SELECTOR
Real-Time Money Management

Monthly Commentary

April 20, 2015

"Good investors gather information, put that information into current and historical context, then make sound decisions."

The theme of domestic and international equity markets so far in 2015 has been rotation. Rotation is when a market sector transitions from a downtrend to an uptrend, or from an uptrend to a downtrend. It can also describe a market that was in an uptrend and rotated to a trading range, or was in a downtrend and rotated to a trading range. The key element is that a significant change of momentum takes place, from a directional standpoint. As hard as that may be to describe in text, it is very obvious when you are looking at price charts. Which, by the way, we do every single day, so we generally see rotations in timely fashions. This affords us distinct tactical advantages because it allows us to exit the 'analysis paralysis' that so often accompanies fundamental point-counterpoint analysis.

Discussing a distinct tactical advantage might appear to afford our competitors an edge, but we have come to know that the vast majority of investment advisors prefer to wear the 'cloak of fundamental confusion.' Large and giant advisors are at a distinct disadvantage with technical analysis because of the natural limitations of being so large. They can only reminisce on the days when they were flexible enough to move with momentum. Meanwhile, we enjoy operating with autonomy, recognizing the rotations and reacting in a timely fashion rather than seeing the waterfall ahead and knowing that a part of our portfolio is going over the edge. On the positive side, when downtrends are broken, bases are formed, and new uptrends established, there are specific advantages to being an early adopter and committing assets to the positive rotation in a timely fashion.

The 2015 rotations started in February with the institutional rotation out of real estate and utilities into European equities. This rotation was very obvious and we elected to be an early adopter in February, committing additional assets to international equities in March in many portfolios. The second rotation of 2015 was the institutional shift from Large Cap domestic equities to Mid Cap, and a little later, to Small Cap equities. The rotational shift for Large Caps began early in the year, was more subtle, and required more confirmation as the sector shifted from an uptrend to a trading range, unlike the real estate and utilities rotations, which resulted in shifts from uptrends to downtrends. Large Cap equities were the most productive domestic sector of 2014 and it was natural to be overweighted in this sector. The rotation into Mid Cap equities began in February and continued into Small Cap equities in March.

The most recent rotation went back to international equities in the form of emerging markets. Emerging market equities are dominated by four countries, **B**razil, **R**ussia, **I**ndia, and **C**hina. Together, these four have been branded as The **BRIC**. There are several issues to be aware of when investing with the BRIC, including the fact that Russia and China are bound in socialism although their economies include significant capitalistic components. China and India are massive net importers of basic materials while Russia and Brazil are net exporters, so all four economies are closely linked to commodity prices. Finally, China and India both include some of the richest and most impoverished people in the world. (China is home to more billionaires than any other nation. India ranks #3.) Accordingly, we find it advisable to invest in the broader emerging markets sectors, which also include Southeast Asia and Eastern Europe. The entire emerging markets sector made an astonishing rotational breakout the first week of April. We are paying very close attention.

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Bond markets have also been experiencing rotations, though far more muted and less dramatic. The bond market rotation has occurred in the high yield bond sector. This sector tends to shadow the Mid Cap and Small Cap equity sectors, so their recent resurgence has fueled the high yield bond rotation. The high yield bond sector has moved back onto the bond market leaderboard behind high quality and emerging market bonds. The U.S. Dollar continues to be an irrepressible force. This lends strength to the entire U.S. bond market. Even with yields of less than 2% on intermediate-term Treasuries, consider that their European cousins are now yielding close to zero. The reality of low global interest rates continues to lend strength to U.S. bonds in spite of persistent fears of rising rates in the future.

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