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
17,924	2,088	4,946	1,226	2.18%	5.98%	$1,182	$58.92

Investment Strategy Report

Stocks and Bonds Retreat in May, As The "Sell in May" Strategy is Looking Better

Every time an important economic data report is released, the press has a way of elevating the importance of the new data by saying that "this is a critical jobs report, or critical earnings season," etc. It's only in hindsight that we realize that it was just another data point in the long list of data points used to discern the direction of the economy and financial markets. Having said that, it looks like today is shaping up to be an important day in the US and global stock, bond, and currency markets. And then adding in tomorrow's April non-farm payrolls report, we might have a lot more information by tomorrow morning on the prospects for the various financial indexes.

As I write (2:30 pm, Thursday), stocks and bonds have just been through a few days of volatility. Just 3 days ago, this past Monday 5/4, the S&P closed just 3 points shy of an all time record. But the index dropped 1.25% on Tuesday, 0.5% yesterday, and about 0.8% in pre-market futures trading this morning. The selling seemed due in part to a statement made yesterday by Fed Chairman Janet Yellen which implied that stocks might be overvalued. But probably the real mover that caused a good deal of concern among investors (Fed Chairmen don't have a good track record on market timing) was the spike higher in interest rates. Investors have been sitting on pins and needles for years now, anticipating the time when interest rates would begin to rise. 2015 began with the 10 year Treasury yielding 2.17%. Three weeks ago on April 17th, the yield had dropped to 1.85%. By this past Monday, the yield had quickly risen to 2.13%. On Tuesday, the yield jumped to 2.18%, then 2.24% yesterday and 2.30% by this morning. Even more disconcerting was that yields on European bonds, which were driving US interest rates lower, had surged in recent weeks. The 10 year German Bund yield, which had bottomed at 0.04% a few weeks ago, had spiked almost 20-fold to a yield of 0.72%. While still extremely low, the amount and the speed of the increase was quite remarkable (the yield has since dropped to 0.58%).

So the table was set. Fear was riding high with rates rising and stock prices falling. And the markets appeared to be ready for another sell-off today. While stock prices would still be only about 2.5% off their highs, it seemed like the sell in May crowd had gotten it right and the long awaited correction was underway.

However, stocks recovered this morning, and by the opening, they had clawed their way back to neutrality. And now, 5 hours later, they are solidly in the black (up about 0.5%). The 10 year Treasury has also seen a dramatic recovery, with its yield down now to 2.17%.

As I have often said before, this does not sound the all clear signal. An ill-received jobs report tomorrow can throw everything off (I would assume that a strong jobs report would be good news, but you never know). Stocks and bonds were oversold before today and today's recovery could just be a one day rebound. Another concern shared by many investors is that stocks are currently overvalued, which they feel will put more downward pressure on prices. But as Warren Buffett said this past Monday, if you think that interest rates will stay low for the foreseeable future, then stocks are cheap. If you think that rates are due for a significant increase, then stocks can be seen as expensive. But it will always be the case that buying good businesses at good prices makes sense. He also said that it's all about relative value, and that right now, stocks are cheaper than bonds. And unless this changes, I would expect that money will continue to flow to where it's treated best, into stocks.

I Will Be Out of the Office - on Monday, May 18th, for a hopefully minor surgical procedure. Assuming that all goes well, I'll be back in action shortly thereafter. *Jeff Feldman*

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