Monthly Commentary

January 20, 2015

SELECTOR
Real-Time Money Management

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

Equity markets are experiencing a rather rude introduction to 2015. As of today, we have seen 8 negative days for the S&P 500 versus 4 positive days. Equity markets are now sitting at the same levels that we saw the end of October 2014. That very bumpy December has carried into January and the short-term trend is now neutral as domestic equities are settling into a trading range. The intermediate trend and the long-term trends for most large cap domestic equities remain positive. It is important to remember that even with the increase in volatility, trend trumps all. From a seasonality perspective, this is still considered to be a historically positive period. Accordingly, we are holding steady with managed portfolio allocations.

International equities also dropped initially in January but have since rallied back to price levels near year's end. European equities are roughly -13% under their June 2014 highs and remain under their long term, intermediate term, and short-term downtrends. Emerging markets are near the bottom of a long term trading range and under the influence of a pronounced intermediate-term downtrend. They have been struggling to form a short-term trading bottom over the last four weeks and are also about -13% under their September 2014 highs. In short, the international equity picture continues to be very cloudy, with a moderate chance of more rain showers.

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As seen in previously difficult equity market environments, the domestic bond market is the beneficiary of the uncertainty. And once again, the higher the quality bonds, the better the response. U.S. Government and investment grade bonds are either near the top of their trading range or breaking out of those trading ranges. Municipal bonds continue to demonstrate strong pricing patterns. Problems persist for the high yield bond sector as they continue to trade lower in concert with their equity cousins.

From a sector perspective, the lead actors continue to be real estate, health care, and utilities. These are all classic defensive equity sectors. Consumer staples, another defensive sector, has also been holding up well. Conversely, the industrial, financial, and technology sectors have slumped into short-term trading ranges, even though they were hitting all-time highs the end of December. Basic materials are in a long-term trading range. The weakest equity sector continues to be energy, which is still plowing lower. We continue to watch this sector closely, looking for signs of base-building, but thus far, the price action has been quite weak and it is still too early to reengage.

From a fundamental and political perspective 2015 continues to walk and talk much like 2014. The U.S. economy is still crawling higher. The Federal Reserve is still anticipating very low interest rates. Political gridlock is still evident in Washington, with the President proposing action that Congress will refuse to implement and Congress proposing legislation that the President will not sign into law. Truth be known, historically, domestic equity markets have liked this kind of environment. The wild card is the volatility factor. A look back to see how much progress has been made the past three years can quickly calm those volatility fears.

The biggest news story lately has circled the dramatic drop in the price of oil, and it is good copy for a variety of reasons. It affects everyone who buys gasoline, propane, and heating oil, which pretty much includes everyone who is working for a living. It crosses not just the top, but all of the midsection and almost all of the tax-payers in America. In short, this can be a dramatic ching-ching to the American consumer and the only question is, what will they do with the extra money? Knowing the national savings rate, they most certainly aren't going to save it or pay down debt. Being true red-blooded Americans they will treat it as a windfall and spend it as quickly as possible on stuff. It's the American way. Consumer spending drives 2/3 of the U.S. economy. It should be a win-win. When oil prices stabilize and start to rise, the interpretation of the institutional investor community will undoubtedly be that oil prices are rising because of increased demand which is an indication of an advancing economy which is good for corporate America which is good for equity prices. So to recap, although falling oil prices are disturbing, low oil prices are beneficial, and rising oil prices are promising. Plus it's good headlines. Sounds like a win-win-win. Now the question is when?

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