
2014: 'A Year of Cautious Optimism'

By Ron Surz Thu, Oct 9, 2014

"This is one of those time periods where the stuff in the middle has surprised by not performing in-between the stuff on the ends," writes West Coast market philosopher Ron Surz in this assessment of U.S. and global stock performance so far in 2014.

Although 2014 isn't quite over yet, it's looking like the optimists are going to have an "I told you so" moment, especially when it comes to the U.S. stock and real estate markets.

Real estate, as measured by U.S. REITs, has earned 14% in the first nine months of 2014, and U.S. stocks, as measured by the S&P 500, have earned 8%. By contrast, foreign securities, gold, and commodities have struggled, due in large part to the strengthening U.S. dollar, which has appreciated 7.5%. (All returns are measured in \$US.) In the following, I review what has been working, and not working, in both U.S. and foreign markets, with a look forward to the homestretch in the remaining three months of 2014.

U.S. stocks

This is one of those time periods where the stuff in the middle has surprised by not performing in-between the stuff on the ends. Large cap core stocks outperformed both large cap value and large cap growth, earning 11%. Core is defined as the stuff in-between value and growth. Small companies have suffered losses of 2%. (I use my own [Surz Style Pure](#) classifications throughout this commentary.)

Sector stocks

On the sector front, there has been a wide range of performance, with healthcare stocks earning 15% while consumer discretionary companies have lagged with a slight loss. Consumer discretionary and healthcare stocks both led last year's rally with 45% returns. There have been both reversals and momentum in economic sector performance, which leads us to heat maps and clues to the homestretch of 2014.

The interesting details lie in the cross-sections of styles with sectors, as shown in the following heat map. The map shows shades of green for "good," which in this case is good performance relative to the total market. By contrast, shades of red are bad, indicating underperformance. Yellow is neutral.

The best performing market segment in the first nine months of 2014 was comprised of mid-

cap core companies in the materials sector, earning 23.9%. We also see that, with the exception of smaller companies, healthcare has done well across the style board. By contrast, the worst performing segment was small-cap core in the utilities sector, losing 18%.

Many quantitative managers employ momentum in their models, buying the “green” and selling the “red.” Non-quants, also known as fundamental managers, use heat maps as clues to segments of the market that are worth exploring, for both momentum and reversal potential.

	STAP	DISC	HLTH	MATL	TECH	ENER	INDU	UTEL	FINC	TOTL
LGVL	5.5	-0.3	13.8	10.6	22.8	2.6	3.9	8.3	6.2	9.2
LGCO	16	5.9	13.9	4.9	6.9	11.3	7.2	18	11.8	10.8
LGGR	-2.4	-0.4	18.4	6.8	5.9	22.3	0.7	0	4.7	4.7
MDVL	1.4	4.2	19.3	-1.6	6.4	6.3	-0.1	12.9	5.8	5.8
MDCO	6.5	5.1	14.5	23.9	8	5	3.9	-3.5	6.5	6.9
MDGR	18.5	-2.8	12.8	3.2	2.8	7.1	0.1	16.3	3.1	4.5
SCVL	-0.6	-6.9	11.7	1.1	7.1	4.7	-2.3	3.6	0.6	0.8
SCCO	-9.2	-11.5	-2.2	-1.2	-3.8	4.2	-7.8	-18	-0.3	-3.9
SCGR	-4.1	-10.5	6.6	-0.4	-12.6	-11.4	-12.6	10	-4	-6.1
TOTL	6.6	-0.1	15	5.1	10.1	6.4	1.7	7.1	5.3	6.5

Foreign stocks

Looking outside the U.S., foreign markets earned 5%, lagging the U.S. stock market’s 6.4% return but outperforming EAFE’s 1.4% loss. For those with a broad foreign mandate, EAFE has been easy to beat because the better-performing regions are not included, namely Emerging Markets, Canada and Latin America. Emerging Markets have led year-to-date with a 17% return. By contrast, the U.K. has lost 2%. On the style front, value has led with an 8% return, while growth stocks earned less than half that amount.

