Monthly Commentary

May 18, 2017

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

Exactly one month ago equity markets were negotiating their way through a mild correction. The S&P 500 had declined by -3.25% from recent highs. From the April 13th low of 2328.95, the S&P rallied back +3.3% over the next four weeks. The table was set once again for a continuation of what has developed into a fairly productive year. Trading ranges and uptrends were the predominant feature presented on technical charts. Then, yesterday, May 17th, equity markets hit a significant pocket of 'clear air turbulence' which took most major market indexes lower by -2%. Clear air turbulence is generally associated with commercial airline travel. It is a significantly unpleasant, albeit rare occurrence, that can ruin an otherwise smooth ride. The reality is that clear air turbulence isn't the airplane's fault, nor is it the pilots' fault. Clear air turbulence is a reality of modern air travel, where we can travel very high and very fast, and cannot clearly distinguish the boundaries of jet streams. Yet we still fly. At least most of us do. For some, flying is intolerable. For others, one turbulent flight is more than enough and nothing will get them back into the 'unfriendly skies.'

The same can hold true for investors who experience sudden, unexpected jolts in the financial marketplace. It can have a solid emotional impact, especially when the news report is being exacerbated by the press. The good news is that to my knowledge, a sudden jolt in financial markets has never crashed a diversified investment portfolio. Domestic equity markets appear to have already begun their recovery following yesterday's decline. That decline occurred near the top of a trading range that has been forming since March. Only a few sectors saw their trading range support affected by the decline. Many equity sectors had recently broken out of trading ranges and were already cruising on well-established uptrends. These sectors also had ample room to absorb the effects of a 2% decline.

It may take several days before there is a complete stabilization. It would also not be surprising if the institutional investors, who were the primary culprits, took their time as they continue to rebalance and redistribute portfolio gains seen thus far this year. Because we have just completed a mild correction, it would be surprising if we entered immediately into another correction. This is especially true in light of the very successful earnings quarter just completed and the absence of negative financial market-relative news.

International equity markets, many of whom were already closed as the U.S. markets slid yesterday afternoon, are lower today, as would be expected. The trouble with being in significantly different time zones, as well as being first to open and first to close, is that you are always working to catch up. The good news for international equities is that their very strong recent price had already propelled them much higher, and they had much thicker price buffers to weather this storm.

Once again, bond markets played their part quite well. Investment grade corporate, U.S. government, and municipal bond sectors saw comfortable advances during the sell-off. High yield bonds were flat to slightly lower. Other bond-sensitive equity sectors such as utilities and real estate also held up very well. This price action echoes the action seen during the mild correction a month ago by these sectors. It also is a telltale sign that institutional investors are merely rebalancing portfolios as opposed to wholesale dumping of equities. My interpretation at this juncture is that yesterday was just a summer rain shower, clear air turbulence, a brief but unpleasant surprise. This parade is still going to complete the route. We just have to wait a little while longer.

Edward D. Foy
Manager, SELECTOR Money Management
www.foyfinancial.com, Ed@foyfinancial.com
(800) 456-4380

©2017 Edward D. Foy

Sources: Bloomberg, Marketwatch.com, StockCharts.com, Stock Traders Almanac