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
30,606	3,756	12,888	1,975	0.92%	4.46%	$1,902	$48.42

Investment Strategy Report

Markets Continue Higher Despite Second Wave Of Covid Surge. What Will The New Year Bring?

2020 will be known as the year that stocks ignored the headlines and news reports, and surged higher despite the tragedy of Covid 19. The fact that the markets as a whole did so well in 2020 continues to mystify most people. Even now, a few weeks into the vaccine rollout, it's still hard to imagine that stocks seem oblivious to the complete upheaval of our society.

The number 1 question for 2021 is whether the market will come to its senses this year and fall back to earth. Or, another way of looking at it, has the market accounted for all the possible good news that can occur in the coming year, and will therefore any disappointments lead to market declines? The number 2 question is whether those companies that were the leaders last year continue their leadership role, or will the downtrodden, economically sensitive companies, assume the mantel of leadership this year. For the first months of the post-crash recovery, it was somewhat understandable that companies that benefited from the new economy, the remote-based, tele-computing companies, saw an explosion in demand, while the companies that suffered due to the lockdowns got crushed. Will the markets sense a return to normalcy in 2021, and therefore spark a resurgence in the value-oriented companies that have lagged for so long? For 2021, it won't be a question of whether or not to be invested, but where to be invested.

In last week's Barron's (12/21) Market Outlook article, the 10 market analysts, on average, forecast stocks rising by about 10% this year (I don't think that it's ever been anything different from that). So nothing surprising there. Many of the analysts listed value stocks, such as financials and energy, as sectors to overweight, in addition to technology. They seem to think that we can have a broader participation this year instead of just seeing big cap technology lead the way. Top industry analyst Dan Niles (AlphaOne Capital Partners) had only one technology company in his list of top 5 stocks for 2021. And he's a technology analyst.

It therefore might seem that embracing an index approach, containing both growth and value stocks, might be the best approach for this year. The question then would be, which index is best? While the S&P 500 has been the index of choice for many years now, small caps have begun to surge higher, beginning in November. The nice thing about a small cap move higher is that once money begins flowing into this sector, since they are smaller capitalization companies, it doesn't take much cash to have a sizeable effect. Plus, since they have underperformed for so many years, their values are very attractive. Once a small cap rally begins, they can tremendously outperform their big cap counterparts.

And then there are the foreign markets, both developed and emerging. Here too, they have underperformed the US markets for many years and are therefore selling at very attractive valuations. Is this the year that these funds need to be added to our portfolios? For now, my approach will be one of patience, to make sure that a new trend is firmly established before making substantial changes to our portfolios. We have seen many head fakes in the past. If a new trend has staying power, it should be able to continue its strength into the new year.

There is usually a sense of optimism as we head into a new year, but my sense is that investors might now be somewhat overly optimistic, and the markets might need to pause before continuing higher. Jason Goepfert (Sentimentrader.com) stated on 12/18, "The market environment is pristine, but with near-historic optimism, gains tend to be muted, with a high probability of being reversed at some point over the ensuing weeks". One of the indicators he uses, the McClellan Oscillator, has turned negative. "And that has typically meant that further gains are limited in the short to medium term" (12/30).

As you know, short term market timing is difficult, and with our economy set to recover nicely this year, it is hard not to start the new year with an overall bullish view. So put me down for 10% this year. At least I'll be in good company. *Jeff Feldman*

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