SELECTOR
Real-Time Money Management

Monthly Commentary

July 21, 2015

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

I saw the movie, Dr. Zhivago, back in 1965. The main thing that I remember was that it ran for over three hours. I fell asleep and woke up two or three times, but I heard that it was good and it did win five Academy Awards. That's pretty much how equity markets have been for the last five months, only this time I have stayed awake for the entire excruciatingly long presentation. And it is not over yet. Over the past month domestic and international equities have rallied from the bottom of their trading ranges back to the top. Greece was the primary motivation for the most recent round trip, the fifth of 2015. It would be nice if we would see some volume, and some passion, reenter these markets. But it looks like Omar Sharif, who played the good doctor, is once again off to the War, or the Revolution, while we continue to wait to see if he ever finds true happiness, and if we ever get back to the business of making money in equities. Yawning again.

Last month I spent a considerable amount of time discussing bond markets and they continue to deserve attention. Domestic bond markets pulled back sharply in May and again in June. The Barclays Aggregate Bond Index is now trading at prices last seen in November of 2014. From those levels it made a very nice four percent run higher. Now, I realize that hardly anyone gets excited about a four percent run, but that's a big deal for the Barclays Aggregate Bond Index. A move of that magnitude is often amplified in other bond sectors, especially in the high yield end of the spectrum. The pullback has affected virtually every bond market sector that we follow and, as a result, prices are lower and yields are higher than we have seen in nine months.

It is even more significant when you consider that this 'bond sale' occurred in the absence of any material news. It was accompanied, however, by two other developments. First, the U.S. Dollar also was involved in a correction after making a fabulous advance the previous nine months. It had broken a downtrend that had pressured the Dollar for years and was definitely in need of a rest after advancing more than 25%. The U.S. Dollar found a base in May, and again in June, and now it is once again moving higher. Historically that has been a positive factor for domestic bonds. Secondly, there were considerable inflows of capital into international equities during the second quarter. That money had to come from somewhere. Domestic equities have been trading range bound since February. In hindsight, it make sense that the outflows from bonds in the second quarter served to fuel the international equity inflows. That can be confirmed to an extent because the bond market pullback was so very broad and structured. Now that international equities have been 'pumped up,' only to be deflated and re-inflated by Greece, it will be interesting to watch the capital flows.

The bottom line on bonds is that they are very cyclical. They do not rise and fall on the promise or disappointment of corporate earnings or economic expansion. They are driven by corporate and government capital requirements, along with investors' thirst for yield. Over the past seven years we have seen corporations' capital requirements become more responsible and restrained, while government capital requirements have grown profusely. It doesn't come close to netting out, but with such low interest rates it does provide for more stability than instability. Investors are very, very thirsty for yield and our current 'bond sale' cannot be ignored for very long. It would be very surprising if bond markets do not rebound in the near future, if only on the basis of the yields that are currently available.

"Yes, the popcorn is cold and the soda has lost its fizz."

As for equity markets, it is much more difficult to predict any sort of timeline other than with the calendar. They are obviously in no hurry to get anywhere right now. Their inability to break higher and out of this protracted trading range is only matched by their unwillingness to break lower. The result is a stalemate of sorts between the Bulls and the Bears. We would like to see improvement in one particular sector, the transportation index. It has been quite weak for several months and a turnaround in the transports could prove to be the catalyst that institutional investors need to once again get excited about equity markets in general. In the meantime, it is just mid-July. We are still a couple of months away from the always-interesting fourth quarter. Yes, the popcorn is cold and the soda has lost its fizz. A good love scene, or battle scene, may be just around the corner. I hope.

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Sources: Bloomberg, Marketwatch.com, StockCharts.com