

Virtus Vital Signs, September 2017
Market Insights from Joe Terranova, Chief Market Strategist
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Interview conducted August 31, 2017
Transcript edited for clarity

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Brian Portnoy: *Welcome to Virtus Vital Signs for September 2017. I am Brian Portnoy, Director of Investment Education at Virtus Investment Partners. I have my friend and colleague with me, Chief Market Strategist Joe Terranova. So here we are, summer is over and we are looking towards the home stretch for 2017. There is a lot coming down the pike after Labor Day in terms of new information, new insights to be gained. I know you watch these things incredibly closely. What should be on investors' minds as we send the kids off to school and focus on our portfolios a little bit more?*

Joe Terranova: It's very challenging for an investor because they are continually struggling with the narrative of where the potential top in the marketplace is, and where the potential correction may be. We all follow the news 24-7, whether it's North Korea, the absence of policy, and whether we can get tax reform done. Is there going to be a potential tax cut, and then what are global banks going to be doing?

It's a challenging time for investors. I know it's incredibly boring to continue to talk about ensuring that within your portfolio you are not ignoring a particular asset class. Once again, I reiterate really what is underperforming.... MLPs (master limited partnerships) – and that is because of the sensitivity to oil. We heard much about August being a very tumultuous month, yet when I reflect back, the emerging markets once again saw strong performance during the month.

So you are clearly seeing challenges for investors—emotional challenges more than anything else—and I think the right way to handle it is to basically say, I don't know what the future path of the U.S. 10-year Treasury or where the S&P 500[®] is going to be. I know there might be elevated volatility, and my opportunity to smooth out the volatility is to make sure I am broadly allocated among multiple asset classes.

Brian Portnoy: *That makes sense—as we always say “prognostication is for show but diversification is for dough.” You touched on international markets and I wanted to come to that for a moment. U.S. investors have traditionally been under-allocated to equity markets outside of the U.S. and they feel kind of fortunate over a long period of time because the U.S. has trounced European and Asian markets for a while, until recently as Europe, Asia, and emerging markets have all picked up. So, as investors look at markets and ask, “Geez, have I missed the run-up,” what is your advice for investors who are under-allocated to international markets but have effectively missed, for example in emerging markets, a nearly 30% run?*

Joe Terranova: Yeah, my answer to that is you need to be prepared to think that you made the wrong move if you allocate now. Obviously, it is very volatile and a lot is dependent upon the path of the U.S. dollar. The U.S. dollar has declined 9-10% so far year to date. That has benefited emerging market currencies. It has tracked capital inflows and lifted emerging markets.

Historically, the moment the retail investor puts money into the emerging markets, that is going to be the moment when a correction unfolds. I believe you have to have the longer term vision of what the emerging markets continue to exhibit based on actual evidence. What emerging markets continue to exhibit is the desire to move toward the capitalist system that we enjoy here. They have a desire to move toward giving the consumer the type of healthcare, energy, transportation, and technology that we enjoy here.

So that is the evidence. As I said, in the short term, you are probably going to make the wrong move. That historically has been the case given where we are, but I think over time it is the right strategy and the right allocation. If you think for a second, a lot of people have talked about the underperformance of small-cap stocks year to date. If you look outside the

U.S. at small caps in the emerging markets, it has been an incredibly strong year, almost twice in terms of performance of what we are witnessing here in the traditional S&P 500 and NASDAQ and indices we are seeing here.

So you are seeing that performance. I would be cautious of commodity-sensitive types of emerging markets like Brazil, and focus on the consumer being correlated with the industries that I identified before and having that desire to enjoy each one of these industries, not over the next five months, but over the next five or ten years.

Brian Portnoy: On the flip side, there are the things that aren't working well. It is always painful to invest in things that are quote-unquote not working or lagging by meaningful amounts compared to other asset classes. As you preach diversification and you look out on the home stretch in 2017, are there any areas that you think you still want to have exposure to?

Joe Terranova: I think laggards lag and leaders lead. In particular, as we move further on into the year, I have been trying to emphasize this point as it relates to energy, certainly with the tragedy we are witnessing in Houston right now, I don't think that is any reason to increase your exposure to energy. I actually think it highlights the efficiencies of technology and what technology has done to the energy industry over the last couple years. I also think for the financial advisor, it is a great condition because no longer do you have to predict the price of oil when trying to design a portfolio and getting whether it be the right positive or negative outcome from where oil might be going. I think oil is less relevant in the portfolio construct, and I think it is really an example of what technology is doing to certain industries.

Brian Portnoy: Okay, good. We are going to leave it at that.

Joe Terranova: Wait a second.... Before we go, we have a new NFL season coming and I know you're a fan of the NFL. I am going to pin you down... Which two teams are going to be in the Super Bowl and who is going to win it? I think we are going to see the Patriots there once again and the Seahawks get a chance to rewrite history and maybe run the ball up the middle this time.

Brian Portnoy: Pittsburgh still courses through my blood even though I live in Chicago, so I am going with a Steelers Packers rematch Super Bowl. Needless to say, my guys in the black and gold are going to take their seventh ring.

Joe Terranova: All right, there we go. We will pick it up in the winter and see who is right [laughter].

Brian Portnoy: Awesome, okay, Joe. And we will catch up in about a month or so when I'm sure there is going to be new and interesting things to talk about.

Joe Terranova: Certainly. Take care, Brian.

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