Monthly Commentary

December 20, 2016

SELECTOR Real-Time Money Management

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

In our opinion, there is no better way of investing with confidence than buying breakouts. After months and months of watching equity markets stuck in a trading range, our recent market breakout can be likened to a game-winning 'Hail Mary' pass, or the 20-foot putt on the 18th green, or the biggest fish on the final cast as the sun goes down. And those are just the sporting analogies! Given the number of breakouts that have occurred in the past few weeks, you can rest assured that our confidence could not be higher. And like all great football, golf, and fishing tales of victory, we can't wait to tell you the story!

All good stories start with the set-up and this one is no exception. After closing out a difficult year in 2015, equities opened 2016 with a vicious 10% correction in the first quarter. By the end of the first quarter they had battled back to break even for the year, only to settle into a tight 5% trading range during the second quarter that threatened to break down the last week of June. Once again equities battled back, only to once again find themselves trapped inside another trading range for the next four months, that once again threatened to break down the last week of October into November. Going into Election Week the large cap S&P 500 and the small cap Russell 2000 were each up less than 2% for the whole year and had fallen for nine straight days. It wasn't looking good.

One more time equities fought their way off the ropes, and this time they kept swinging until they completely broke free. Small cap equities were the first to break out, on November 11th, followed by mid cap equities on the 14th, and finally the heavyweight large caps broke out on November 22nd. The major market sectors were quick to break free as well, led by the financials, the transportation stocks, and the industrials. Consumer discretionary and technology sectors joined in. The bull market was finally on the move, and there was no room for laggards!

As much as this was good news for the aggressive segments of the financial markets, it was anything but for defensive sectors. As the breakouts began, those defensive sectors that had been advancing so strongly mid-year, most notably the utilities and real estate sectors, fell totally out of favor. Even worse price action was seen with gold and silver. Last but not least, bond markets found themselves being sacrificed by institutions who couldn't seem to get their hands on enough capital to keep buying and supporting the breakouts in equities. The result was a 'parting of the financial seas' as aggressive and defensive sectors that had both been wallowing in trading ranges throughout 2016 were suddenly polarized and thrust into opposing roles.

International equities once again discovered that they were not invited to the party, and left to their own devices. Their previous issues unresolved by the market gains in the U.S., European equities continued to struggle with their respective identities in a post-Brexit reality. Emerging markets, which had been enjoying a generally prosperous 2016, found themselves at the mercies of profit-takers eager to rotate back into U.S. equity markets. Emerging markets countries fortunate enough to be oil and basic materials exporters have had more stable pricing since the election. However, those countries that are more vulnerable to trade agreements, such as China, have not fared as well.

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The reality for equity investors is that once again the months of November and December have matched their reputation for positive returns. From a seasonality perspective where else, and why, would you ever want to be invested but in U.S. equities? From an election year perspective, once again equity markets have applauded an American presidential election with a successful year-end run. That record should figure out to 15 winners in 17 elections since 1950. From an economic perspective, the U.S. economy continues to expand, which in turn continues to prod along this old bull market. Only a contrarian could be making negative comments at this juncture, and while bearish contrarians tend to make more headlines, they rarely make more money. That being said, the last couple of Januarys have been quite rough on equities. It will be interesting to see what 2017 has in store for us. Merry Christmas, and Happy New Year!

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Sources: Bloomberg, Marketwatch.com, StockCharts.com