Is Everybody Getting A Trophy?

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Key takeaways:

- Global equities continued to rally, with 30 countries now up double digits in 2019 and 72% of global stocks trading above their 200-day moving average
- Equity ETFs outgained bond ETFs by $18 billion but are barely ahead in 2019 given the earlier risk-off stance
- Sector flows rebounded, led by the financial sector, which broke 12 months of consecutive outflows
- Bond flows were 22% below their 3-year monthly average, dragged lower by inflation protected and emerging market (EM) debt strategies

Rally caps were donned for the fourth consecutive month, as April saw the fourth straight month of gains for global stocks. The longest winning streak since January 2018 pushed 72% of global equities to trade above their 200-day moving average – a reversal from how the year began, when only 23% of stocks were trading above their 200-day average.

This is combined with the fact that the S&P 500 Index and the NASDAQ Composite Index are once again trading above all-time highs, and what once appeared to be the "endgame" for the longest running bull market in history has now been replaced with a rally in which everything is moving higher and everyone is getting a trophy.

The notion that "everybody gets a trophy" is derived from the rules of American T-Ball. There are no outs and everyone gets to bat at least once. No one keeps score and all baserunners advance one base at a time. It's just a game of singles and every five-year-old running after the same ball – the earliest sign of return chasing, perhaps.

Beyond the rally's returns, another characteristic of this "everybody gets a trophy" market is the change in the volatility regime. The CBOE VIX Index (VIX) has averaged 15.5 over the past four months, down 26% from Q4's average of 21.9. So far in 2019, the S&P 500 has had just 15% of its trading days with a daily price move greater than one percent in either direction, down from 25% of its days in 2018.

When everyone reaches safely, it's no surprise that risk is low. This complacency is apparent from the price investors are paying for next year's earnings compared with current levels of volatility. That ratio now sits in the 76th percentile of the last 10 years, up 30% from the start of the year.

April showers bring May flowers, but will the global equity markets 16% gain through April translate into the currently calculated annualized 56% full-year 2019 return?

Global central banks are likely to remain accommodative, and fiscal policy will also be wind at investors' backs, considering the rise in populism around the world and the likelihood of some pro-growth policy posturing ahead of the 2020 elections from both sides of the isle. The latter, however, could also devolve into political brinksmanship and spur some idiosyncratic volatility. Risk assets overall, however, are likely to be supported by both policy functions being in their favor.

But a 56% return in 2019? Three factors bear watching:

1) **Participation:**[i] It has been a low participation rally, with trading across all US exchanges down 12% from last year[ii]. This signifies a lack of broad-based conviction. If volumes tick higher, that may confirm that further gains have room to run as more investors come to the table.
2) **Margins**: The blended net profit margin for S&P 500 firms is set to post the largest year-over-year decline since Q4 2016, with 10 of 11 sectors posting declines. The declines are not solely US-centric either. Net profit margins for non-US stocks have now declined year-over-year for five consecutive months. Earnings growth being a rally catalyst is likely to face challenges if this continues.
3) **Valuations**: In the US, valuations are no longer attractive, trading in the 84th percentile over the past 15 years. Outside the US, valuations are more appealing. However, they are not what they were at the start of the year. In all major regions, multiple expansion accounts for over 100% of this year's return. Growth will need to follow for investors to keep paying.

Double-digit gains aside, everyone won't get a trophy. That only happens in T-Ball, and this isn't T-Ball. This is the big leagues, where macro data can ride in on the hands of hitters jamming any power stroke, and earnings misses can buckle a batter's knees like when Clayton Kershaw introduces them to Uncle Charlie.[iii] For the next few at-bats of this late cycle game that keeps getting extended, consider these 3 ideas:

1) **Growth** – Stay invested with equities but target inexpensive firms with sustainable cash flows and quality balance sheets to mitigate slowing margins
2) **Bonds** – Make sure bonds acts like bonds, providing diversification, stability and income to temper equity risk in the portfolio
3) **Diversify** – Non-US stocks have lagged over the past few years, but shifts are cyclical and targeting foreign fiscal policy beneficiaries may enhance and diversify returns.

Equities Hit it Out of the Park

Grip and rip was the mantra in April, as investors sought to take on more risk within portfolios in seeking to capture further upside in equities that have already run up over 16% to start the year.

