

Rochester Financial Services

Fee-Only® Financial Management Services

Jeffrey Feldman Ph.D., CFP
Certified Financial Planner

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Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Crude Oil	Gold
10,448	1,105	2,234	643	2.71%	7.24	\$74.35	\$1,249

Principal



Investment Strategy Report

Investing in a Schizophrenic Market

Professional investors describe the stock market's performance the last few months as moving in a trading range. Everyone else is pulling their hair out, finding it impossible to figure out. After gaining about 6.5% for the first 4 months of the year, the stock market dropped 8.3% in May and 5.3% in June. It then rose 6.9% in July but fell 4.8% in August. And for the first 3 trading days of September, the market is up around 5%. If you had known ahead of time that the market would be bumping up and down in a range all summer, you could have made a lot of money by "buying the dips and selling the rips", as they say on CNBC's Fast Money. But that is of course much easier said than done. Back in early July, when the recovery was rapidly losing steam and employment and housing data were deteriorating, it would have been difficult to ignore the warnings and buy in time for the July rally. It would have been just as hard in early August to take profits and determine that the July rally was just a dead cat bounce and we were due for another market drop. And finally, you have to give credit to those who only a few days ago, didn't listen to the market pundits who were saying that the odds of a double dip recession were growing and more pain was ahead for investors.

In addition to the economists and analysts who pore over the economic data, there is also the "underworld" of market technicians who analyze chart patterns and try to prognosticate the future. In mid August, the ominous "Hindenburg Omen" flashed several warning signs. While it is a somewhat obscure technical indicator having to do with new stock highs vs. lows, its triggering has in the past raised the probability of a stock market crash or severe downturn. This signal together with an economy that has slowed substantially in the past few months definitely gave investors pause.

However, the general consensus of the analysts I follow has begun to turn more upbeat. One observation has been that while this has been the worst of times for consumers burdened with debt, it is the best of times for corporations flush with cash. Companies like Microsoft, Cisco, and Intel have P/E ratios of only 8 if you subtract out the cash on their balance sheets. One indicator of global economic health, the price of copper, has been rising and is back near the highs reached back in April. This week, China's Purchasing Manager's Index came in at a 4 month high, the US Institute for Supply Management index was higher than expected, and today's employment numbers were better than expected. We are in an environment in which investor sentiment has been very negative and the money leaving stock mutual funds has reached an extreme level. This is bullish from a contrarian standpoint. While I'm feeling that market is looking better, I recall that I said the same thing last month before stocks dropped 7%. So now is not the time to sound the all clear signal. But it is also not the time to hunker down in a fallout shelter. Problems still exist and only time will tell how they get resolved.

Interest Rate Concerns - For at least a year now, we have been warned that 1) interests will begin to move higher at some point and 2) this will wreck havoc on bonds and bond funds since existing fixed income investments will lose value if rates move higher. The rationale is fairly straightforward. With our government having to borrow over a \$1 trillion year for the foreseeable future, inflation and rising interest rates are a given. Back in April, when the yield on the 10 year Treasury hit 3.99% from year ago rates of 3.3%, it seemed that the inevitable rise was beginning with no end in site. Instead, rates peaked at that point and have done the opposite, falling precipitously to a low of 2.48% on Aug. 31st. Therefore, bonds and bond funds have had a great year thus far, while those betting on (or protecting against) rising rates have suffered. Our strategy of mitigating portfolio risk by increasing allocations to bond funds has paid off nicely for us this year as stocks have languished. However, the one fund I have used as a hedge (or insurance) against rising rates, the Yieldquest Total Return Bond fund, has suffered. But since Sept. 1st, we have seen the 10 year Treasury yield begin to back up to today's 2.71%. And while most bond funds have suffered, the Yieldquest fund has done very well. So thanks for your patience with this fund and I will continue to keep a close eye on the interest rate situation and its effect on our funds. *Jeff Feldman*

Tel: 585 / 442-7580
Fax: 585 / 473-9947
Email: jmfeld@aol.com

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



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