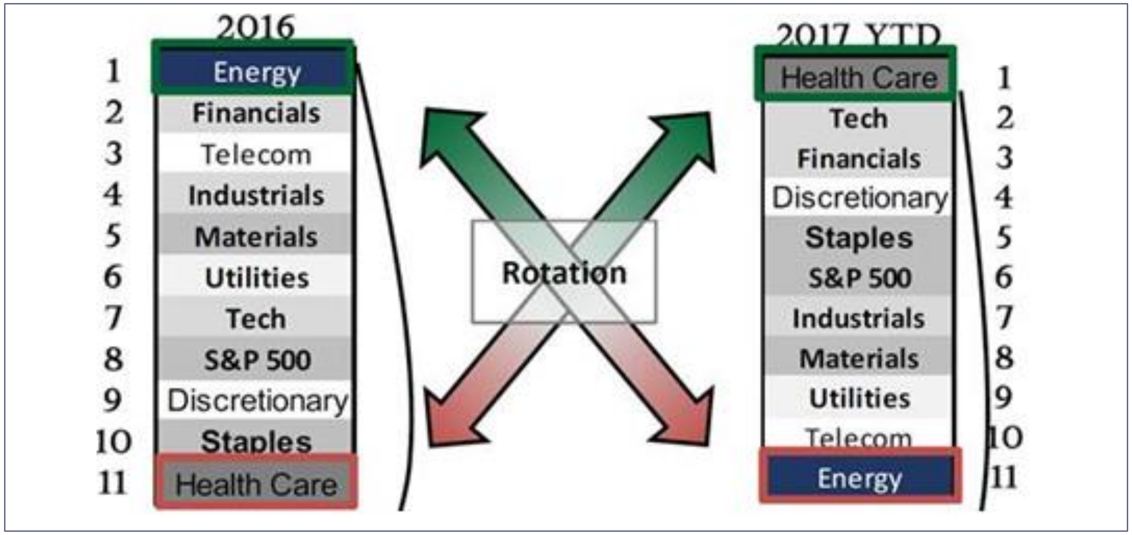
Market Recap

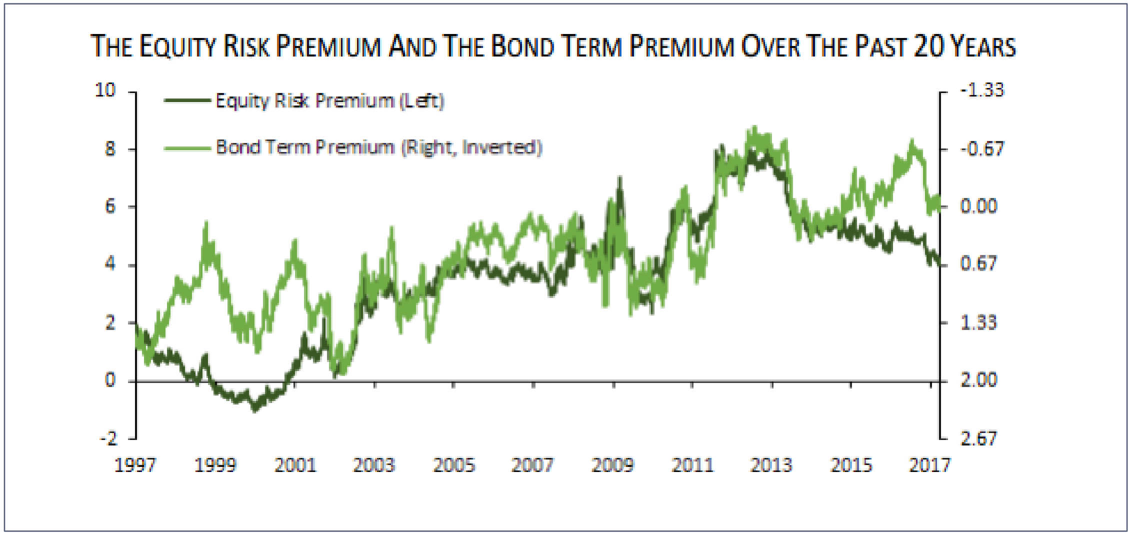
Reversion to the Mean?



Source: Cornerstone Macro

Following the election in November, investors piled into inflation-sensitive sectors of market (such as Energy, Industrials and Materials) in the hopes that a new set of pro-growth policies and the unwinding of Congressional gridlock would lead to stronger economic growth in the months ahead. A quick examination of year-to-date performance, however, suggests that the "reflation" trade may be overdone, at least in the short term. Sector leadership in recent months has instead favored more defensive areas of the market such as Health Care and Staples. The outperformance of Health Care is particularly notable – while negative sentiment around drug pricing and political uncertainty led to subpar returns in 2016, valuations have finally bottomed despite the tumult leading up to last week's failed attempt to replace the Affordable Health Care Act.

