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
16,401	1,868	4,081	1,108	2.59%	6.21%	$1,308	$99.93

Investment Strategy Report

Bonds Continue to Grind Higher as Stocks Hit Resistance

2014 was not supposed to be a good year for bonds. Quite the opposite. With interest rates rising in 2013, everyone expected the trend to continue. Last year, the yield on the 10 year Treasury rose from 1.7% early on, to 3.0% to close out the year. And of course rising rates led to bond losses. The question for 2014 was supposed to be how can we minimize losses in bonds and how high would interest rates climb. Most estimates were for the 10 year Treasury yield to move higher to somewhere between 3.25% to 3.75%, and the objective would therefore be to choose those bonds that would hold up the best in this adverse environment. In fact, many analysts were advising their clients to avoid bonds altogether. Why invest in a losing investment class, with such low yields, when you could invest in stocks that were in an uptrend and were likely to produce a far greater return?

As often is the case, the reality this year has been nothing like what was predicted. The yield on the 10 year Treasury has seen a substantial decline to its current level of 2.59%. Falling rates have pushed up prices of all types of bonds and bond funds, what I call both traditional and non-traditional funds. Already during the first 4 months of this year, out bond funds are up about 4% on average, basically matching the return of our bond portfolio for all of 2013.

And what about stocks? Let's just say that we have not seen a continuation of last year's stellar performance. While the S&P is up about 1.5% year to date, we have seen a sharp uptick in volatility. In January we saw a sharp sell off, while in February we recouped all the losses and then some. March and April were mostly a roller coaster ride with the averages ending up about where they started. The S&P 500 has made 3 attempts on the 1900 area, only to be turned back each time. In last month's letter, I talked about how, following a favorable jobs report, the market made a new all time high only to reverse lower and experience significant losses. This past Friday we had an even better jobs report, with close to 300,000 new jobs added and the jobless rate falling to 6.3%, a huge drop from the previous month's 6.7% rate.

The market's reaction to this good news? Two lackluster trading days followed by a significant decline today. It appears that stocks have thus far been spending 2014 in consolidation mode. The two consecutive favorable jobs reports were not enough to get the S&P 500 past 1900, which appears to be a resistance level. However, each time the market has sold off, it has turned out to be a buying opportunity. After all, in the face of good economic news, it's hard to keep a good market down. The consensus view is that now that the bad weather from this winter is over, the economy has the potential to pick up steam and resume its steady uptrend.

Of course you're all probably thinking that I'm avoiding the 800 pound gorilla in eastern Europe. We all know that geopolitical events can negate any positive economic developments. The escalating tension between Russia and the Ukraine can very well be what's keeping a lid on stock prices. It can also be the reason why interest rates of US Treasurys continue to trend lower, as the flight to quality has investors turning to super safe investments.

Another reason for investors to be nervous now is that we are seeing a continuation of a trend that I talked about last month, in which growth and small cap stocks are lagging and the larger more value oriented stocks are holding up better. Most of the damage has been inflicted upon high flying stocks with minimal earnings, as today's 18% drop in Twitter exemplifies. As long as this trend does not spread to the rest of the market, I think that we will be OK. The strong jobs numbers we've been seeing should be enough to help support the market. *Jeff Feldman*

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