# 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 |
|---|---|---|---|---|---|---|---|
| 26,258 | 2,867 | 7,829 | 1,556 | 2.50% | 5.93% | $1,292 | $61.77 |

## *Investment Strategy Report*

### *Stocks Continue To Rise Despite Inverted Yield Curve*

This past month we celebrated the 10th anniversary of this historic bull market. For those investors who have been brave enough to ride this tumultuous bull, the gains have been extraordinary. From the market low on March 9, 2009 of 666, the S&P 500 is up over 300%. However, we all know that this soon to be longest bull in history will end at some point. And for all of us savvy investors (after all, we all think that we can beat the market), we are looking for the telltale signs of market fatigue that will allow us to get out before this bull market finally meets its maker.

If you were to ask me to name the one indicator that has been the best predictor of economic recessions, and therefore of bear markets, I would have to say the inverted yield curve. Most analysts define an inverted yield curve as occurring when the yields on short term bonds/Treasurys are higher than those of longer term securities, e.g., when the yield of a 3 month Treasury bill is higher than that of a 10 year Treasury. This anomalous situation usually occurs when bond traders feel that the economy will soon be slowing, causing interest rates to fall. These traders would therefore invest in longer maturity bonds to take advantage of the anticipated fall in interest rates. Just about every recession in the past 50 years has been preceded by an inverted yield curve.

Well, 2 weeks ago, the yield curve inverted when the yield on the 10 year Treasury dropped to 2.35% while the 3 month Treasury yielded 2.43%. It had come close many times, but this time, it actually happened. This set off alarms among many investors who felt that this was the warning that they must heed. On March 22nd, stocks fell 2%, They continued to fall the following Monday but then recovered, stabilized, and have since begun steadily rising. We had a solid stock rally today and the 10 year Treasury yield shot up to 2.50%, ending the inversion.

So was this a false signal that we can ignore, pretending it never happened? Or will smart investors use this as an opportunity to turn cautious on stocks and prepare for the beginning of the end of this golden age for stocks?

My answer is the former. This yield curve inversion was an anomaly caused by the Federal Reserve that just plainly got it wrong. As I have mentioned during the past few months, the Fed should never have raised the Fed funds rate in December, which caused short term rates (the 3 month Treasury) to rise. Absent that mistake, the 3 month Treasury yield would never have risen to over 2.4% and the yield curve would never have inverted. Investors finally realized this and pushed stocks higher for their best quarterly performance since 2009.

Of course we can't totally throw caution to the wind and let up on our defenses. And keeping a close eye on the fundamentals will serve to do that. One beneficiary of the lower long term interest rates has been the housing industry, as existing home sales were up 12% year over year in February. With 30 year mortgage rates down to 4.3%, housing affordability is up markedly. The employment picture continues to be strong and now wage growth is beginning to pick up. Estimates for GDP growth for 2019 are in the range of 2 to 2.5%, a slowing from the 3% rate for 2018, but still no where close to recession levels. Earnings estimates for the S&P 500 for 2019 are in the $170 range, which when combined with a very reasonable P/E ratio of 17-18, would result in an S&P 500 level of between 2,890 and 3,060. Getting past the old high of 2,930 will still be a challenge, but getting a trade deal with China could be the catalyst that gets us over the top. Another positive development for the market would be if investors, who in the first quarter withdrew $60 billion from stocks and added $118 billion to bonds, reversed this trend, got more bullish and began pouring money back into the stock market.

**Taxes on Capital Gains** – As I mentioned in an email to you, due to large capital gains distributions last year, many of you will owe more in taxes than you might have expected. The good news is that gains in future years will be lower. *Jeff Feldman*


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