Bridgewater®

Daily Observations

October 5, 2018

(203) 226-3030

Greg Jensen
Melissa Saphier

US Equities Are Increasingly an Outlier; The Vast Majority of Global Assets Are Down in 2018

Seventy-five percent of the markets we track are down this year (particularly when measured in USD), but this market action is largely happening under the radar, as the most important asset in most portfolios—US equities—is doing fine. The outperformance of US equities is an outlier, and from what we see in markets, it looks like more and more money is flowing into US equities at rates that likely can't be maintained going forward. The rush into what has been working looks unsustainable to us.

The strength in US equities is in our view idiosyncratic, as the US has been insulated from the tightening of US liquidity and moderating global growth by both the one-off fiscal stimulus and the wave of corporate repatriation since the start of the year, which have boosted US growth and driven more money into the equity market but are now approaching their peak impacts. US exceptionalism is now being taken as a given after almost a decade in which US equities have consistently been one of the best-performing asset markets. The drivers of past US equity strength are set to gradually reverse as the fiscal boost fades, the slow but persistent withdrawal of liquidity progresses, and late-cycle dynamics build. This shift in fundamentals is occurring while markets are pricing in an extrapolation of the recent past.

The table below shows the returns of assets across the globe since the start of the year. You can see how much of an exception the US equity market has been. Almost every other asset class around the world has sold off, with a few isolated exceptions in countries like Russia and Mexico, where prior acute strains have been alleviated.

Global Assets Ranked by Performance, Year to Date (Excess Returns)

	USD	Local
Oil	32.4%	--
United States Equities	9.8%	9.8%
Natural Gas	9.0%	--
Russia Equities	7.0%	17.3%
Mexico Govt Bonds	5.6%	-1.4%
Mexico Equities	3.0%	-5.6%
Mexico Sov Spreads	1.3%	1.4%
Korea Sov Spreads	1.0%	1.0%
United States Corp Spreads	1.0%	1.0%
Japan Equities	1.0%	3.3%
France Equities	0.7%	6.3%
Russia Sov Spreads	0.5%	1.1%
Japan Govt Bonds	-0.2%	-0.4%
China Sov Spreads	-0.2%	-0.2%
Brazil Sov Spreads	-1.3%	-1.3%
United States Govt Bonds	-1.9%	-3.0%
Canada Equities	-2.0%	0.2%
Nickel	-2.1%	--
Germany Govt Bonds	-3.3%	1.0%
Spain Sov Spreads	-3.3%	1.3%
Korea Govt Bonds	-3.7%	0.8%
Canada Govt Bonds	-4.5%	-1.3%
United Kingdom Equities	-4.6%	0.2%

75% of assets have sold off this year

	USD	Local
Australia Equities	-4.7%	3.3%
France Sov Spreads	-4.8%	0.1%
United Kingdom Govt Bonds	-5.3%	-2.0%
Turkey Sov Spreads	-5.4%	-4.8%
Euroland Corp Spreads	-6.3%	-0.5%
Australia Govt Bonds	-6.3%	1.2%
Aluminum	-6.5%	--
Germany Equities	-8.2%	-3.0%
Italy Equities	-8.3%	-2.8%
Italy Sov Spreads	-8.7%	-6.8%
Gold	-9.4%	--
Spain Equities	-9.8%	-4.5%
Brazil Equities	-11.6%	1.9%
Korea Equities	-11.7%	-7.5%
India Govt Bonds	-13.8%	-4.7%
Copper	-14.0%	--
Russia Govt Bonds	-15.2%	-4.0%
India Equities	-15.9%	-7.2%
Zinc	-17.9%	--
Brazil Govt Bonds	-18.5%	-0.7%
China Equities	-21.5%	-17.4%
Turkey Equities	-45.8%	-21.2%
Turkey Govt Bonds	-61.2%	-23.6%

