Monthly Commentary

May 20, 2013

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

There is a rhythm to the S&P 500 thus far in 2013. It is an eight count, with six positive weeks followed by two mild corrective weeks. We are now in the third refrain of this 'Bullish Rumba', with the count on week six. Other equity indexes and equity market sectors have been participating in a variety of levels as the year has progressed. The past two weeks they have all joined together, not unlike the popular 'flash dance' craze when everyone is on the floor at the same time with a magnificent crescendo right before the music stops.

We can't predict, nor do we want to anticipate, the end of the music because it has been an impressive performance thus far. There is a lot of money on the table right now in the equities market, which increases the temptation to lock in profits. The only way to do that is to sell, and this year equity markets have been quite unkind to sellers who take their profits only to watch markets continue their advance. This equity market has been equally challenging for buyers. They would like to get on the dance floor, but prefer to step onto the floor during a slow dance, such as a market slowdown or a correction/ pullback.

There are a number of positive technical developments in place for equities. Several sectors had very nice breakouts above resistance levels the past couple of weeks. Most of those breakouts have not been 'tested' with a pullback in prices to those breakout levels. There should be a host of impatient buyers when those tests occur, which should keep the pullbacks brief. These impatient buyers are an interesting force. Normally, financial markets reward the patient and punish the impatient. But impatience is infectious. The fear of missing an opportunity can drive money into pricier positions with greater execution risk. We can see this in a lottery such as Powerball, where ticket sales increase exponentially as the pot goes higher, even against ever-increasing odds. Fortunately, equity markets do not operate like a lottery, where there are a handful of winners and millions of losers.

Bond market performance was handicapped in May as we witnessed heavy rotation out of bonds and into equities. Most bond sectors are now essentially flat for the year. Even the intermediate-term high quality bond and TIPs sectors experienced significant price setbacks in May. The exceptions have been the high yield and the convertible bond sectors, who have followed their equity cousins higher. With little to no changes in interest rates this is clearly an institutional rotation towards the higher performing equity markets. This goes to show you that even conservative institutional investors will occasionally try to crash the party. The biggest losers this year have been gold and silver. Gold is down over 20%, and silver down over 30% YTD.

Financial markets consistently seek to challenge investors who are not disciplined. Typically, they are quick to point fingers at those investors who lack effective Sell disciplines. This year they have been making life difficult for investors who do not have effective Buy disciplines. They increase the temptations to chase returns, to change one's investment approach in order to accommodate higher risk, and to focus more on the short-term rather than the long-term investment horizon.

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At SELECTOR® we appreciate the positive momentum that equity markets have been demonstrating, but we are not intoxicated by it. More importantly, we continue to keep close watch on our proprietary trend reversal indicators, which increase in value the higher that markets climb. At this writing, we are getting green lights across the board for equities. That will change eventually and we will respond accordingly. In the meantime, let the good times roll, and keep the exits clear.

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Sources: Bloomberg, iShares.com, Marketwatch.com, Stock Trader's Almanac 2012, StockCharts.com.