# 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 |
|---|---|---|---|---|---|---|---|
| 24,175 | 2,713 | 7,503 | 1,660 | 2.84% | 6.01% | $1,254 | $74.14 |

## *Investment Strategy Report*

### *Stocks Continue Sideways, Still Waiting For a Breakout*

It's half time for the 2018 stock market year, so it's a good time to assess where we've been before discussing where we are likely headed. After a tumultuous start to the year, stocks have settled down somewhat and are struggling to establish a positive drift higher.

Thus far in 2018, the S&P 500 is up 1.5% while the Dow is down 2.2%. Not much there. But there have been some significant gains in the Nasdaq (up 8.7%) and the small cap Russell 2000 (up 8.1%). The gains in the Nasdaq are representative of the outperformance of technology and growth stocks, which has been the case for several years now. The Russell 2000 has been the newcomer to the leader list, as outsized gains the last few months have established a new trend for the small caps.

While growth stocks continue to do well in 2018, value stocks and high dividend paying stocks have not done much, with flat to slightly lower performance for the year. However, the biggest losers this year have been foreign stocks. Both developed market and emerging market funds are down in the high single digits, not being able to continue their solid performance from 2017. While many are blaming the imposition of tariffs and the threat of trade wars, there also appears to be fundamental problems in these markets. We had begun the year in what many had thought was a nirvana-like scenario of global synchronized growth, whereby for the first time in many years, the US wasn't the only country in the world to sport solid GDP numbers. That does not seem to be the case now, as it appears that growth is slowing overseas. That is why, as I mentioned in last month's letter, I have sold the small positions we had in foreign funds (and any value funds we might have had) and have replaced them mostly with small cap stock funds.

Turning to bonds, there have been modest losses thus far in 2018. We began the year with the 10 year Treasury yielding 2.40%. Its yield has spiked to as high as 3.1% before coming down to its current level of 2.84%. As most of you know, rising interest rates have a short term negative effect on bonds, so our bond funds have seen slight losses thus far for the year. Our portfolio of bond funds is down about 0.4% for the year, which isn't great, but is significantly better than the minus 1.6% return of the Vanguard Total Bond Market fund. While the spike in interest rates has caused minor losses for bonds, the average yield on our funds is now above 4%, which should produce nice gains for these funds going forward.

Looking now towards the second half of the year, many of you have expressed concerns about the market in light of the aforementioned tariffs and trade wars, politics in Washington, divisiveness in our country, etc. In my mind, this is all noise. Any market sell-off thought to be caused by these issues will lead to a market rebound once they get resolved. These are all most likely short term issues. Longer term, the only thing that matters to the market is earnings and the probability of a recession. And right now, earnings are surging, our economy is on a tear, and the probability of a recession during the next 6 to 12 months is almost nil.

While earnings growth has gotten a boost from the new tax bill, corporate revenue growth, which is not affected by the tax bill, is also surging. Economist Fritz Meyer, in his June 12th webinar, was very upbeat on the economy, citing a surge in the Leading Economic Indicators and increases in small business optimism, business investment, personal income growth, and retail sales. Household balance sheets are improving, their savings rates are increasing, and their FICO scores are moving higher. DoubleLine's Jeff Gundlach, in his June 12th webinar stated "Clearly, there is no recession coming". He added that "Annual GDP growth is projected to be as high as 5.6% for the 12 month period ending 6/30/18". In other words, the key to being a successful investor for the second half of the year is to not watch the news! *Jeff Feldman*


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