Monthly Commentary

August 19, 2014

SELECTOR
Real-Time Money Management

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

The last thirty days have been full of fireworks for equity markets! After most major market equity indexes climbed to record highs the third week in July, they had a precipitous drop the last week of the month, with the biggest drop on the final trading day of July. That day the DJIA, (which I quote in spite of the fact that it only represents 30 stocks, but is the most recognized and most often-quoted domestic equity index by the media,) fell -317.06 points, or -1.88%. Other major domestic and international market indexes fell across the board and continued their declines into the first week of August. The total decline from the July to the August low for the S&P 500 Large Cap Index was -4.37%, the S&P 400 Mid Cap Index fell -6.61%, and the beleaguered S&P 600 Small Cap Index dropped by -8.27%, once again sending it into negative territory for the year.

On August 8th equity markets began their recovery with as much unity as had been seen during the declines of the previous two weeks. That rally remains in place at this writing, with handsome recovery rallies across the board the past two weeks. The rally has extended into the International Emerging Market equity indexes, while European equity markets have been much slower to recover. Year-to-date, the MSCI Emerging Markets Index is now up +9.46%, while the S&P Europe 350 is up a mere +1.22%. On the domestic side, the S&P 500 is up +8.06% YTD, the S&P 400 Mid Cap is up +6.13% YTD, with the S&P 600 Small Cap up +0.90% YTD. These advances are significant in that they held their ground throughout the lazy days of summer. This is another excellent example why it is important to be 'real-time' in one's evaluations of current events and not enslaved to the Farmer's Almanac, or in our case, the Stock Trader's Almanac, which we do reference for historical and seasonal tendencies, but not at the expense of what we see.

The most troubled equity markets in the world can be linked directly to the conflict in Eastern Europe. The MSCI Russia 25/50 Index remains down -11.52%, while the MSCI Emerging Markets Eastern Europe Index is down -8.30%. Germany has also fallen into the Eastern Europe economic tar pit with the MSCI Germany Index down -6.84%. We exited developed international equity markets a few months ago, but continue to see substantial potential in emerging markets. However, we continue to monitor the European markets for reentry opportunities as hostilities work towards peaceful solutions and the Russian oil dependent countries respond to those actions. It should be noted that with regards to the Middle East, the only stock market of significance is Israel and that market is both very sophisticated market and closely aligned with the U.S. market. Accordingly, the Gaza Strip military activity had literally no impact on their prices.

Bond markets have also been involved in their own brand of rodeo the past month. High yield and convertible bonds in particular fell sharply during the recent equity correction, although they, too, have been rebounded nicely the past two weeks. High quality bonds, on the other hand, more than held their own, and are once again approaching yearly highs. The bottom line is that it continues to be a very productive environment for both equity markets and bond markets and we see little on the horizon that would immediately impact either in a negative fashion.

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From a seasonal perspective, we are approaching what has historically been a bit of a 'speed bump' for equities markets, namely the months of September and October. That being said, equity markets have actually been cruising along at a rather mundane, albeit productive, rate of speed. After the August correction, which proved to be more constructive than destructive for almost all major market and industrial sectors, it appears that we are approaching the speed bump with adequate, but not excessive, momentum. I would be surprised to see any excessive drama looking forward over the next 60-90 days, which takes us into the tail end of the year, a historically and seasonally productive time of year. We are not looking at this market through rose-colored glasses and remain very mindful of the risks that can develop in a late-stage Bull Market. It is just that the skies are remaining clear, the jet streams are where they normally run, and to continue the weather analogy, we see no need to pull out any umbrellas or tune into any emergency weather stations. Let's see how this plays into the end of the year. I must say, it looks quite promising.

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