SELECTOR
Real-Time Money Management

Monthly Commentary

June 18, 2014

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

In last month's Commentary we discussed a number of unresolved issues. We had an unnamed Latin dance, a negative divergence on the part of small cap equities, and a real yawner of a trading range for the rest of the equity markets. This month I am happy to report that all three issues are resolved. The name of the dance/market pattern is the Conga (thank you, Laurine, for the remembrance), small cap equities have resolved their divergence and rejoined the flock, and both domestic and international equities markets successfully broke out of that trading range to higher ground.

The trading range breakout began the last of week of May, a very nice run that included eleven positive trading days and only two mildly negative trading days for the S&P 500 Index. This was followed by modest corrective action that gave equities an opportunity to exhale and catch their breath. The gain for the S&P 500 Index during this sprint was a respectable +5%, and it now stands at +6.08% YTD. The S&P 400 Mid Cap Index likewise pushed ahead +6% and is now +6.07% YTD. This positive action pulled the recalcitrant small cap equities back into the black as they put together a 9% rally. The S&P 600 Small Cap Index is now +1.75% YTD. While small cap equities did not break into new high territory, their price action has resolved a number of technical problems that were outstanding. Our patience with small cap equities was rewarded, although they remain on light probation.

International equities were relatively casual about this domestic equities rally, tagging along enough to see new highs, but slipping behind in the YTD race. At this writing the broad MSCI EAFE Index is up +4.21% YTD, while the MSCI Emerging Markets Index is up +5.23% YTD. European equities continue their leadership role with the S&P Europe 350 now up +6.06% YTD. Of particular interest was the move to the upside of the emerging markets equities. This sector has been well-contained by a long-term trading range for the past three years. While this recent break to the upside was marginal, emerging markets have always held the potential for significant advances when they have regained institutional favor. Accordingly, we are closely monitoring this progress.

On the domestic sector front, almost all of the major industrial sectors that we follow are in positive territory. The leading sector YTD continues to be real estate, while the largest advances over the past 30 days have been in energy and technology sectors. The Dow Jones U.S. Real Estate Index is currently up +14.16% YTD. Utilities have also continued to be a leading sector, with the Dow Jones U.S. Utilities Index now up +13.51% YTD. The Dow Jones U.S. Oil & Gas Index is up +11.92% YTD, while the Dow Jones U.S. Technology Index stands +9.28% YTD. The only two negative domestic equity sector indexes are the Dow Jones U.S. Select Investment Services Index, down -0.70%, and the Dow Jones U.S. Select Home Construction Index, down -2.53%, actually a very nice improvement from last month.

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It was interesting that in spite of the strong domestic equity rally the past month, domestic bond markets held relatively firm, with just minor pullbacks. This is encouraging, as the equity market rally did not occur at the expense of bond market investors, which have also been enjoying nice progress through the year. This lack of rotation out of bonds and into equities means the capital to fuel the rally had to come from another source. So where did all of the capital come from to fuel the rally? It has been no secret that institutional investors, as well as corporations, have been sitting on significant amounts of cash and very short-term investments. These investments are pretty darn safe, but have been earning next to nothing. The catalyst required to make the monies move from cash into equity investments was Confidence. This increase in confidence is an outstanding positive indicator. Another source of capital for this rally would be international investors. Earlier in the year they had been primarily buying their own securities, as U.S. equity markets languished in a trading range. When U.S. markets rallied this past month, it was international equities that languished, indicating that money flows were once again being directed to U.S. markets. This is not fickle money and another positive indicator. These factors compel us to remain positive on both international and domestic equity markets, in addition to bond markets. Broadly advancing markets generally have the power to fulfill their own ambitions.

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

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