Like the U.S., healthcare stocks in emerging markets have performed best, with a 36.6% return, while utilities in the U.K. have performed worst, with a 20.8% loss.

	STAP	DISC	HLTH	MATL	TECH	ENER	INDU	UTEL	FINC	TOTL
LGVL	5.1	-1	1.1	-0.4	23.3	7.1	8.1	11	7.3	7
LGCO	4.2	-6.4	18.4	0.4	18.6	3.6	-2.3	10.3	0.9	3.4
LGGR	4.5	-6.2	18.2	-6.8	-2.8	4.8	1.8	-16.6	0.8	0.3
MDVL	4.7	2.2	14.1	9.8	17.8	4.2	6.7	16.2	12.8	10
MDCO	6.7	4.7	8.6	3.9	12.4	1.8	1.2	1.4	2.8	4
MDGR	4.2	1.3	12	3.9	8.5	-0.8	2.7	10	8.3	5
SCVL	15.1	11.6	24.3	18.6	16.2	9.7	13.4	21.8	16.4	14.8
SCCO	9.3	15.2	21.1	13	13	-1.4	12.9	2.6	9.4	11.7
SCGR	9.2	13.7	16.3	16.4	17.1	3.8	17	14.7	11	14.8
UK	2.5	-1.9	13.4	-3.2	-4.9	-3.8	-5.1	-20.8	-0.1	-1.9
JAPN	7.4	0.7	9.5	0.1	5.3	3.6	6.6	-1.6	-9.8	1.2
CANA	18.8	6.5	7.2	-0.4	10.8	7.8	19.4	1.2	7.8	8
AUST	1.2	3.3	6.9	-7.6	3	7.6	3.8	13.4	10.2	5.2
APXJ	13.3	3.9	18.9	9.7	13.9	5	11.8	19.8	12.8	12.1
EURO	0.6	-10.2	13.6	-1	0.3	5.1	-4.9	9.3	0.5	0.4
EMRG	11.8	28.8	36.6	13.2	16.3	8.6	22.5	10	20.5	17.1
LATN	0.4	5.3	0.1	-4.1	18.5	9.9	3.2	13.3	16	7.4
TOTL	5	-0.8	16	2.6	7.8	4.9	3.8	7.4	6.6	5

	UK	JAPN	CANA	AUST	APXJ	EURO	EMRG	LATN
LGVL	-0.6	2.1	6.1	5.2	11.7	4.9	14.2	11.9
LGCO	0.4	-1.5	8.5	3.2	4.9	2.9	11.3	9.8
LGGR	-4.3	-3.1	8.9	4.2	2.1	-3.3	16.4	3.3
MDVL	5.7	0.9	7.5	9.1	16.6	1.5	21	9.7
MDCO	-3.7	5	5	10	10.2	-4.2	13.9	7.5
MDGR	-4.6	1.5	6.2	0.8	12.3	-4.8	16.2	3.9
SCVL	6.2	12.3	11.1	4.3	18	4.7	28	7.2
SCCO	-0.9	8.6	7.4	6.4	19.7	1.3	22.7	-4
SCGR	-5	-0.7	7.8	-0.2	27.8	-4.6	17.5	1.3
TOTL	-1.9	1.2	8	5.2	12.1	0.4	17.1	7.4

As mentioned above, the strengthening U.S. dollar penalized investment performance in foreign countries, especially in the third quarter.

How to use this information

It just keeps getting better—until it doesn't. U.S. stocks and real estate are up this year, while metals and commodities are down. Will these trends continue? Which asset classes will continue to deliver strong returns (momentum) and which will not (reversal, aka regression to the mean)?

We all have our own outlooks on the economy and the stock market, and adjust our thinking as results roll in. I personally remain surprised and grateful that stocks have performed so well in the past five years, following the 2008-2009 meltdown; it's been a long-term reversal. You can use the information above to test your personal outlooks, to see which are unfolding as you think they should and which are not, with the intention to clear the haze from those crystal balls.

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