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
25,475	3,056	9,552	1,405	0.66%	4.91%	$1,751	$35.56

Investment Strategy Report

After A Difficult First Half Of May, Markets Turn Again to Rally Mode

After a strong month of April, I expected that the markets would find it difficult to make much progress in May. After all, US Covid-19 deaths were surging towards 100,000, and 40 million Americans had filed for unemployment since the middle of March. And as expected, we did see some weakness early on in the month. The S&P 500 drop 2.8% on May 1st. It then rallied but fell back on May 12th and 13th, losing a combined 3.8%. It looked as if the struggling economy would keep a lid on any further stock market upside.

However, May 13th marked the low point for the month and beginning on May 14th, the markets began moving higher. The S&P 500 has now seen an impressive 8.4% rally since then. And judging by the market action, you would never know that we are still in the midst of a pandemic and historic levels of disruptions to our economy, not to mention the violence just experienced in our cities in response to last week's police brutality incident. As they say in the market forecasting business, it's hard to argue with the action of the market.

Market technicians use moving averages to track the progress of the market, and two in particular, the 200 day moving average (DMA) and the 50 DMA. On April 24th, the S&P 500 crossed above its 50 DMA (2,800) and on May 27th, it crossed about its 200 DMA (3,000). These levels typically act as resistance, as the market tries to regain its footing. Now that these levels have been breached to the upside, they should act as support on any market pull backs.

Louis Navellier listed several reasons to explain the market rally on May 26th. He pointed out that consumer confidence had risen in May and that new home sales had risen in April. States around the country are beginning to open up and many businesses are trying to reopen. Mark Putrino of Stansberry Research (5/18) stated that the massive negativity that exists today towards the stock market is actually a positive sign. He points out that according to the American Association of Individual Investors (AAII) poll, more than 50% of investors, 53%, are bearish today. This is only the third time in history that a level that high has been reached, and the previous 2 times were great buying opportunities. "When so many people are feeling bad, the market is running out of sellers. And prices are rising as a result."

An opposing view is presented by Justin Brill of TradeStops. "Due to the outbreak and subsequent shutdowns, the economy is now weaker than it's been in decades. And following the big rebound in stocks, the broad market is now even more expensive than it was before the whole mess started. And none of this considers the not-insignificant risk of a second wave of Covid-19, nor the recent re-escalation of trade tensions with China".

One fact that remains indisputable is that volatility is still high, even if it has dropped significantly from the highs back in March. One measure of volatility, the VIX, hit a high of 82 on March 16th, but has since dropped down to about 27. While a level of 27 translates into a much calmer market, it is still almost twice as high as the average level of the past five years, 15. As I mentioned in last month's letter, even though I am optimistic about the market's long term prospects, it makes sense to be a little more conservatively positioned during these tumultuous times.

Fixed Income Investing – While stock volatility is still relatively high, the bond market has settled down quite bit in the last 2 months. We have the Federal Reserve to thank for this, as they stepped in towards the end of March with the addition of a tremendous amount of liquidity to the fixed income markets. Because of this, I have made sure that most of you are fully invested in the bond fund portions of your portfolios. If I have not done this for you, it is because you have told me that you want to remain in cash for now. Please let me know when you do feel comfortable having me invest some of that cash for you.

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