Rochester Financial Services

Fee-Only Financial Management Services*

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

March 8, 2015

Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
17,857	2,071	4,927	1,218	2.24%	6.28%	$1,164	$51.47

Investment Strategy Report

Stocks, Bonds Falter On Strong Jobs Report: Another Market Turning Point?

Stocks entered February like a lion and continued higher throughout the month. A dismal January was forgotten and the stock indexes hit several all time highs, culminating in the highest close ever for the S&P 500 of 2,117 just last Monday, March 2nd. Bonds, however, were a completely different story. At the same time that stocks were reversing higher in February, bonds reversed lower as investors left the safety of bonds and poured money back into stocks. Bond yields rose throughout the month, climbing from the end of January low of 1.67% to end February at a yield of 2.00%.

This inverse relationship between bonds and stocks is often expected. As the economy improves and interest rates rise, stocks do well but bonds come under pressure. For balanced investors, this can produce smoother returns as the two sectors tend to offset each other. However, this all changed this past Friday, albeit only for one day thus far, as a strong February non-farm payroll report caused both stocks and bonds to suffer large losses.

On the surface it appears that Friday's report was good news. Despite what seems to be the coldest winter ever, the number of jobs created in February exceeded the most optimistic of forecasts, with 295,000 new jobs added and the unemployment rate dropping to 5.5%. Continued strong growth for the economy should have been cheered by Wall Street. However, by the end of the day, stock indexes had dropped on the order of 1.5% and the 10 year Treasury lost almost 1%.

The latter result might have been expected as stronger than expected economic growth should lead to higher bond yields. However, stocks dropped despite the good news, seemingly because investors fear that strong growth will force the Fed to raise rates sooner than expected, thus withdrawing economic stimulus from the markets.

Hence the question about whether we have arrived at a turning point for the markets. Are we now in an environment in which good economic news is bad for both stocks and bonds? Have interest rates truly bottomed and will we now be experiencing the long awaited rise in bond yields? Has the bull market for stocks, in which we have seen prices seem to levitate higher for 6 years now, run its course? My answer: Don't count on it.

1) Bond Yields - It was only about 2 months ago that the top bond fund manager in the country, Jeff Gundlach, predicted a decline in interest rates and stated that the yield on the 10 year Treasury could possibly fall to 1%. With the yield backed up now to 2.24%, has he gotten it totally wrong? Are yields going to rise instead of fall? I'm going to say no. The major reason that rates should remain stable is that yields in Europe remain incredibly low. On Friday, the yield on the 10 year German bund "jumped" from 0.34% to 0.39%! Many European bonds with maturities of less than 5 years have negative yields!, meaning that investors have to pay to invest their money. It seems that European investors would be foolish not to invest in US bonds, not only to obtain substantially higher yields, but because the strengthening dollar would give them added returns. This off shore buying pressure should serve to keep a lid on US yields.

2) Stock Market - Good economic news is good economic news. Very simple. People have complained for years that the current economic recovery is very tepid and the weakest since the Great Depression. Well, the economy is gaining momentum. I've said many times in the past year that as long as employment growth is strong, the stock market should do well. Even with the recent rise in interest rates, they are still historically at extremely low levels. A modest increase would still leave us with very accommodative rates. A stabilization now would be even more favorable for stocks.

Were Friday's losses just a one day phenomenon? My guess is that if not, it will only be a temporary set back. Longer term, we're still looking good. *Jeff Feldman*

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

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