With global equities continuing to rally, investors poured $25 billion into the segment in April. This is the highest monthly flow total for equities in 2019, helping to push the category above fixed income for the first time this year.

Fixed income ETF flows slowed as a result of this exuberance expressed by investors with a lesser desire to ballast portfolios from volatility, given the complacency that exists today. A turn of events from earlier in the year.

The risk-off stance expressed by investors coming into the year benefited the bond segments, pushing its Q1 flows to a record for any first quarter. In April, however, fixed income flows came in 22% below their 3-year average.

Another indication of investors eschewing potential risk mitigation tools is the continued decline in commodity flows, led by gold-backed strategies.

Overall, it has been a rocking chair type of market since episodic volatility pushed markets lower last fall, as we have done a lot of moving but haven't gone anywhere. It is more likely than not we stay in the rocking chair and muddle along as the market waits for its next catalyst.

Figure 1: Asset Class Flows

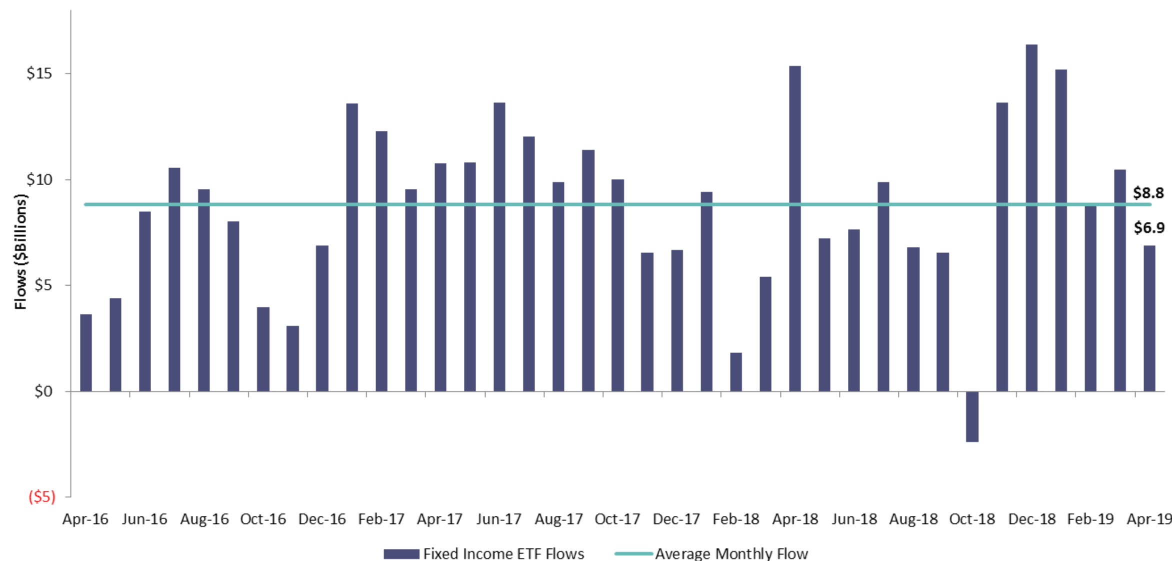
In Millions	April	Year to Date	Trailing 3 Months	Trailing 12 Months	2019 Start of Year AUM %
Equity	25,138	41,997	61,230	196,009	1.6%
Fixed Income	6,676	41,256	27,966	107,576	6.3%
Commodity	-2,110	-2,233	-4,174	-5,391	-3.6%
Specialty	265	660	525	-45	23.3%
Mixed Allocation	141	-103	267	2,067	-0.9%
Alternative	2	-205	-174	747	-5.5%

Top two and bottom two categories per period are highlighted. Past performance is not a guarantee of future results.

Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

Figure 2: Historical Fixed Income Flows

The chart below depicts the monthly flow totals over the past three years. After posting above average flows for the past four months, the momentum slowed with fixed income flows coming in 22% below the 3-year average.



Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

International Prospects

The US took in the most flows out of any segment as investors allocated back to the biggest piece of the portfolio pie. Broad developed ex-US and EM exposures also witnessed inflows on the month, as only two geographical segments had outflows. EM funds have taken in the second-most behind the US year to date and in the past three months, as investors have scooped up the attractively valued segment all year. The year-to-date flows for EM represent an 8.3% increase in assets, and are one reason why EM ETF assets are nearing $200 billion.

US-focused equity ETFs are the largest market based on assets under management, making absolute flow comparisons difficult as they are likely to be leaders and laggards for any given month based only on their sheer size. This is why we find it constructive to examine flows based on the percent of start-of-period assets, as it can foretell the magnitude of shifts on a relative basis across different market segments.

Taking this approach, we see that while the US grabbed the headlines, international regional and single-country funds witnessed the highest flows as a percent of their asset base in April. The $1.4 billion into regional funds and the $2 billion into single country funds represent a 2.8% and 2.2% increase, respectively. Chinese equity-focused ETFs took in $400 million, extending their year-to-date lead in the category to over $2 billion, as investors continued positioning for renewed hopes of a US/China trade deal and the stabilization of downbeat economic data.

At the regional level, it was the return of European-focused strategies, which snapped a 13-month losing streak of outflows. Valuations continue to remain attractive and there has been a slight improvement with economic data with the recent gross domestic product (GDP) report for the region coming in better than expected. The latter of which is like a D student coming home with a C-. It's better, but still not refrigerator material. With tense European elections this May, these positive flow trends bear watching.

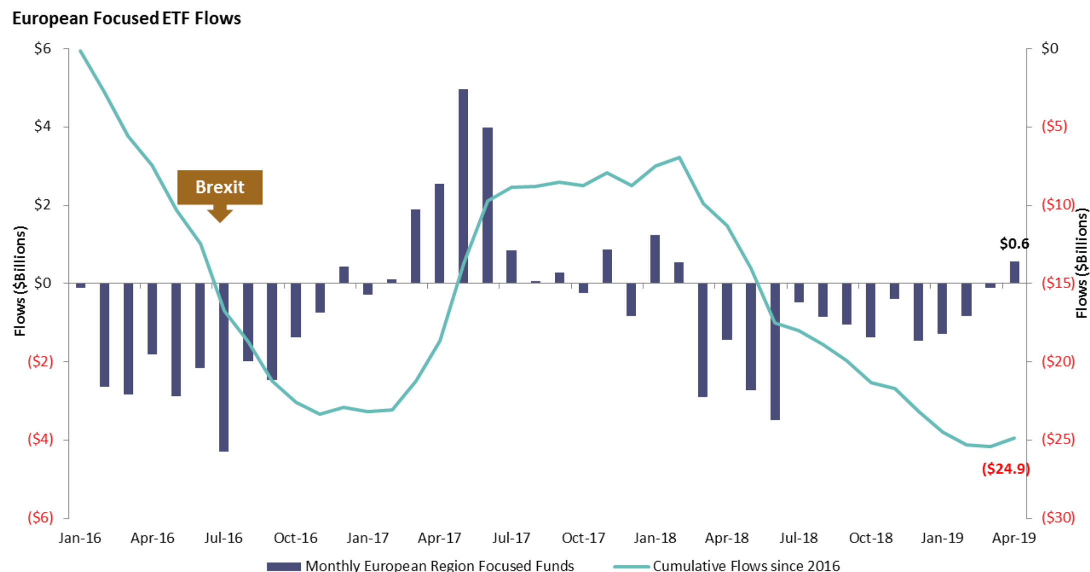
Figure 3: Equity Geographical Flows

In Millions	April	Year to Date	Trailing 3 Months	Trailing 12 Months	2019 Start of Year AUM %
US	19,866	30,128	53,188	158,732	1.6%
Global	-669	-3,176	-2,374	6,108	-3.6%
International-Developed	1,962	1,251	1,961	27,954	0.4%
International-Emerging Markets	989	14,141	8,180	15,029	8.7%
International-Region	1,421	538	1,093	-7,941	1.1%
International-Single Country	2,041	2,642	1,393	7,849	3.2%
Currency Hedged	-472	-3,526	-2,211	-11,721	-16.4%

Top two and bottom two categories per period are highlighted. Past performance is not a guarantee of future results.
Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

Figure 4: European-Focused Flows Since 2016

The chart below signifies how negative the positioning has been towards the European region since 2016 and the start of Brexit.



Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

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Health Care Sent to the Bench, Financials Called Up

Health Care funds went on a policy induced slump in the month of April and investors put them on the bench. Health care stocks fell 2.7% on the month and were the worst performing sector in the S&P 500. The selloff, in what was one of the best performing sectors over the last six months, was a byproduct of the recent announcement from Health and Human Services Secretary Alex Azar calling for large employers to ensure their workers get prescription[iv] drug rebates at the pharmacy counter.

This renewed negative policy sentiment towards the sector just in time for the next presidential elections. As a result, outflows ensued, with Health Care posting the most monthly outflows since February of 2016 – the same month that Hillary Clinton tweeted about affordable health care for all.

Overall, however, sector flows were positive for the month. This was second time that has happened in the last seven months. The drivers behind the flows were the more cyclical parts of the sector landscape – Financial and Technology funds.

Financials snapped their 12-month consecutive streak of outflows. The renewed interest in Financials is likely a byproduct of attractive valuations combined with supportive earnings results so far this earnings season. Not to mention, the yield curve pulling itself out of an inversion and lessening the negative headline sentiment that had built up over the past few months.

Looking ahead, the Q1 earnings season will provide more clarity on the trajectory of this rally. Firms have been surprising to the upside more than average. However, based on consensus analyst estimates, right now, five sectors are projected to have negative earnings growth in Q1, and all sectors have had negative revisions to full-year 2019 estimates over the past three months.

Those trends indicate uneven sentiment and may lead to more tactical opportunities for investors to target areas with improving sentiment. One sector with that trend is Communication Services, where earnings surprises are high (80%) as is the magnitude (firms beating earnings by 11%) so far this season– a likely reason for its strong flows in 2019.

Figure 5: Equity Sector Flows

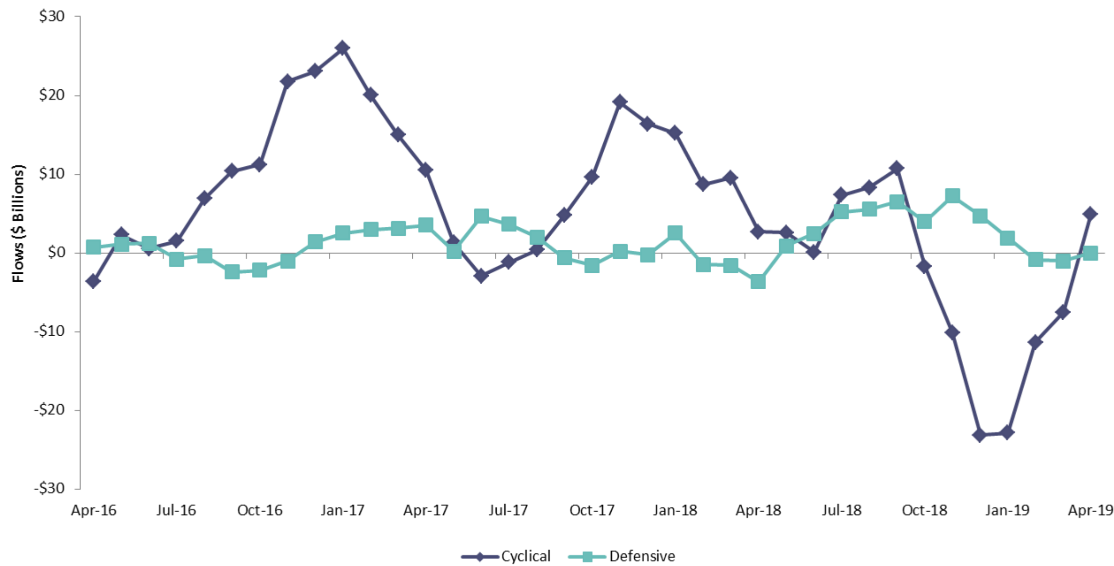
In Millions	April	Year to Date	Trailing 3 Months	Trailing 12 Months	2019 Start of Year AUM %
Technology	2,556	-142	3,211	3,856	-0.1%
Financial	1,548	-3,731	-2,518	-16,628	-8.0%
Health Care	-1,973	-693	-624	7,704	-1.2%
Consumer Discretionary	931	-62	577	-1,426	-0.3%
Consumer Staples	162	513	556	3,530	3.2%
Energy	-608	-4,852	-1,819	-4,504	-11.4%
Materials	-487	-2,597	-1,673	-1,055	-7.9%
Industrials	50	-1,378	-292	-5,748	-6.2%
Real Estate	-345	2,607	3,157	2,207	4.4%
Utilities	479	1,229	1,368	3,206	9.0%
Communications	501	3,017	1,994	6,801	61.0%

