Monthly Commentary

December 18, 2013

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

After most major equity market indexes broke out to annual highs (and even some all-time highs) a month ago, things have quieted down. The last four weeks we have seen Large Cap, Mid Cap and Small Cap Indexes all settle into trading ranges. Although there hasn't been a whole lot of progress in the last month we have to respect the fact that prices of all the domestic major market indexes and most all of the S&P sector indexes are resting above those breakout levels. Additionally, the long-term up trends that have been supporting these indexes remain intact, continue to rise, and are comfortably below current prices. Currently, the path of least resistance for these equity markets appears to be higher.

Eight of the ten S&P industry sectors we follow have participated in these advances and are very near their highs set in mid-November. The strongest performances have been in Health Care, Consumer Discretionary and Industrials. The next tier includes Financials, Consumer Staples and Energy. Basic Materials and Technology have also recently joined the party. Each of these sectors have made advances at different times in the course of the year. For example, the Energy sector started fast in January, then settled into a trading range from February to May before breaking out and advancing steadily the rest of the year. Basic Materials were stuck in a trading range from January to May before breaking out, testing the breakout June, and advancing the last six months. The first six months were very steady and strong for Financials, but they went quietly into a trading range from July to October, only breaking out in mid-November. Two of the ten primary industry sectors we follow, Utilities and Real Estate, are noticeably absent from the party. These are both generally regarded as defensive sectors, so its not too surprising that haven't been participating in what has been a very offensive equity environment. Utilities indexes are slightly higher for the year, but have essentially been contained in a trading range since they sold off with bond markets back in May. Real estate equities also sold off sharply in May and are sitting just under their January prices. We currently own neither of these equity sectors.

Unfortunately, it has generally been an opposite year for bond markets. Only two bond sectors have been steady performers in 2013, Convertibles and High Yield. These two bond sectors have close financial links to equity markets, and accordingly, have been riding on their coattails for much of the year. They were not invulnerable to the general bond market sell-off that occurred from May to July. But their recovery was much more rapid and most of the convertible and high yield indexes were breaking into new high territory in November. The rest of the bond market did not fare so well. This includes Long-term and Mid-Term US Treasuries, Long-term and Mid-Term Investment Grade Corporate Bonds, International and Emerging Market Bonds, Mortgage Bonds, Floating Rate Bonds, and Bank Loans. The worst sell-offs were seen in TIPs and Municipal Bonds.

The good news for equities and the continuing challenge for bonds is that the economic and political conditions that accompanied these performances in 2013 appear to remain firmly in place for 2014. The US economy is still plodding along, slowly improving, slowly adding jobs, and slowly increasing manufacturing. The Federal Reserve has clearly indicated that even when they do begin to back off their Quantitative Easing assistance they expect rates to remain low until markedly lower unemployment numbers are with us. Inflation is not a factor, still under 2%. We haven't had any surprises for so long, positive or negative, that it is difficult to assess their potential impact should they appear.

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Some investors, as well as some advisors, spend an inordinate amount of time attempting to guess what is going to change, and when and how they can anticipate the change. We find that to be quite inefficient and believe that such thinking can handicap full participation, especially in a favorable investment environment. It is like taking galoshes and umbrellas to the beach when there is not a cloud in the sky. By carrying what you don't need, you are less likely to be packing everything that you may need. We prefer to be attentive and responsive. 2013 has been a very good year for equity investors and a discouraging year for bond investors. We do not see anything on the horizon that would affect that scenario, so we plan to continue to enjoy the opportunities in equities and can only counsel patience with bonds. If your patience with bonds is wearing thin, you may wish to reconsider your portfolio's investment style with your advisor.

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