HIGHVISTA STRATEGIES

Market Commentary

February 6, 2018

The year 2017 was characterized throughout by rising markets against a backdrop of record low volatility. A solid world economy, robust earnings growth, continuing low bond yields and tame inflation together made for a Goldilocks market environment. All of this was the more remarkable given heightened geopolitical tensions and the fractured state of domestic politics.

It was a particularly strong period for emerging equities, which outperformed developed market equities by 12%, and for growth stocks, which outperformed value equities by 14%. The long-awaited reduction in U.S. corporate tax rates was a significant positive for equity prices as the year ended.

It was also a year in which cryptocurrencies grew from $17 billion to over half a trillion dollars in "market value." The cryptocurrency phenomenon now represents either one of the most significant and rapidly evolving bubbles in history, or a harbinger of profound changes we are about to witness in the world's payments and monetary systems, or very possibly both.

Market valuations are being underpinned by low bond yields coupled with economic fundamentals that are globally robust. In particular, consensus forecasts of earnings growth for 2018 are fairly high—in the 10% to 15% range—and forecast earnings yields are well in excess of bond yields across broad categories including U.S. equities (**Exhibit 1**). As long as this state of affairs continues, equity markets will continue to look relatively attractive, especially non-U.S. equities.

Exhibit 1: Earnings Growth, Forward P/E Ratios, and Forward Earnings Yields[1]
(As of January 31, 2018)

		U.S. Equities	Non-U.S. Developed Equities	Emerging Market Equities
(1)	2018 estimated EPS growth (FY 2018 versus FY 2017)	15%	10%	14%
(2)	P/E on estimated 2018 earnings	18.6 x	15.3 x	13.5 x
(3)	Earnings yield (based on estimated 2018 EPS)	5.4%	6.5%	7.4%
(4)	U.S. bond yield (10 Year)		2.7%	

[1] Source: HighVista Analysis.

When and how the current environment may change for the worse is anyone's guess. High on the list of suspects would be disappointing corporate earnings and an unanticipated shock to inflation and interest rates. Our main protection against earnings risk is to utilize managers with a strong value bias whose expertise lies in bottom-up security selection. However, protecting against an inflation or rate shock is much more difficult. We write about the potential sensitivity to interest rate shocks in some detail in a white paper titled "Will Rate Shocks End Goldilocks?".

Important Disclosure

Definitions for Exhibits 1 as follows:

Asset Class	Index
U.S. Equities	Russell 3000 Index
Non U.S. Developed Equities/Markets	MSCI EAFE Index
Emerging Market Equities	MSCI Daily TR Net Emerging Markets USD Index