Rochester Financial Services

Fee-Only® Financial Management Services

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Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
16,205	1,880	4,363	986	1.85%	6.38%	$1,174	$31.00

Investment Strategy Report

Correction Comes Down Hard on Tech Stocks

This past Friday was a particularly scary day for the stock market. The broad US stock market, as measured by the S&P 500, dropped by 1.85%. While a bad day for sure, given the volatility that we have been subjected to as of late, it was nothing that unexpected. However, the tech heavy Nasdaq fell a much larger 3.25%. And to make matters worse, there were stocks that got absolutely obliterated. LinkedIn, which operates an online professional network, dropped 44% on that one day, and Tableau Software, a business software provider dropped 49%. Even more well established companies such as Facebook and Amazon fell a substantial 6%. Amazon, which had been trading at $635 per share just a little over a week ago, closed on Friday at $502 following last week's disappointing earnings report. However, Facebook had a stellar earnings report on Jan. 28th and saw its stock price surge to $115 last week. But the wave of selling sent its shares down to $104. And Google's (now called Alphabet) performance might have been the most disappointing. It reported much better than expected results on Tuesday and saw its stock price surge to $790. But just 3 days later, its price had plunged to $684.

We began 2016 with hope and anticipation of a better year for stocks. Instead, we have gotten nothing close to that, as fear has taken hold and stock markets across the globe have been suffering. So what is happening? Some have described this market turmoil as a rolling correction. First it was only the oil and energy companies that got hit, with declining oil prices decimating their earnings. Then the financials, both because they have some exposure to the energy sector and because their business has been adversely effected by low interest rates, which makes it more difficult for them to be profitable. Now it is time for the technology companies, last year's high fliers, to be brought down to earth.

The question that then arises is that now that last year's winners have finally been taken down, is that it for the correction? Has the sell off been completed and can we get back now to a more normal market?

In today's Barrons, there is a quote from Citigroup's Tobias Levkovich in which he addresses market sentiment. According to his analysis, market pessimism hasn't gotten so extreme (which because of its contrarian nature is a positive sign) that there is a 95% probability that the S&P 500 will be higher in 12 months. Jason Goepfert of Sentimentrader.com reached a similar conclusion based on his research, saying that the current behavior of the Nasdaq almost always signals a market bottom. However, he did go on to say that if the markets could not rally in the next 3 days, then our current correction could get worse.

There seems to be a consensus among fundamental analysts that our economy is not doing too badly. In Bob Brinker's newsletter of Feb. 1st he states that "We do not anticipate a recession in the US economy this year. Therefore, we do not expect a bear market decline in excess of 20% to materialize. As a result, we are looking for a potential correction related buying opportunity in the event our indicators identify a successful correction testing process".

Dr. David Kelly, JP Morgan Chief Global Market Strategist, agrees that there are no signs of a recession in the US. He emphasizes that earnings suffered in 2015 because of the strong dollar. If the dollar stabilizes in 2016, as has been happening thus far, this will remove a headwind from last year and we should see close to 10% earnings growth this year. With a P/E ratio of around 15, the market is looking cheap.

However, Dr. Steve Sjuggerud of Stansberry Research has gotten cautious recently. In his February issue of TrueWealth, he says that "Stocks have started out 2016 terribly. We're now on the verge of testing August's lows, and if stocks fall below those lows, a lot of hope will be lost. I don't think that the great bull market is over yet, but I can't tell the market what to do either. The safe play is to close out your trades that hit their stops and see what unfolds from the safety of the sidelines". As I mentioned in my email to you early in January, I have begun to pare back in our portfolios, getting more defensive as the markets have turned sour. If the situation doesn't improve soon and key support levels are broken, I will continue the process.

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