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
21,006	2,383	5,871	1,394	2.49%	5.46%	$1,235	$53.20

Investment Strategy Report

Stocks Pierce Another Milestone As Dow Hits 21,000

For those of you who thought that the stock market was hitting lofty levels when the Dow hit 20,000, you must be really anxious now, with the Dow at 21,000. The latest spike in stock prices came this past Wed., March 1st, when the Dow rose over 300 points following President Trump's Tuesday night address to Congress. His conciliatory tone and presidential demeanor sparked a renewed optimism among investors. Cash inflows into the S&P 500 index exchange traded fund, SPY, was the largest since 2014. It seems like stocks are just levitating, on what many investors feel is just hopes of accelerating economic growth. Investing based on hopes without what they feel is real substance is why so many investors are becoming increasingly apprehensive.

These concerns about whether the stock market surge is due only to hopes of an economic rebound, without any fundamental underpinnings, is nonsense, says independent economist Fritz Meyer. In a Feb. 14th webinar he outlined his views on the current state of the economy and the stock market. He began by asserting that the proverbial "wall of worry" (as in "A bull market climbs a wall of worry") is still very much intact. When the Dow first closed above 20,000, the Wall St. Journal's headline read "Dow Tops 20,000: Resurgent Appetite for Risk has Fragile Economic Foundation". He also talked about the "Billionaire Bears Club", as legendary investors Soros, Icahn, Druckenmiller, Gundlach, Gross, and Grantham have all come out in recent months to warn about high stock prices. This healthy dose of skepticism, he states, helps to fuel higher stock prices.

Examples he cited of a strong fundamental economy were 1) that bank credit is in good condition, 2) that consumer sentiment is strong, and 3) the presence of an upwards sloping yield curve (recessions don't occur without a downward sloping yield curve). One of the most important factors that he pointed to was the surge in small business optimism, similar to what was seen in 1983. Small businesses account for about 50% of all private sector jobs and 60 to 80% of all newly created jobs.

He also mentioned that the Citigroup US economic surprise index reported that upwards revisions to earnings estimates were running better than expected and that the US Index of Leading Economic Indicators popped higher by 0.5% in December. He pointed out that this isn't just a US phenomenon. Growth around the world is beginning to accelerate. He also feels that the reduction in regulations in the US combined with Trump's promise of lower tax rates could boost the 2017 earnings for the S&P 500 to 142. Using this value together with a "reasonable" P/E ratio of 18 could get us to the mid 2,500s for the S&P, another 7% higher from here. While stocks are definitely due for a pause right now – you know that they never go up in a straight line, especially after the recent surge we've experienced – I do believe that they can continue to move higher longer term.

I mentioned in last month's letter that I might begin to add foreign stocks to our portfolios, starting with emerging market funds and possibly continuing with developed (European) market funds. My guy Steve Sjuggerud (Stansberry Research) reconfirmed in a Feb. 21st note that he feels that the next emerging market boom is starting now. However, their performance in February was a little spotty, and I don't want to make a significant commitment under those circumstances. My feeling is that if this sector is now ready for substantial gains, being a little patient should be OK.

Finally, for those concerned about rising interest rates and the effect on our bond funds, note that for the first 2 months of the year our funds are doing just fine. The average gain for our bond funds during this time is about 1%, which would result in a 6% return if annualized. They continue to serve their purpose of providing good income while reducing risk. *Jeff Feldman*

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