SELECTOR
Real-Time Money Management

Monthly Commentary

August 19, 2013

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

After setting record highs two weeks ago, equity markets are taking a well-deserved rest. This rest results in a change in trend. There are three types of trends; uptrends, downtrends, and sideways trends. The equity markets' recent push to new highs was an uptrend that ran for six weeks. Remember that in my camp short-term means three months or less. Intermediate term means approximately six months. Equity markets have made considerable progress since mid-February, so the intermediate term trend is definitely up. Long-term means one year or longer, not to exceed three years, which is almost ancient history. Equity markets are substantially higher than one year ago. The long-term trend is also up. So, no bad news on the equity market trends.

A trend change doesn't mean that an investor needs to change their strategy. It just means that they may need to reload their expectations. Uptrends can be nicely profitable depending upon when you got involved. If you were invested prior to the uptrend, congratulations. Hopefully you realized the full benefit of the move. If you got invested during the uptrend, excellent. There's nothing better than some immediate gratification on your decision to get invested. If you got invested just as the uptrend changed, be attentive, and patient. Long term investors learn to recognize that uptrends are favorable winds that can speed them towards their destination. Downtrends and sideways trends can slow, still, or even detour their progress. The most important part of the journey is knowing your destination. Trends, like winds, are ever-changing.

Major equity market indexes are now consolidating their gains, and have pulled back approximately -3% in the past two weeks. A market pullback is called a correction. A mild correction within the context of a long term trend is normally in the -5% range, so a little more weakness over the next week would be consistent with a mild correction. Mild corrections are considered to be healthy for long-term Bull Markets. Even moderate corrections, in the -10% range, can be constructive for the long-term. Severe corrections of -15% can be destructive and frequently portend greater problems down the road.

Bond markets are not enjoying the same progress as equity markets. Bond prices peaked in early May and declined sharply in June. After a brief bounce in July, they are now in the process of testing those June lows. Bond corrections are measured on a different scale than equity market corrections. While a 5% correction in equity market prices is considered to be mild, 5% is a moderate correction for bonds. A 10% correction in equity markets is regarded as moderate, but a 10% price correction in bonds is severe. The Barclays Aggregate Bond Index is now -4.5% lower than its high on May 1st. The iBoxx Investment Grade Corporate Bond Index is -8.0% lower than on May 1st, and the Barclays 20+ Year Treasury Bond Index is -16.6% lower than its May 1st close. The Barclays TIPs Index is -9.25% lower than its yearly high. High yield bonds have fared better, posting numbers very close to the Aggregate Bond Index.

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It has been a tough year for bond investors on a price basis. On a yield basis, results are far more selective. High quality, long term bonds have suffered the greatest losses. Conversely, lower quality, shorter-term bonds have weathered the storm more securely, and those higher yields continue to satisfy. Higher yield bond sectors include not just high yield corporate bonds, but also bank loan, convertible, and preferred stock fixed income sectors. When you couple their dividend yields with their recent price declines, they can represent a tempting alternative to equities from a total return standpoint. It would not be surprising if investors who are catching their breath from this year's equity market run take a hard look at those bond market sectors.

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Sources: Bloomberg, Marketwatch.com, StockCharts.com.

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