# It Just Keeps Getting Better

By Ron Surz   *Wed, Jul 9, 2014*

"Don't worry. Be happy," suggests the president of PPCA, Inc., who attached this video when distributing copies of his "Review of the Capital Markets in the First Half of 2014." He deconstructs a market climate that, despite his own dire predictions, has been sunny.

"Stocks have reached what looks like a permanently high plateau" — Irving Fisher, economics professor, Yale University, 1929.

Irving Fisher was a brilliant economist who learned a lesson from his 1929 quote above: forecasting is hard. As we entered 2014, many observers, including me, thought there would be a price to pay for the 2013 extraordinary 33% gain in the U.S. stock market.
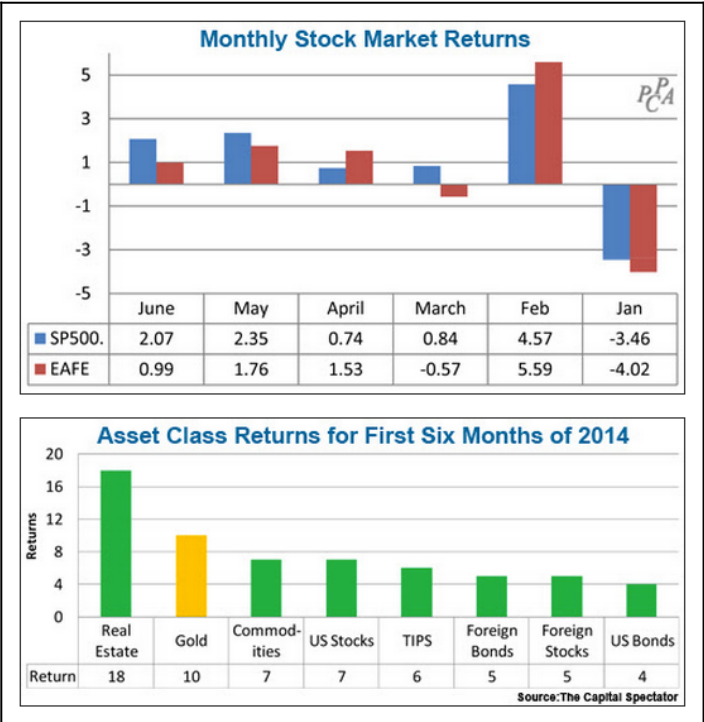
In my [end-of-year commentary](#) I forecast a 16% loss for U.S. stocks in 2014, and in January it looked like I was going to be right (see graph on the right). But then stock markets, both here and abroad, rallied in the next five months. 2014 isn't over yet, but it's looking like I'm going to be wrong.

In fact, everything is performing very well so far this year, and it just keeps getting better.

The June 28 issue of *The Wall Street Journal* carries the headline, "Financial Markets Enjoy Broadest Rally Since '93." It's very unusual for all asset classes—stocks, bonds, commodities, etc.—to all go up in value at the same time, but that's what has happened in the first half of 2014, as shown in the graph on the right. The last time this happened was more than 20 years ago, in 1993. As the song says: "Don't worry. Be happy."

I'll resist the temptation to double down on my market forecast for the remainder of the year and turn instead to an examination of what has been driving U.S. and foreign stock markets in the first half. History is much easier to get right than the future.

But before I dive in, I'd like to draw your attention to the hottest investment in pension land: target date funds. This $trillion train is speeding down a rickety track. You may want to get off the train, or you could help us fix the track. You can read more at ["Understanding the Hidden Risks in Target Date Funds](#)," a short introduction to the situation.

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. Mid-cap stocks have outperformed large and small companies, earning 8.4% in the first half. Similarly, large cap core stocks outperformed both large-cap value and large-cap growth, earning 9.2%. Small companies have lagged, earning 4.8%. I use the [Surz Style Pure classifications](#) throughout this commentary.

