

Virtus Vital Signs, February 2016
Market Insights from Joe Terranova, Chief Market Strategist
From an Interview Conducted on February 3, 2016

Brian Portnoy: *Hi, welcome to Virtus Vital Signs for the month of February 2016, I am Brian Portnoy, director of investment education for Virtus Investment Partners. As always, I have my friend Joe Terranova on with me today. He is our chief market strategist and senior managing director at Virtus. Welcome Joe.*

Joe Terranova: Good morning, Brian, thank you for inviting me on the call once again.

Brian Portnoy: *Absolutely. So, we had a pretty rocky start to 2016 in terms of global equity markets, but in the themes that you've been talking about for months now in terms of commodities, currencies, China, and so forth, let's try to untangle this web a little bit. First of all, let us talk about the equity markets specifically. How do you assess the market activity over the last few weeks, which generally has been quite negative?*

Joe Terranova: I think the strategy and the script, so to speak, Brian, that we traced out in the last three months of 2015 and talked about back in January is really working out perfectly. Let's first begin when we talk about the S&P, there is a theme in which the bottom third of the S&P 500 tends to outperform, and when I say the bottom third, I mean 2015 laggards tend to outperform from the crossover period from December into February of the following year. So, year to date you have names like Cabot Oil & Gas and Coach and Michael Kors and Macy's, some of the names that did not perform too well in 2015, that are leading the market higher. So that is working year to date.

Secondarily, I think the market in the last couple of weeks is finding a lit bit of stabilization on the return of institutional buying once again. We are here at February 3rd, by Friday you'll have 80% of the S&P 500 having reported and buybacks can return once again to the marketplace. So I think we are seeing a little bit of stability in terms of the equities market, which is finally a good thing. We are up about 150 basis points in the last five days. As far as earnings go, information technology, consumer-oriented discretionary, and staples are both doing well. I think the problem with earnings has been that the expectations, believe it or not, for energy, which were very low, were not low enough, so that is the problem. But stabilization is the first thing that we wanted to see in an environment where everything is 'guilty until proven innocent' and 'flat is the new up.' I think we are beginning to see a little bit of stabilization.

Brian Portnoy: *Okay, big picture, let us talk about the global currency market. It was a huge theme for how you interpreted the markets last year. Into 2016, the U.S. dollar remains strong. You see interesting central bank activity in Japan in terms of the introduction, potentially of negative interest rates. How does all of this play out in the near to medium term with potentially a strong dollar causing problems throughout the rest of the world?*

Joe Terranova: Now again over the last three months, the number one indicator -- and it remains the number one indicator -- when I suggest stabilization in the U.S. equity markets, what do I want to look at? I want to look at the U.S. dollar index. I want to see if the U.S. dollar index can initiate finding a little bit of a corrective selloff if the U.S. dollar can pull back from the significant appreciation that it is witnessing right now as global currencies are depreciating in this cycle of deflation that we have talked about where countries are monetizing their debt and trying to export their deflation to the U.S. Well, U.S. dollar so far month to date, first three days, is down 1.2%, and year to date, Brian, U.S. dollar index is actually down 26 basis points. So those are some of the things that I like to see. Again, I go back and I highlight it is only three months into the month of February, but we are witnessing the U.S. dollar kind of pulling back a little bit. That is the most important indicator and dynamic when you ask me about the currency markets and what we want to look at. That is incredibly important. I like what I am seeing there. That lends itself to stabilization for risk assets.

Brian Portnoy: *So even though we have what appears to be, for the first time in quite a while, disparity in central bank policy where we know that the U.S. Federal Reserve raised rates recently. The Bank of Japan seems to be going in a different direction. We have also talked about Europe in the past. How does this bode for the strength of the U.S. dollar in the coming weeks and months?*

Joe Terranova: Well, I think what you want to witness is a leveling off in terms of the imbalance as it relates to global monetary policy, so let's first talk about Japan. It is consistent with the message that we have delivered

over the last year and it is consistent with, I believe, the next three to five years as it relates to Japanese risk assets and Japanese equity markets. They have an incredible tailwind behind them and the tailwind is a monetary policy that will continue to support further depreciation for the Japanese yen. As it relates to Europe, Mario Draghi and the European Central Bank have suggested that in the second quarter, if they continue to be challenged, and I believe they will by incredibly low inflation, disinflation, almost deflation, they will fight that through further easy monetary policy, but you want to level off the imbalances and you are beginning to see that leveling off of the imbalance process, Brian, domestically here in the U.S. Because I will ask you and I will ask anyone else right now that looks at the marketplace, the elevated volatility, some of the economic numbers here domestically in the U.S. on the manufacturing side, do we really think the Federal Reserve is going to raise interest rates four times to get the 100 basis point move that they are suggesting? I don't believe we are going to get that and I think that correctly warrants a little bit of a smoothing out in some of the imbalances that you talk about in central bank policy and the impact on currencies.

Brian Portnoy: *Okay, so just by way of conclusion, it has been a very volatile start to 2016. Investors that I speak to, probably you speak to, seem nervous. What parting words would you leave the investing public with in terms of how to really think about and maybe think through the near-term volatility that we have all endured?*

Joe Terranova: Flat remains the new up. Everything is guilty until proven innocent. Things look like maybe there is a possibility for stabilization. If I were to characterize the potential for 2016, headwinds continue to persist. No one should get incredibly excited about the opportunities for 2016, but I think the dynamic that we are witnessing at the end of January into February is a little bit of modest optimism for the very first time, that the rate of decline that we are seeing in risk assets can stabilize, can moderate. I also would suggest to everyone, and I think this is an important dynamic to think about, the presidential election I think is going to garner far more attention and has far greater impact on the equities markets here in the U.S. than we have given it credit for. The performance of healthcare tells you that as the candidates are obviously talking about policies that would certainly be restrictive in growing earnings on the healthcare side. Financials again, the regulation, a lot of what is going on right now, seeing the financial sector perform so poorly, the worst sector year to date, I think that has largely a lot to do with the election, but I think ultimately right now the economy cannot stand gridlock. Gridlock is generally good, Brian. Gridlock right now is not good for the economy and we need to have a handoff and I think the Federal Reserve very quietly acknowledges it and knows it and has talked about it in the past. Monetary policy that is very accommodative needs to hand off the fiscal policy that is pro-growth and we are not witnessing that right now. It is very important and I think the election, I think it is now time for investors to pay attention to the election, because I think it is going to impact the markets and I think we're seeing a little bit of that right now, so that is a new dynamic I want to introduce into our conversation looking forward for the year.

Brian Portnoy: *That is fantastic. As always, Joe, great perspective and I look forward to talking to you next month.*

Joe Terranova: Thank you, Brian. Have a wonderful month.

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