Rochester Financial Services

Fee-Only® Financial Management Services

Jeffrey Feldman Ph.D., CFP
Certified Financial Planner
Principal

February 5, 2013 (2 pm)	Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
	13,998	1,512	3,171	908	2.01%	7.02%	$1,670	$96.74

Investment Strategy Report

Stocks Breakout in 2013, Nearing Record Highs

As we approached 2013, most investors thought that the stock market was due for a pause, either because our politicians were going to screw things up with the impending fiscal cliff, or because after a strong 2012, stocks needed to catch their breadth. As so often is the case, investors got it wrong as stocks have continued to move higher in the new year. It's only Feb. 5th and already the Dow is up year-to-date almost 900 points. It is the contrarian nature of stock prices that confounds most people. When you dwell on the daily headlines of the world's problems and the financial ineptitude of our politicians, you miss the fundamental reason of what drives stock prices higher - earnings. And as the economy recovers and earnings increase, prices will be driven higher.

Of course, part of me hesitates to make my previous statements because I find myself falling into a sense of complacency. And as is also part of the contrarian nature of the stock market, when investors let down their guard, feel comfortable ignoring the headlines, and resign themselves to the fact that they were wrong to listen to all the chicken little pundits, that is when the stock market wakes us up with a panicky decline that reminds us that yes, things can go wrong. This occurred yesterday when the Dow dropped 130 points, its first triple digit decline of the year. The cause for yesterday's concern - what else but Europe.

However, there is and has been less concern about Europe for quite a while now, mostly because of Fed Chariman Bernanke's counterpart in Europe, European Central Bank President Mario Draghi. Both men have shown that they are willing to do whatever it takes to get past the recent financial crises. My favorite analyst, Steve Sjuggerud of StansberryResearch.com, has been saying for years now that stocks will do well because of an asset bubble that is being created by the money printing of central banks. The fuel of money printing will cause asset price inflation, pushing all asset prices higher. Eventually the bubble will have to burst, he says, and rising inflation will have to be stopped with the Fed withdrawing this stimulus. But until then, he recommends that investors take advantage of the situation.

Sjuggerud also addresses a common concern investors have, that with the major indexes now approaching record highs last seen in October 2007 and March 2000, we may now face the same fate experienced both those times - stock market crashes that saw declines of over 50%. He thinks that as long as the Fed employs its policy of accommodation, asset prices can move much higher. Only when the Fed begins raising interest rates, which would be in response to inflation getting out of control and/or surging economic growth leading to a substantial lowering of the unemployment rate, will we need to begin to get defensive. And neither of those events is expected to occur any time soon.

Which brings us to the topic of bond funds and rising interest rates. Probably the most often asked question I have gotten this year is about bond funds and aren't we going to lose money in these funds this year because interest rates have no where to go but up. The simple answer to this question is "yes". Since Jan. 1st, the yield on the 10 year Treasury has risen from 1.76% to 2.01%. This has caused "traditional" bond funds to experience significant losses. For example, the Vanguard Intermediate Term Bond Index and Long Term Bond index funds are year-to-date down 0.73% and 2.43%, respectively. However, the four bond funds that I am currently using for our portfolios are up an average of 1.2% thus far. As I have explained previously, I am using a barbell approach. On one side, there are actively managed, lower risk "traditional funds" and on the other side, more moderate risk less traditional funds, that tend to balance each other out. So yes, I am aware of the potential risks that we face this year and will continue to actively monitor the situation. *Jeff Feldman*

Tel: 585 / 442-7580
Fax: 585 / 351-2458
Email: jmfeld@aol.com

7 Hastings Circle, Pittsford, NY 14534
http://www.rochesterfinancial.com

Fee Only ™