Give Feedback

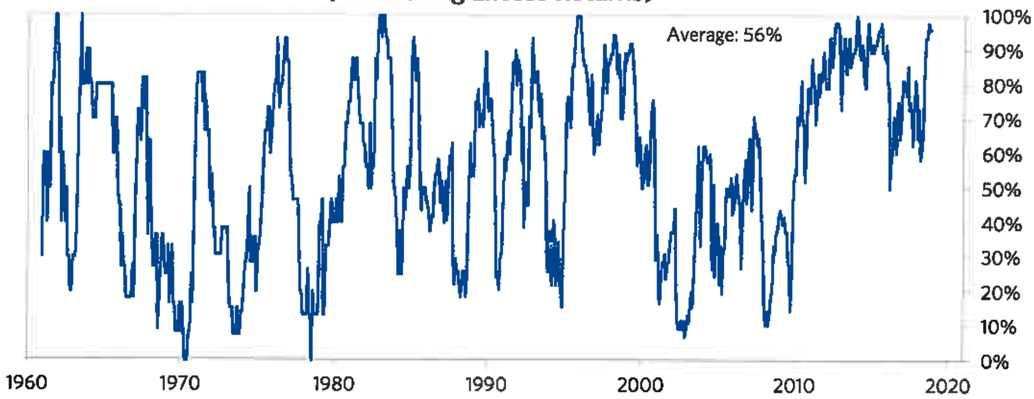
The impact of tightening is also becoming evident in global economic conditions, with growth slowing toward potential in almost every country this year. The US stands out as experiencing among the strongest growth relative to potential of any country, with very little moderation this year. By our estimates, the fiscal stimulus has been a significant driver—without it, US growth would have fallen to potential.

The US Is Experiencing the Strongest Growth and Has Slowed Relatively Little This Year

	Recent Growth vs Potential	Change in Growth This Year
United States	1.3%	-0.2%
Estimate ex-Fiscal Bump	0.0%	-1.5%
Spain	0.9%	-0.7%
Canada	0.8%	-0.1%
Germany	0.8%	-0.8%
Australia	0.7%	0.0%
Italy	0.7%	-0.8%
United Kingdom	0.5%	-0.2%
Japan	0.4%	-0.9%
France	0.2%	-1.0%
Mexico	0.2%	1.3%
China	0.1%	-0.4%
Korea	-0.2%	-1.0%
Russia	-0.2%	-0.6%
India	-0.4%	-0.8%
Brazil	-1.2%	-0.7%
Turkey	-4.9%	-7.1%

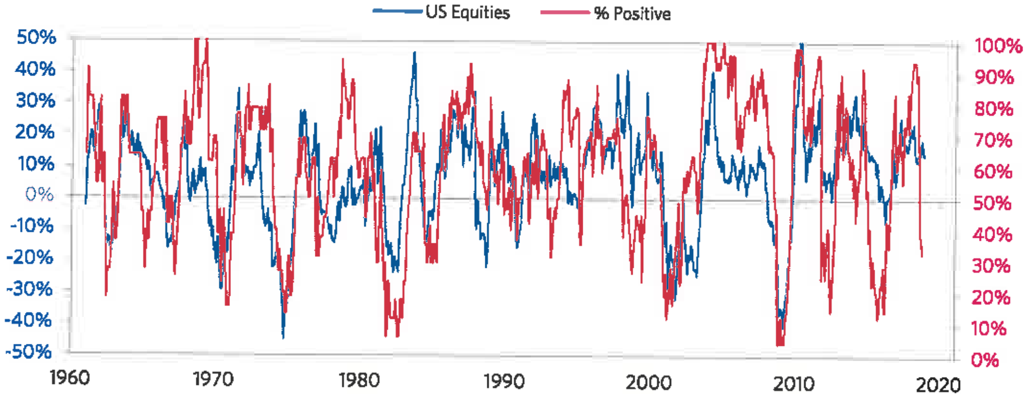
While US equities have been one of the best-performing global assets for the last 12 months, on average of course US equities are normally near the middle (they average 56% on the list since 1960). It is for that reason that diversified strategies are typically more reliable, but periods like the recent one generally lead to concentration in US equities.

