[Martone Capital Management: Weekly Investment Commentary (2/16/2016)]

Despite a strong rally on Friday, stocks continued their decline, with more of the major averages entering bear market territory last week.

In a world in which central bank stimulus is losing its sway over markets, investors are reliant on earnings growth for equity market returns - something that will be hard to produce in an environment of decelerating growth. This all suggests that markets will remain volatile and may see lower valuations before we can assume we have found a long-term bottom.

More and more equity markets globally have slipped into bear market territory, typically defined as losses of 20% or more from the prior peak. By that definition, the global stock market, as measured by the MSCI All-Country World Index, has now entered a bear market. Many of last year's momentum plays are among the worst performers.

European shares are now down more than 15% year-to-date, with the worst damage in southern European and bank shares. Even Japan, a relatively cheap market with a sound banking system, is getting hit. Part of the problem is that negative rates imposed by the central bank are being seen as a tax on the banking system and are not providing the expected boost.

With earnings heading lower and investors taking less solace from central bank stimulus - the market took little comfort in Janet Yellen's Congressional testimony last week - stocks are struggling to find a bottom. Unfortunately, while valuations have become more reasonable, outside of emerging markets, they are not particularly cheap.

However, it is worth highlighting that despite the increasingly pessimistic tone, the U.S. economy is not falling off a cliff. Last week's retail sales report continues to support our thesis that, while the manufacturing sector is in a contraction, the household and services sectors appear to be growing.

The weakness in U.S. equities has been widespread, but the pain has been most acute in the more volatile stocks. Another notable trend: Small-cap stocks continue to struggle relative to their large-cap brethren. Part of the challenge is that small caps still remain far from cheap. The Russell 2000 Index is trading at over 32x trailing earnings, versus less than 17x for the S&P 500. In addition, we are seeing a sharp spike in credit spreads along with a general tightening in financial market conditions. Historically, this has had a more negative impact on riskier segments of the market, such as small caps.