

***Virtus Vital Signs, May 2016***  
**Market Insights from Joe Terranova, Chief Market Strategist**  
**Interview conducted on April 28, 2016**  
**Transcript edited for clarity**

*Brian Portnoy: Welcome to Virtus Vital Signs for May of 2016. I'm Brian Portnoy, Director of Investment Education for Virtus Investment Partners. As always, I have my friend and colleague Joe Terranova with me. Joe is our Chief Market Strategist as well as Senior Managing Director with the Firm. Hi Joe.*

Joe Terranova: Good morning, Brian.

*Brian Portnoy: Thanks for joining us, as always. We are entering the month of May. As the old saying goes, "Sell in May and go away." Does that make sense this year?*

Joe Terranova: Well, I think it's important, Brian, to understand where are the capital markets specifically, and fixed income? Where are the equities markets when you are trying to make the assessment if that is going to be the right strategy for someone's portfolio? Now, reflect back to last year, May 20 – 2134.72 – that was the S&P 500 high for the year in 2015. The [sell in May] strategy worked. Well, why did that strategy work? Can it work again? I think there are specific indicators that I would list for you now that I want investors to look at.

*Brian Portnoy: Sure.*

Joe Terranova: First, and obviously most importantly, has been the correction in the U.S. dollar. We now see the U.S. dollar once again down nearly five percent for the year. Another negative month for the U.S. dollar. The question becomes can it continue? Brian, the U.S. dollar is approaching very strong support at the 93 level. Investors need to watch what happens there, if it breaks down further. That continues to be favorable for a continuance of the equity rally.

Secondarily, I think Brian, we have to look at technology. What has happened here in terms of technology reporting, there have been incredibly disappointing earnings in sales growth. So far we have got 38 of the 68 major S&P 500 companies in the technology space reporting – earnings growth -6.8%, sales growth 3.34%. We must watch what goes on with technology. I have to tell you, I am very suspicious that technology can recover.

From a technical standpoint, the third indicator we need to look at is the S&P itself. We have identified 2060 as a critical support level. We don't want the market to go below 2060. Brian, if it does, it goes back to all this confluence of moving averages, the 50-day, the 100-day, and 200-day, which rests between 1995 and 2020. We're trying to identify the indicators that would suggest to the investor, okay, yes, "sell in May and go away" is going to work. Sell away and go away for me, by the way, means we do not add much risk. We neutralize risk. We protect positions. We certainly don't leave the marketplace.

*Brian Portnoy: On a technology front, Apple obviously reported some news that the market did not like. It fell relatively sharply. Would you put extra weight on Apple's prospects within the technology bucket that you were referring to?*

Joe Terranova: Well, I think there is significance in terms of waning demand from the technology sector. Specifically right now, the demand is retreating in the Asian economy.

There is significance to where we have seen that loss of demand. Many have suggested that the market has rotated towards value over growth. Well, that is moderately correct. But also let's understand that when we talk about technology, there are some significant value technology names that are also disappointing now.

The other dynamic as it relates to technology, Brian, is the incredible amount of cash on the balance sheet and the hesitancy and the lack of clarity that is right now the dynamic of 2016. Blame it on what you want – central bank policy, political uncertainty – but technology companies are not being as aggressive as they were in 2015. In 2015, M&A activity surged 120% for the technology of the S&P complex. In 2016, we're seeing a contraction of nearly 40%. Buybacks are not as strong. The capital allocation strategy from technology doesn't seem to be as strong this year in 2016. That is why I am a little cautious, a little bit skeptical, and a little bit concerned about technology's ability to resurrect itself and be a leading sector once again, which it was for so many years.

*Brian Portnoy: What do you think the key indicators, the main allocators that the big tech companies are looking for in order to extend themselves in terms of new spending, new projects, and new initiatives?*

Joe Terranova: Well, they need clarity, first and foremost, and they need vision. They need products. They need a willingness to go out. When I say clarity, I think they need strong fiscal policies to go out and, as you correctly identified, to go out and spend on R&D, spend on acquisitions.

I think right now, the other thing that I am very disappointed in. I think last month we spoke about is, I look at the financial analysis of the S&P. The S&P is trading right now at a very rich 19.25 P/E. That's rich. At the end of last year, we came into the year trading at around 18.5 P/E. Earnings expectations full year for the S&P 500 come in at around 116-117. We have taken the expectations down considerably from where they were six months ago.

*Brian Portnoy: Right.*

Joe Terranova: But the profit margin dynamic is so key. Technology has such a significant contribution to profit margins. I keep talking about that. 2013 – 9.62% profit margins; 8.09% in 2015. I thought we would get a much larger recovery in the profit margin, Brian. We are only four basis points higher than where were in December at 8.13%. That is incredibly disappointing. That is reflective of the technology space right now. That is clearly slowing on multiple metrics.

*Brian Portnoy: Interesting, so what you are saying is you have got the dollar. You have got the tech sector. You have got the S&P itself that are some of the primary indicators for how investors should be approaching the market in the months that come as we enter the summer doldrums. Is that right?*

Joe Terranova: Correct, and again, we do not want to enact upon “sell in May and go away” unless we are dictated to do so by the particular indicators that we are looking at. One could make the argument that we are only 2% away from an all-time high, which is incredibly good when you think about the earnings reporting season so far -- 270 companies out of the 500; sales growth down 50 basis points; earnings growth down 5%; energy, materials, both down double digits; industrials down

7% on earnings growth. Really, consumer discretionary, which has had a very strong quarter; healthcare which has come back on a very strong quarter; and telecommunications companies, but there are only five of them in the S&P 500. The rest whether it be utilities, health, and financials, they really are experiencing very difficult quarters in terms of contraction in sales and earnings growth. Despite that, the S&P is still only 2% away from its all-time high, up 2.5% for the year, and having a positive month in the month of April.

*Brian Portnoy: The last question, does that surprise you? We are just about at all-time highs. There seems to be plenty of things to be concerned about. Are those in conflict?*

Joe Terranova: I think it is a great question. I think it identifies how money managers were positioned coming into the year. We have seen a recovery in emerging markets. We have seen a recovery in a lot of the high beta resource and commodity trades. The reflation trade is back once again. Money managers were not positioned for that at all. They've actually in certain instances taken the other side of that.

So while the market is recovered, what is recovering is particular assets that are not popular to own. You are seeing a little bit of a chase right now, whether it is short covering, or whether it is a chase to acquire these assets. It is not an incredibly strong rally. But it is a bearish sentiment rally that is driving the marketplace higher. I think that is important to understand. You never want a time when that is going to end. You want to go back to what I said at the beginning of this conversation, and let specific indicators guide you as to when that process will end. Ultimately, I believe it will end.

*Brian Portnoy: That is great. Alright, well, a month from now, we are going to check in on these indicators. This is really interesting. Thank you so much, Joe.*

Joe Terranova: Thank you, Brian. Enjoy the month of May.

*Brian Portnoy: Yeah, you too.*

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