Sector analysis

Style Returns for First Half of 2014

Sector Returns for First Half of 2014
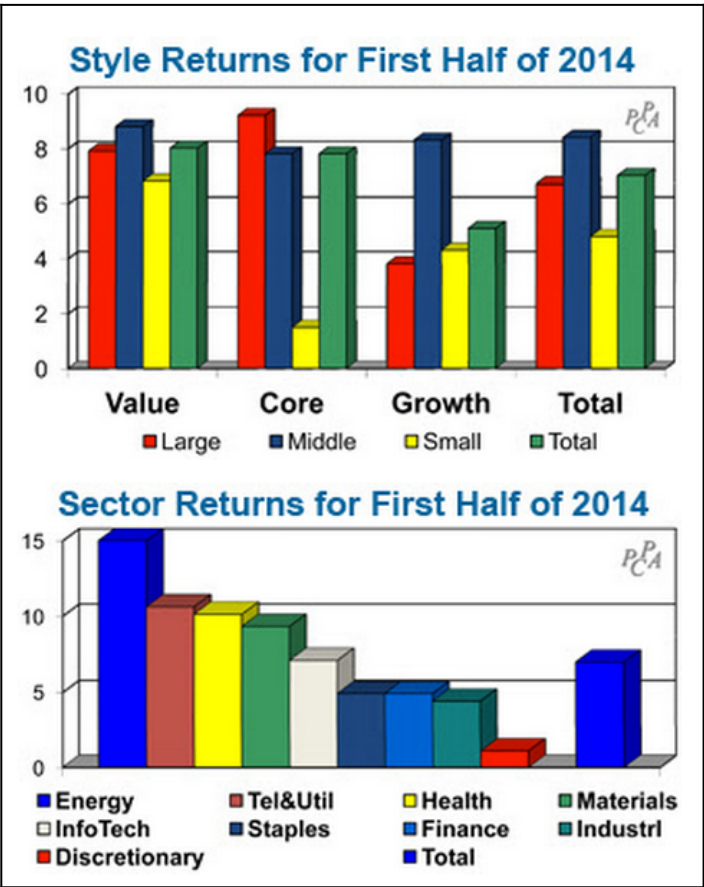
On the sector front, there has been a wide range of performance, with energy stocks earning 15% while consumer discretionary companies have lagged with a mere 1% return. Consumer discretionary stocks led last year's rally with a 45% return, and energy companies were among the worst performing sectors. There have been reversals in economic sector performance, which leads us to heat maps and clues to momentum and reversals.

The interesting details lie in the cross-sections of styles with sectors, as shown in the heat map below. A heat 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.

In the table below, we see that the best performing market segment in the first half of 2014 was comprised of large-cap growth companies in the energy sector, earning 34.2%. And the worst performing segment was small-cap core in the utilities sector, losing 9.1%. 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	2.5	7.8	10.6	13.2	13.1	7.4	3.8	9.5	4.4	7.8
LGCO	8.7	3	7	4.9	9.5	26.9	6.1	10.1	6.5	9.3
LGGR	3	-1.3	9.4	8.4	1.1	34.2	4.4	-8	3.1	3.7
MDVL	2.6	2.4	19.5	6.3	9.1	15.3	5.6	17.4	7.7	9
MDCO	5.1	4.8	12.1	12.3	6.1	14.5	5.9	3.5	9.3	7.8
MDGR	15.6	-0.9	9.7	9.4	5.3	17.7	6.3	23.5	6.7	8.4
SCVL	2.4	-0.2	13.7	7.7	11.5	15.7	5.6	11.4	5.1	6.9
SCCO	-5.4	-4.5	1.1	7.3	0.2	18.8	-2.5	-9.1	3.1	1.6
SCGR	-3.5	-1.5	11.1	14.3	-2.6	15.9	-2.9	24.2	2.5	4.2
TOTL	5	1	10.3	9.5	7	15.2	4.5	10.6	4.8	7.1

Foreign stocks

Looking outside the U.S., foreign markets earned 7.7%, exceeding the U.S. stock market's 7% return and EAFE's 5% return. For those with a broad foreign mandate, EAFE has been easy to beat because the better performing regions are not included, namely Emerging Markets and Canada. Emerging Markets have led in the half with a 16% return. By contrast, the U.K. and Japan have earned only 3.5%.

