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
27,433	3,351	11,011	1,569	0.55%	4.48%	$2,042	$41.43

Investment Strategy Report

Does This Rally Make Sense? And Will Growth Stocks Continue To Outperform?

It seems like every month we are asking the same question: How can stocks continue to rise in the face of an economy, still stuck in the midst of a global pandemic? Since I last wrote to you 5 weeks ago, the S&P 500 is up 7.1%, the Nasdaq is up 7.9%, and the Dow is up 6.2%. The small cap Russell 2000 is finally showing signs of life, rising 9.6%. And gold has surged an extraordinary 14.3%. Even bonds have fared well during this time as interest rates have fallen, with the 10 year Treasury yield dropping from 0.67% to 0.55%.

My answer to the above question last month was that the market was responding to the massive amounts of stimulus being spent by the government and by the Federal Reserve. That and the fact that the markets were looking ahead to a time, 6-12 months from now, when the economy will almost certainly be improved. I will add to that this month by saying that despite a continuing rise in the number of cases and deaths, the economy is beginning to reopen, and corporate profits are surprisingly strong.

Al Root, writing in the August 1st issue of Barron's stated that "Companies are crushing overly bearish estimates. About 85% are beating Wall Street earnings estimates by an average of 22%. Both numbers are huge." Louis Navellier echoed similar sentiments in his Aug. 5th flash alert. "This second quarter earnings season has been absolutely stunning. In fact, I can't remember the last time earnings surprises were this big. The tone of the underlying market is nothing less than incredible." Navellier continues to emphasize how bullish it is that the yield on the 10 year Treasury (0.55%) is so much lower than the dividend yield of the S&P 500 (about 2%) and Dow (about 3%). "Investors have no where else to turn to but to stocks".

Analyst Tony Dwyer repeated (on CNBC, Aug. 5th) what he has often said, that the Federal Reserve will continue to do whatever it can to achieve its goals of full employment and 2% inflation. "They are not out of bullets and will come up with ambitious plans".

The answer to the second question, about the outperformance of Tech stocks, was paramount on the evening of July 30th. That was when the tech giants Apple, Amazon, Facebook, and Google were all reporting earnings. Apprehension was high. The concern going into earnings was that it would be a lose/lose situation. Since their performance had been so strong and expectations had been so high, if earnings disappointed, the stocks could get clobbered. And if the earnings reports met expectations, then investors might sell on the news, taking profits. What in fact happened was that earnings were so strong, the first 3 companies rose an average of 7.4% the next day. Only Google dropped on a disappointing report. The strength of technology has continued to power tech stocks higher, as the Nasdaq has now surpassed 11,000.

Of course at some point, as we begin to turn the corner in the fight against the virus, and the prospects of a vaccine or improved therapeutics become more of a reality, our reliance on remote technology will subside and stocks representing the core areas of our economy will begin to rebound. Tom Lee, on CNBC today, stated that the number of virus cases peaked on 7/27, and he expects that by 3 weeks later, we can begin to see a violent rotation from tech stocks to what he calls epicenter (or more value-oriented) stocks. This is something that I will be carefully watching. He also stated that there is still $5 trillion of cash on the sidelines, as individuals are still conservatively positioned. If these epicenter stocks return to their February levels (as the Nasdaq has already done and then some), they can add another 200 points (or about 6%) to the S&P 500.

With the huge runup in stocks that we have seen since the March lows, we still need to exercise caution in the short term. However, the market's long term prospects still remain quite positive.

Last Chance – Just to repeat my message from last month: Since RMDs are not required for this year, if you have already made IRA withdrawals, you are able to put that money back into your IRAs if you do so by August 31st. *Jeff Feldman*

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