Top two and bottom two categories per period are highlighted. Past performance is not a guarantee of future results.

Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

Figure 6: Rolling 3-Month US Sector Equity ETF Flows: Cyclical versus Defensive

The rotation out of Health Care and into Financials pushed cyclicals ahead of defensives now on a rolling 3-month basis.



Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019. Cyclicals and Defensive classifications based on MSCI classification schemes. Cyclicals are Communications Services, Consumer Discretionary, Real Estate, Financials, Industrials, Materials and Technology. Defensives are Consumer Staples, Energy, Health Care and Utilities.

High-Priced Growth

Given that US equities were in net inflows, the size and style category was the same. Large-cap and broad market exposures were the direct beneficiaries of investors' return to US equity markets.

In April, growth funds saw their largest monthly inflows in the past nine months, as investors turned to the old adage "if growth is challenged, buy growth." And that growth is coming at a high price given that growth stocks trade in the top decile relative to their 15-year history, based on price-to-earnings.

Figure 7: US Size and Style

In Millions	April	Year to Date	Trailing 3 Months	Trailing 12 Months	2019 Start of Year AUM %
Broad Market	1,572	6,523	6,976	31,671	3.3%
Large-Cap	15,462	24,698	36,495	98,076	4.9%
Mid-Cap	477	3,887	3,142	14,823	2.4%
Small-Cap	-1,397	-1,625	315	16,694	-0.9%
Growth	1,659	449	2,116	12,159	0.3%
Value	-175	-1,597	79	26,623	-0.8%

Top two and bottom two categories per period are highlighted. Past performance is not a guarantee of future results.
Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

High Yield Still Hitting

Fixed income flows were mostly positive, with the exception of inflation protected and EM debt strategies. Outflows hit the former, as investors' desire to mitigate the effects of inflation was lessened. Inflation readings came in very weak, as the Personal Consumption Expenditures Index – the Federal Reserve's (Fed) preferred measure of inflation, slumped to 1.3%, which is below the Fed's 2% target. For EM debt, the outflows coincided with recent dollar strength, a headwind for the segment, and some likely profit taking as EM debt has rallied. Most other major segments had inflows, led by credit sectors and interest rate-sensitive government exposures. High yield has enjoyed a strong 2019 after a disastrous 2018, as investors were attracted to the segment given the rise in yields to start the year. Since then, yields have come down and the relative attractiveness is no longer as strong. Spreads now sit 30% below their 25-year average. Flow momentum may dissipate from here, particularly if growth concerns are realized.

Figure 8: Fixed Income Sectors

In Millions	April	Year to Date	Trailing 3 Months	Trailing 12 Months	2019 Start of Year AUM %
Aggregate	1,343	3,714	7,576	25,672	1.8%
Government	3,871	8,473	2,214	45,472	7.1%
Inflation Protected	-1,692	-1,943	-2,226	-1,184	-4.7%
Mortgage-Backed	623	5,317	3,465	8,619	23.4%
IG Corporate	1,401	13,761	6,963	18,979	10.6%
High Yield Corp.	874	8,368	6,338	3,644	23.0%
Bank Loans	33	-570	-125	-3,322	-5.8%
EM Bond	-1,587	1,265	-52	3,162	4.9%
Preferred	904	1,033	1,518	-1,194	4.0%
Convertible	-43	-254	-149	-206	-6.0%
Municipals	949	2,092	2,445	7,934	5.7%

Top two and bottom two categories per period are highlighted. Past performance is not a guarantee of future results.
Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

Investors Dig the Long Bond

Investors favored longer duration bond segments in April as the yield curve modestly steepened. With marginally higher longer-term rates, the yields became attractive, particularly in light of the waning inflation and slowing growth dynamics.