When Equity and Bond Markets Disagree



Source: Cornerstone Macro

The 'equity risk premium' can be defined as the expected excess return of equites (estimated S&P 500 earnings yield) minus the yield on a risk-free asset (10-year treasury rate). A measurement of risk, a low equity risk premium indicates that the market *is not* concerned about the future. The 'bond term premium', a similar measure applied to the fixed income market, is the excess yield investors require on longer-term bonds versus shorter-term bonds. A low bond term premium indicates that bond investors are *more* worried about future risks. When equity and bond investors have a similar view of market risk, the two premia move in sync. Today, however, the bond market is pricing in more risk than the equity market. In two other similarly divergent periods (the late 1990's and 2007), the bond market's risk assessment was correct. If pro-growth fiscal policy fails to materialize, equity investors may be forced to re-assess their risk outlook for the market.

Market Recap

Protracted Market Stability May Not Indicate Future Weakness

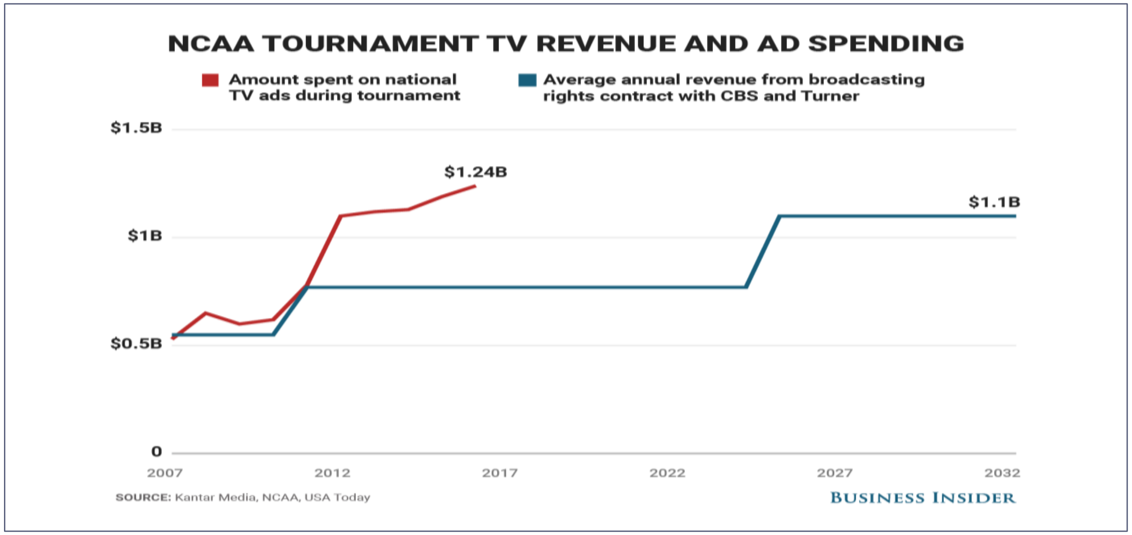
S&P 500 performance following long periods of market stability

Start	End	Trading days without 1% decline	S&P 500 return during period	S&P 500 return after period ends: 3-mo	6-mo	12-mo
Jan-85	Jun-85	112	16 %	(1)%	13 %	34 %
Oct-92	Feb-93	87	10	1	2	9
Jun-93	Nov-93	95	6	4	(2)	2
Dec-94	May-95	110	19	7	15	30
Jul-95	Dec-95	105	13	5	9	21
Jul-06	Nov-06	94	14	4	9	5
6 episode median		100	13 %	4 %	9 %	15 %
Current						
Oct-16	Feb-17	93	11 %			

Source: Goldman Sachs

Long periods of market stability are often mentioned as a contra-indicator of potential stock market weakness on the horizon. Theoretically, an extended run of market appreciation alongside an absence of downside volatility indicates investor complacency, which would then be followed by panic when something unforeseen does go wrong. The S&P 500 just broke a 109-day streak without a 1% decline, and many market commentators have recently pointed to the run as a cause for concern. However, historical data on trailing returns following similar runs shows that the market is not pre-destined for a pull back after long bouts of low volatility. There have been six other occasions when the S&P has gone over 85 days without a 1% drop since 1980. The average 3-, 6- and 12-month returns following those periods are 3%, 8%, and 17% respectively, and were only negative once for the two shorter timeframes. Simply put, long stretches of market stability – in isolation - are not effective predictors of future equity market declines.

Golden TV Times for College Sports



Source: Business Insider

Televised major college sports events offer extraordinary revenue opportunities for the NCAA and networks, alike. As recently as 2010, the annual broadcasting rights for the NCAA Basketball Tournament were just over $550 million. Soon after, the NCAA agreed to a new 14-year, $770 million/year extension. This may seem like a large increase, but, during that same period, advertising revenue taken in by CBS and Turner doubled from just under $600 million to $1.2 billion/year. Even though the current deal does not expire until 2024, the NCAA and CBS recently agreed to another 8-year extension, increasing the broadcast right's annual fees to $1.1 billion. Given the pace of advertising spend growth to this point, the extension may look like a bargain for CBS by the time it activates in 2025.

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