

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
17,949	2,103	4,863	1,157	1.46%	5.87%	\$1,345	\$49.28



Investment Strategy Report

Brexit Vote Leads to Early Fireworks

Britain's vote on June 23rd to leave the European Union was a surprise to just about everyone, and the stock market doesn't like surprises. During the 4 trading days leading up to the referendum, the S&P 500 rose 2% in anticipation of a "remain" vote. After all, British odds makers were projecting an 80% chance of "remain" although polling had it quite a bit closer. Following the surprise "exit" decision, investors decided to sell first and ask questions later.

The selling bloodbath was most pronounced in Europe. Beginning in Britain, the FTSE market on Friday June 24th, dropped "only" about 3%. However, for an American investing US dollars in a fund that invests in Britain (EWU), you would have to include the effect of a 9% drop in the value of the pound vs. the US dollar. The total loss for the day: 12%! The rest of Europe saw worse percentage drops but lower currency losses. A fund that invests in Europe, Vanguard Europe (VEURX), lost 10.6% that day. Not good for a 1 day result.

Thankfully, our portfolios have very little exposure to Europe, which is only a small consolation to the fact that the US markets dropped 3.6% that Friday, with the Dow experiencing a 611 point drop, the 8th largest one day loss on record. The selling continued the following Monday, June 27th, as the Dow fell another 260 points, completing a 870 point 2-day drop.

Of course we now know that following that 2 day disaster, stocks have staged a ferocious recovery, with the Dow regaining 809 points from Tues. thru Friday of last week. In other words, much ado about nothing, as stocks stand at just about where they were right before the vote.

The S&P 500 now sits above 2,100, only about 1.5% away from an all time high. We have been above 2,100 several times before, beginning in May 2015, then in July, November, April, June, and now this past Friday, July 1st. Every time before now it would have been prudent to take profits at this point, as the market was not able to hold onto its gains. Will this time prove to be different? Will the S&P be able to punch through the all time record of 2,135 and move higher? Or will fears of a collapse of the European Union, with a domino effect causing other countries to leave the Eurozone, torpedo the world's stock markets. My answer is that I think that stocks can move higher this time for a variety of reasons.

To begin with, the Brexit contagion fears are overblown mainly because it is now apparent that Britain's decision will be very negative for that country. Jobs will be lost in Britain and growth will slow. Other countries contemplating an exit should now be persuaded against it. Plus, for a country such as Italy, that is also part of the Euro currency union, an exit would be much more difficult to manage. Bondholders of Italian debt would not want to be paid back in devalued lira if Italy were to leave.

Another factor to consider is that time is on the side of the bulls. The S&P hit its record high in May 2015, 14 months ago. Since then, corporate earnings have continued to grow while stock prices have not. Increased earnings will put upward pressure on prices. For those of you who are frustrated with the absence of stock gains in the last 14 months, you need to put this into perspective. From March 2009 to May 2015, stock prices tripled. Stock prices don't always go up. The fact that the market has gone sideways recently should be seen as a victory, that stocks have been able to keep their gains without giving them back.

One of the reasons why stocks went nowhere in 2015 was because they faced strong headwinds. Oil prices cratered last year and energy company profits collapsed, bringing down corporate earnings. In addition, the strong dollar made it harder for large multinationals to export. Thus far in 2016, we have seen oil prices stabilize, recovering from a low of \$26 a barrel back in January to its current price of \$49. Plus, the dollar has weakened by about 5% this year. These changes should shift the balance back in the favor of increased corporate profits. Add to these benefits the fact that the 10 year Treasury yield has plummeted from 2.27% at the beginning of the year, to its current yield of 1.46%. Lower interest rates will enable companies to invest more profitably in their businesses. *Jeff Feldman*

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