On the style front, value led in the half with an 11% return while growth stocks earned less than half that amount. Further insights into overseas market behavior are provided by heat maps, as shown below. As you can see, both the UK and Japan were red in most styles. The best performing segment was Latin American technology stocks with a 43.3% return, while the worst performing companies were utilities in the U.K. with a 20.5% loss.

	STAP	DISC	HLTH	MATL	TECH	ENER	INDU	UTEL	FINC	TOTL
LGVL	13	7.9	11.3	8.3	19.8	18.4	12.9	9.7	7.9	10.5
LGCO	9.4	3.6	15.9	8	16.1	14.6	5.8	12.3	1.4	7.6
LGGR	4.1	-0.1	14.8	2.7	2.1	11.6	4.8	-12.4	1.6	3.5
MDVL	7.8	5.9	14.6	12.4	23.1	12.1	10.3	16.7	14.2	12.6
MDCO	11.1	7.3	11.8	10.9	13.7	16	6.7	4.8	6.5	8.6
MDGR	4.9	4.2	9.6	5.8	7.7	9.7	6.4	12.1	7.7	6.5
SCVL	14.1	12.4	20.8	17.2	16	15.3	13.8	21.1	15	15
SCCO	10.9	13.4	15.7	11.7	14.9	4.9	13.5	1.5	9.7	11.7
SCGR	6.6	10.7	13.7	12.3	15.3	8.5	11.2	16.4	8.1	11.7
UK	9.9	3	18.4	5.7	-1.7	12.1	3.5	-20.5	0.7	3.4
JAPN	11.3	1.7	8.7	2.5	5.5	12.8	7	0.9	-2.6	3.5
CANA	12.6	7	5	15.5	12.1	20.3	12.8	6.4	9.1	13.3
AUST	6.6	10.6	6.5	2.4	12.8	11.3	10.6	13.6	16.3	11.2
APXJ	7.7	3.6	9.9	4.1	15.8	3.9	5.4	7.7	6	7
EURO	8.5	4.9	13.2	11	3.8	17.8	7.8	17.1	5.9	9
EMRG	7.7	21.3	22.4	15.6	6.6	17.8	24.4	10.8	18.2	16.3
LATN	3.5	10.9	11.3	-2.8	43.3	2.3	6.2	15.4	15.6	9.4
TOTL	7.8	4.9	14.1	7.7	9.3	14.3	7.9	7.7	7.3	7.6

	UK	JAPN	CANA	AUST	APXJ	EURO	EMRG	LATN	OTHR	TOTL
LGVL	7	4.6	8.3	12	6.4	13.4	16.3	15	2.1	10.5
LGCO	3.4	1.4	18.1	6.4	5.2	9.5	12.8	9.5	5.3	7.6
LGGR	-1	-2	12.4	6.5	2.6	5	9.2	4.4	8.6	3.5
MDVL	12.5	6.4	15	15.2	9.8	12.2	21.1	13.2	-0.4	12.6
MDCO	4	7.3	17.3	16.2	7	9.4	14	6.9	3.8	8.6
MDGR	2.7	3.4	16.7	7.5	5.2	7.3	14.6	6	-0.4	6.5
SCVL	12.5	12.6	16.8	8.9	12.5	14.4	26.6	11.6	4.1	15
SCCO	5.5	10.8	15.5	10.6	11.4	14.1	20.5	-1.2	-0.6	11.7
SCGR	3.2	4	27.1	6.1	12	9.5	17.3	4.2	12.6	11.7

It just keeps getting better, until it doesn't. Everything is up this year, but will it continue? Which asset classes will continue to deliver strong returns (momentum) and which will not (reversals, also known as regressions to the mean). We've already seen reversals in U.S. economic sectors. I'd like to hear your thoughts. As Yogi Berra said, "The future ain't what it used to be."

We all have 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.