Rochester Financial Services

Fee-Only® Financial Management Services

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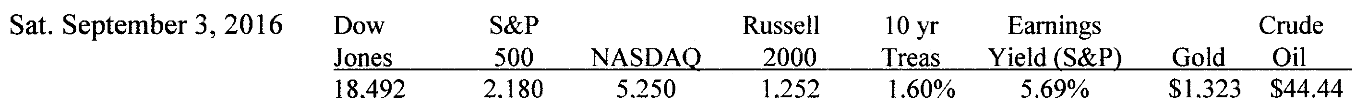

Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
18,492	2,180	5,250	1,252	1.60%	5.69%	$1,323	$44.44

Investment Strategy Report

Summer Doldrums Hit Stocks in August

For those of you who took the month of August off, you didn't miss much (and you must have a good financial advisor!). The S&P 500 and the Dow Jones were basically unchanged, moving lower by less then 0.2%. It was only in the more aggressive, higher growth indexes like the Nasdaq (up 1.0%) and the small cap Russell 2000 (up 1.6%) that experienced any significant gains. This is good news for investors since a) the large gains of July were kept largely intact and b) the higher growth areas of the market continued to outperform. As I mentioned in last month's letter, when the more aggressive sectors outpace the broader market, it is a sign that the bull market might have more room to run.

This sideways market got a boost yesterday (Friday 9/2) from a favorable August non-farm payrolls report. The data showed that only 151,000 jobs were created in August, less than the 180,000 jobs expected. This turned out to be a Goldilocks number, not too hot and not too cold. A strong (high) number is always a positive since it indicates a healthy economy with more people employed. However, the Federal Reserve has been indicating recently that while they remain data dependent, they are anxious to resume raising short term interest rates, trying to get rates to a more historically average range.

While 151,000 new jobs added last month is still a solid number, since it was less than expected, it is probably low enough to keep the Fed on hold, probably until December. So investors got exactly what they wanted – an improved job picture and a Fed that won't be taking the punch bowl away from the party.

Investors have good reason to be wary of an overly restrictive Fed, since an increase in interest rates in the US would be counter to what central banks around the world are doing. Rates in Europe and Japan have been pushed down to zero and even lower, resulting in a large disparity between rates here and abroad. This has served to strengthen the dollar and make it more difficult for US multi-national corporations to compete. Higher rates would also result in a less accommodative Fed policy at a time when economic growth here in the US is somewhat shaky.

Real GDP growth in the first half of this year has been approximately an anemic 1%. While forecasts for second half GDP look to be closer to 3%, there are no guarantees. GDP forecasts in previous years have been consistently revised downwards. It would be discouraging to see a continuing economic recovery stifled by a trigger happy Fed.

The fundamentals of our economy seem to be pointing to higher prices for stocks. Earnings have been coming in better than expected, which is probably the major reason why the stock market has been doing well. And this trend of better than expected earnings should continue when the third quarter results are reported. Compared to this time last year, when low energy prices and a strong dollar were pressuring corporate profits, favorable year over year comparisons should continue to propel stocks higher.

Many analysts fear that this era of central bank monetary stimulus will come with a cost, and that a day of reckoning will come one day soon. The traditional belief that low rates will cause consumers to borrow and spend more is not proving correct, as those planning for their retirement have begun to realize that with rates as such low levels, they will need to save more for their future needs. The advent of negative interest rates for the first time in history seems to be an unnatural situation, one in which artificial bubbles will be created. We seem to be OK in the short term, with an economic recovery continuing throughout the world. But longer term, we need to have our safety nets in place for whatever may come our way.
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