SELECTOR
Real-Time Money Management

Monthly Commentary

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

An old saying begins, "If it looks like a duck, walks like a duck, and quacks like a duck…" The same can be said for a Bull Market. In spite of an 18-month-long trading range, we are still in a long-term Bull Market that has most recently once again began to look, walk, and talk like it should. It is a very old Bull Market so we probably shouldn't be expecting any backflips or unnecessary chatter. That being said, domestic equity markets have once again been stepping out and we are seeing expansion of market breadth, a very good sign.

Market breadth expansion means that institutional investors are buying more midcap and smallcap equities in addition to large caps. For the past year or so, institutional investors were consolidating their capitalization-weighted investments towards large cap domestic equities. While this defensive action has propped up that sector nicely, it has happened at the expense of midcap and smallcap equities. It is significantly harder to make money in equities when institutional investors are being defensive. Increased money flows into midcap and smallcap equities is an indication of renewed interest in embracing the risk/reward equation.

It is significant that this expansion is taking place in spite of recent negative headlines. Equity markets that are very vulnerable and reactive to headlines tend to be on more shaky ground. On the other hand, equity markets that quickly shrug off negative headlines are more reflective of underlying foundations of strength. A good recent example of this resilience is domestic equities response to the 'Brexit vote' headlines. While international equities fell 10-15% the first day, domestic equities declined by only about 3%, and three days later were trading higher than before the news broke.

This divergence between domestic and international equities holds additional considerations. It was no secret that domestic equities were outperforming international equities prior to the Brexit vote. Post-Brexit, the international equities impacts were compounded, while the domestic equities impact was minimal. Additionally, the S&P 500 Index has since broken higher out of an extended trading range to new all-time highs. Several other domestic equity sectors have also broken higher. Meanwhile, international equities have floundered, which begs the question, if you were an investor, anywhere in the world, would you rather be adding to U.S. equity positions or European equity positions? The markets have shown us the answer.

"If it looks like a duck...."

Institutional investors love strong foundations and the trading range that we have all been 'enduring' for the past eighteen months just may have developed into quite the foundation. Recently we have been seeing the breakout of the S&P 500 Index broaden to other important sectors including midcap domestic equities, technology, basic materials, industrials, consumer discretionary and health care. These sectors are joining the real estate, utilities, and consumer staples, which broke out several weeks ago. Energy and financials are the laggards, but breakouts of eight of the ten S&P sectors is pretty indicative of the primary direction.

The positive price action in equities has not been a negative for bonds, which have held strong. Investment grade, U.S. government, high yield, and municipal bond sectors have been performing quite well year-to-date. Last week municipals bonds took a quick reprieve from their very strong rally, but they quickly recovered this week. Total returns for both equities and bonds are now in positive territory for the year, albeit the numbers are not large. This year we have seen quite the reversals in seasonal trends, with a correction occurring in normally strong January, and now a nice breakout rally in normally quiet Summer months. It was worth the wait.

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Sources: Bloomberg, Marketwatch.com, StockCharts.com