US Equity Return Percentile vs Global Assets Shown in First Table (12m Rolling Excess Returns)



The strong US equity performance obscures for many investors that most assets have had a negative return in the last 12 months. It is rare but not unprecedented for US equities to do well while most assets do poorly, but that typically does not last long.

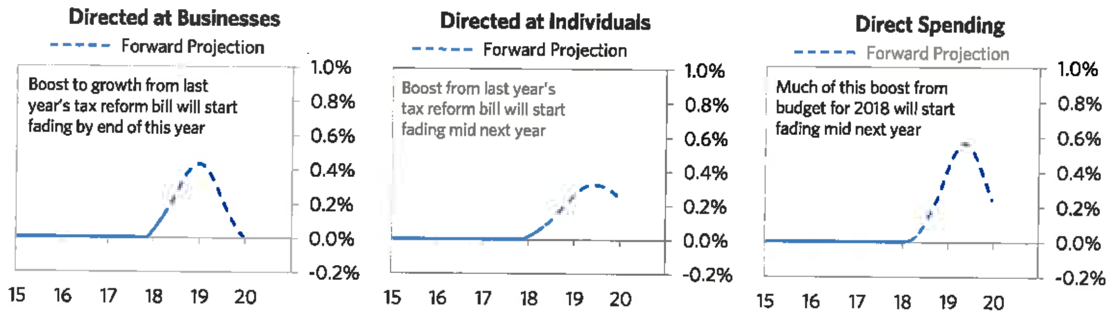
Rolling US Equity Returns vs Percent of Assets with Positive Return



The Fundamentals That Have Made the US Different Are Starting to Shift

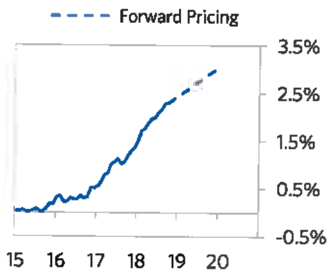
The fundamentals that have made the US different than the rest of the world are starting to shift. The fiscal bump will start to fade in coming quarters. Stimulus has been a big support; as it rolls off, we expect US growth to moderate further, bringing it more in line with the rest of the world.

Fiscal Stimulus Estimated Impact on Growth (%GDP)

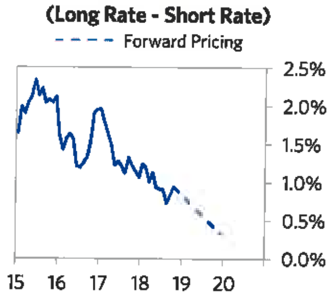


While the fiscal stimulus is fading, the effect of the tightening—which impacts the economy with a lag—is accelerating. The tightening cycle we've had so far has been cautious but long, and including the removal of QE, it is adding up to be significant. Strong conditions this year have allowed the Fed to keep tightening at a regular clip, and the tightening cycle is on course to continue into next year. But by our measures, the impact of that tightening will be peaking just as the fiscal bump wears off.

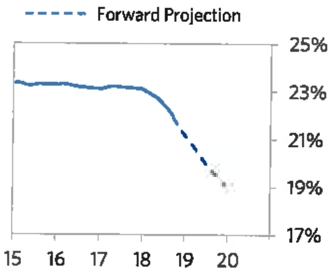
US Sovereign Short Rate



US Yield Curve (Long Rate - Short Rate)