A continued dovish stance from the Fed could lead to some price appreciation if the curve resumes it flattening ways, after this brief steepening that was likely in part driven by the curve flattening too quickly back in March.

Figure 9: Fixed Income Maturity Flows

In Millions	April	Year to Date	Trailing 3 Months	Trailing 12 Months	2019 Start of Year AUM %
Ultra Short	53	-1,518	-1,942	12,364	-4.7%
Short Term	131	3,469	1,109	20,873	7.9%
Intermediate	573	2,476	530	7,005	8.8%
Long Term (>10 yr)	3,221	4,538	2,942	6,754	35.3%

Top two and bottom two categories per period are highlighted. Past performance is not a guarantee of future results.

Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

No Gold Glove

All but one commodity segment were in net outflows in April, likely a byproduct of the reduction in inflation mitigating exposures in light of the sanguine outlook for inflationary spirits.

Gold-backed ETFs had $1.8 billion of outflows in April, as the aforementioned inflation trends combined with the continuation of the risk-on rally dampened sentiment for the yellow metal.

Figure 10: Commodity Flows

In Millions	April	Year to Date	Trailing 3 Months	Trailing 12 Months	2019 Start of Year AUM %
Precious Metals	-1,872	-682	-2,972	-3,977	-1.3%
Industrial Metals	-12	-5	-3	-121	-2.9%
Energy	-162	-764	-668	-623	-25.9%
Broad Based	-68	-763	-522	-483	-11.7%
Agriculture	4	-19	-9	-188	-3.0%

Top two and bottom two categories per period are highlighted. Past performance is not a guarantee of future results.
Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

Smart Defense

Smart flows have averaged $5 billion of inflows a month in 2019, with the majority going to defensive-oriented factor exposures like quality, dividend yield and minimum volatility, which took in the most.

The rotation into these areas adds credence to the notions expressed above that investors, while seeking to buy the rally, are concerned that the torrid pace of gains may slow. Overall, smart beta funds – based on our classification – now have over $400 billion in assets. For more information on how we break out factor flows, check out our latest blog on the classification conundrum.

Figure 11: Strategy Type

In Millions	April	Year to Date	Trailing 3 Months	Trailing 12 Months	2019 Start of Year AUM %
Active	1,860	5,845	5,494	25,177	8.4%
Smart Beta	4,520	21,101	16,340	50,147	6.1%
Sector Smart Beta	160	225	594	-892	2.1%
ESG	357	2,054	2,041	4,305	20.9%

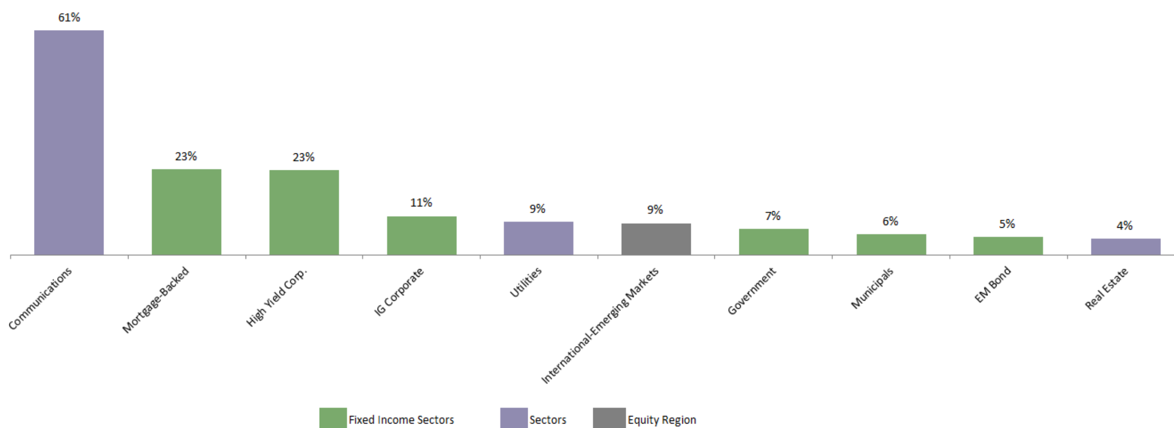
Top two and bottom two categories per period are highlighted. Past performance is not a guarantee of future results.

Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

League Leaders

When dissecting flow patterns, flow as a percent of assets helps us discern noticeable shifts in buying behavior. Figure 12 summarizes the 10 areas that witnessed the largest flow totals as a percent of start-of-year assets in 2019 in the Equity Region, US and Fixed Income Sectors categories.

Figure 12: Flows as a Percentage of AUM
(2019 Flows as % Start of Year AUM)



Source: Bloomberg Finance L.P., State Street Global Advisors, as of April 30, 2019.

Definitions

BofA Merrill Lynch US High Yield Master II Index
The BofA Merrill Lynch US High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have a below investment grade rating (based on an average of Moody's, S&P and Fitch).

Basis point
1/100th of 1 percent

Bloomberg Barclays U.S. Aggregate Bond Index
The Bloomberg Barclays U.S. Aggregate Bond Index is a market weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues.

Bloomberg Commodity Index
A broadly diversified commodity price index distributed by Bloomberg Indexes that tracks 22 commodity futures and seven sectors. No one commodity can compose less than 2 percent or more than 15 percent of the index and no sector can represent more than 33 percent of the index.

Bloomberg Dollar Spot Index (DXY)
The Bloomberg Dollar Spot Index tracks the performance of a basket of 10 leading global currencies versus the US Dollar.

Bloomberg Barclays Corporate US High Yield Bond Index
A rules-based, market-value-weighted index to measure the performance of publicly issued non-investment grade USD fixed-rate, taxable and corporate bonds.

CBOE SPX Volatility Index (VIX)
A measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices.

Earnings Per Share (EPS)
A profitability measure that is calculated by dividing a company's net income by the number of shares outstanding.

Growth
Characterized by higher price levels relative to fundamentals, such as earnings.

Risk asset
Any asset that carries a degree of risk, generally refers to assets that have a significant degree of price volatility, such as equities, commodities, high-yield bonds, real estate and currencies.

MSCI EAFE Index
An equities benchmark that captures large- and mid-cap representation across developed market countries around the world, excluding the US and Canada.

MSCI Emerging Markets Index
The MSCI Emerging Markets Index captures large and mid-cap representation across 23 emerging markets countries. With 834 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI ACWI Index
The MSCI ACWI Index captures large and mid-cap representation across developed and emerging markets countries.

MSCI ACWI Ex-US Index
The MSCI ACWI Ex-US Index captures large and mid-cap representation across developed and emerging markets countries outside of the USA.

Moving Average
A succession of averages derived from successive segments (typically of constant size and overlapping) of a series of values.

Multiple Expansion
When the price-to-earnings ratio for a market segment increases from an increase in price with little change in the earnings part of the ratio.

Net Profit Margin
The net profit margin is equal to how much net income or profit is generated as a percentage of revenue.

Personal Consumption Expenditure Index
Is one measure of U.S. inflation, tracking the change in prices of goods and services purchased by consumers throughout the economy.

Russell 2000 Index
The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market.

S&P 500 Index
Standard and Poor's 500 Index is a capitalization-weighted index of through changes in the aggregate market value of 500 stocks representing all major industries.

S&P/LSTA Leveraged Loan Index
The S&P/LSTA Leveraged Loan Index is a market value-weighted index designed to measure the performance of the U.S. leveraged loan market based upon market weightings, spread and interest payments.

Smart Beta
A term for rules-based investment strategies that don't use conventional market-cap weightings.

Spread Compression
When credit spreads decline and tighten

Trailing three-month average
Average over the prior three months.

Uncle Charlie
A nickname for a curveball pitch.

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[i] Funny because usually the trophy everyone in T-ball get is a participation trophy

[ii] Based on Tape A+B+C Volume (MVALUSE Index) per data from Bloomberg Finance L.P. as of 04/29/2019 comparing this year’s volumes to the first four months of last year

[iii] A nickname for a curveball pitch, also known as a yakker

[iv] “Managed-Care Stocks Tumble as HHS Chief Adds to Policy Worries”, Bloomberg April 11, 2019

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