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
15,594	1,747	3,857	1,079	2.61%	6.67%	$1,307	$94.29

Investment Strategy Report

Markets Overcome October's Hurdles to Hit New Highs. Another Fork in the Road?

October turned out to be a pretty remarkable month for the US financial markets. Considering that we experienced a government shutdown and that we came within a few hours of a US default, the fact that US stocks hit another all time high is hard to believe. While in my letter to you last month, I did state that "Three months from now, it is quite likely that the world will not have ended and the budget battles will have been resolved", I must admit that living through the experience was a little more nerve racking than I might have let on. As I said to many of you who called me prior to the resolution in Washington, the stock market is probably the best forecaster of future events. And during October, the market was telling us that our worst fears were probably not going to materialize. This powerful market momentum has continued through the latter part of October and into November.

That is until today. Today's trading was a bit disconcerting. The markets began the day near the flat line until news came from Europe that the European Central Bank had made a surprise 0.25% cut in their benchmark interest rate. That move sparked a rally in European markets that spread over here. The Dow opened the day up 52 points, hitting a high of 15,798. However, by 10:30 am this morning, the index went negative and then continued its slide, ending the day down 153 points, a 205 point reversal. Intraday reversals are never good, but they are especially worrisome now that stocks have basically levitated higher over the past 2 months. Another point of concern is that market sentiment, as measured by Jason Goepfert of Sentimentrader.com, has, as of yesterday, reached a new intermediate term high in investor complacency. High complacency is a negative from a contrarian viewpoint. When everyone is feeling good about the stock market, that's a warning sign.

Tomorrow could very well be another volatile day for the markets. The October non-farm payroll report comes out at 8:30 am. This number is looked to as a key indicator of the health of the economy and usually has a significant impact on the market. So we now have a situation where a) stocks have just reached all time highs, b) investors have been chasing stocks higher as the market continues to climb, and c) today, we have seen the first crack in the foundation as stocks reversed lower on a day of positive news. In addition, over the past 2 weeks, we have seen momentum stocks like small caps, begin to underperform the market.

While I have set up a fairly negative picture here, another thing to keep in mind that is after basically just one negative day for the market, fear has ratcheted up significantly. Analysts on CNBC tonight are now talking about how much of a correction we are in store for. Nothing fundamental has changed in the last few days or weeks. The only difference now is that stocks have gotten a little cheaper and may get even less expensive in the days ahead. On Oct. 31st, Jeff Clark of Stansberry Research wrote that stocks were over bought. They were stretched to the upside and were due for a pull back. They are now down 0.5% since then. Are they headed for a major correction?

Steve Sjuggerud (also of Stansberry Research) doesn't think so. Or at least his long term view of a market uptrend remains intact. On Nov. 4th, he wrote that we are in the 6th inning of this bull market. Interest rates are still at 0% and people are still scared (despite what the short term sentiment indicators say). He also feels that global markets are about 1 to 2 years behind the US market and therefore have more room to run on the upside.

In the short term, the market is definitely ripe for some sort of a pull back. However, our strategy of using bond funds to cushion any declines should help us weather any short term corrections. For the year, our bond funds are averaging about a 4% return. While this may seem low compared to what the stock market has returned this year, keep in mind that most bond index funds (you can go to Vanguard.com to see their bond funds' performance) are in negative territory for the year. And on days like today, I feel better knowing that we have some downside protection in place. *Jeff Feldman*

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