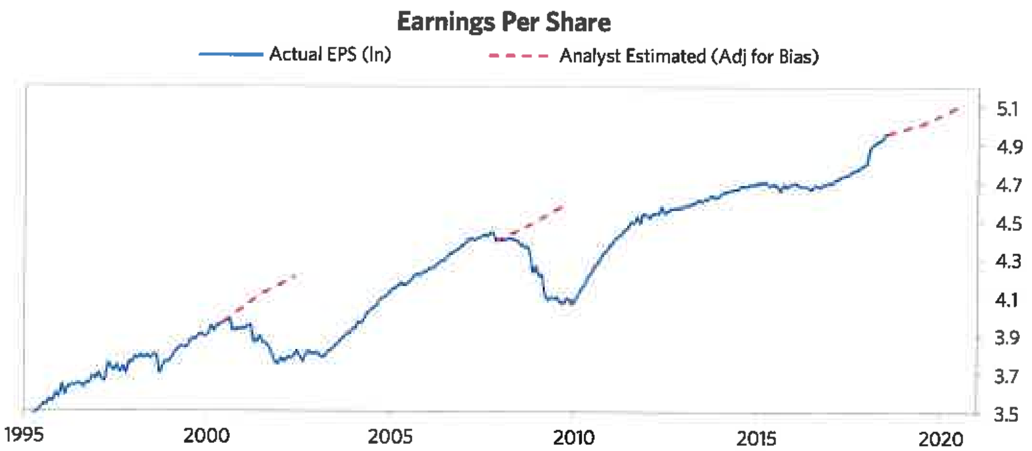
Fed Balance Sheet (%GDP)



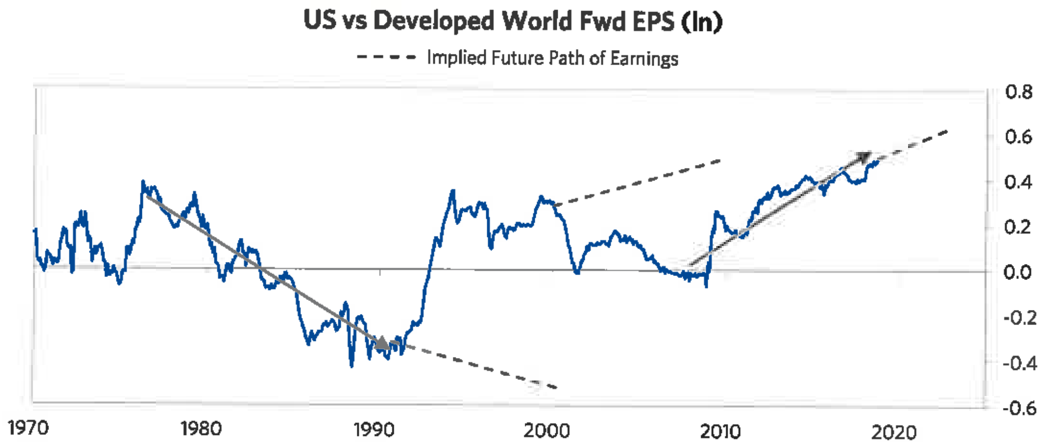
Give Feedback

While the Fundamentals Are Shifting, Market Pricing Is Extrapolating Great Times for US Companies

As the strong monetary and fiscal stimulus that supported corporate profits fades (and wages and the dollar continue to rise), it will be a tough environment for US profits. The chart below shows the level of earnings per share today and what is expected going forward, along with expectations at prior times that turned out to be peaks. Today's level of earnings has been a reflection of the impact of strong monetary and fiscal stimulation, which has supported corporate profitability. These strong earnings are being extrapolated going forward, as is often the case, even just before turning points. Expectations are not as extreme as at some past points (note the tech bubble), but they're still notable after a period of strength and at a time when many of the supports are beginning to fade.



Below, we show the same chart of earnings in the US relative to the rest of the developed world. US corporations have had a great decade relative to the rest of the developed world, and market pricing is for US corporates to continue to outperform the rest of the world.



Concentrated US equity portfolios have outperformed for some time now. We are seeing many investors respond by shifting to more equity-like and less diversified portfolios. This concerns us; balance will be important again—we expect pretty soon.

[Give Feedback](#)