Virtus Vital Signs, November 2015
Market Insights from Joe Terranova, Chief Market Strategist
from an interview conducted on November 3, 2015

Brian Portnoy: *Welcome to Virtus Vital Signs for the month of November 2015. I am Brian Portnoy, director of investment education. As always, I have with me Joe Terranova, our chief market strategist and senior managing director. Welcome Joe.*

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

Brian Portnoy: *Yes, absolutely. Let's dive right into the market action. In October, the S&P 500® was up 8.4%, the biggest monthly gain since October of 2011, and the fourth largest gain for an October in recent market history. Can you talk a bit about the source of that rally? Was it technically driven, or more based on fundamentals?*

Joe Terranova: I think what happened at the end of August was more of a trading event, not an investment type of condition. You had rules-based, momentum-driven algorithmic funds that were stomped out of the marketplace. Combine that with a lot of the fundamentals that were witnessed from the Chinese economy, and you had a correction that accelerated to the downside and bottomed out on August 24th and 25th.

Looking forward, I think money managers incorrectly identified the correction as one that would be a price correction, taking out October of 2014's lows. That did not happen. It was a time correction. You are witnessing a very sharp snapback in the markets. It is driven by two things. Money managers positioned the wrong way, and a little bit of a chase for performance, with hedge funds in particular playing it from the short side. So the chase for performance is clearly on. Secondarily, the anticipation of a very strong buyback season, historically, in the month of November is really what lifted equities in the month of October.

Brian Portnoy: *Okay, great. Let's move on to the FOMC and central bank activity. Fed chairperson Yellen has clearly indicated that an interest rate rise hike could be in the near-term offing. What is your view on her recent announcement, and what does this mean for investors?*

Joe Terranova: Well, what it means for investors is the same thing that it has meant for the last year or so, as we have talked about this occurrence [in past podcasts]. The reality is, do we believe that there is a cycle of interest rate hikes about to occur? The answer to that is no. This will be a one and done, 25 basis point hike, that has no impact on investor portfolios. Look at the U.S. 10-year Treasury, which is really the proxy for Federal Reserve rates. We had a low of 1.71% back in late January. It rallied in June all the way up to 2.49%, which is a very benign trading range for the 10-year. We are at 2.20% right now. Investors need not pay attention to the FOMC potential rate hike until the indication is clear that we are entering a cycle of rate hikes. I do not expect that any time soon.

Brian Portnoy: *Okay, understood. Let's move on to earnings, where I know you have some views in terms of what to expect in the coming weeks and months.*

Joe Terranova: That is the juicy part of the market right now. It is so interesting. The U.S. Dollar [Index] is beginning to rally back above 97 once again. As of right now, 376 S&P 500 companies have reported, and earnings growth is negative, down 4%, and sales growth is down 5%. But a lot of that contraction is witnessed in energy, down 34%, materials, down 15%, and industrials and utilities, also down single digits.

Where is the strength? The strength is found exactly where the expectation would be, if you believed the U.S. dollar was going to rally, which is what we have witnessed. It is in consumer discretionary [which has reported] 16% earnings growth and 4% sales growth – and how about healthcare, with 8% sales growth and 11% earnings growth.

Brian, understand that 33% of S&P 500 companies derive sales from overseas. For consumer discretionary and healthcare, you are looking at [foreign sales of] about 20% for healthcare, and 25% for consumer discretionary. There is insulation by [their] domestic exposure, and it is exactly what I want investors to focus on: *domestic economy growth*, what sectors and what companies will benefit most from that, and what companies are insulated from a lot of the contagion we are seeing globally.

Brian Portnoy: *Okay, that makes a lot of sense. Finally, we are only eight weeks from Christmas and the end of the year. How are you thinking about November and December, and what should investors be thinking about now in terms of their own portfolios?*

Joe Terranova: November for investors should mean the same thing that it means to an institutional money manager. It's your month where you begin to prepare for 2016. It's the month where you begin to trace out what your playbook and your strategy are. Go back to November of 2014. The playbook and strategy at that point was the avoidance of Chinese related types of assets and the avoidance of commodities and resource type names. We wanted exposure to healthcare. We wanted exposure to consumer technology and consumer discretionary. That playbook has worked out incredibly well in 2015.

Looking forward to 2016, investors are sitting with their advisors right now, and they are saying, "What is the plan for 2016?" The time to do it is now. You do not do it in January. You do not do it in December. You get it done before Thanksgiving. You know exactly where you want to be. I think that is the prudent and right thing for investors, if they want to achieve success in 2016.

Brian Portnoy: *That is fantastic advice, very helpful. As always Joe, thank you so much for your time. We will talk to you next month.*

Joe Terranova: Thanks Brian. Have a happy Thanksgiving.

Brian Portnoy: *You too.*