Rochester Financial Services

Fee-Only® Financial Management Services

Jeffrey Feldman Ph.D., CFP
Certified Financial Planner
Principal

March 3, 2021 1 PM	Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
	31,426	3,851	13,147	2,240	1.48%	4.41%	$1,717	$61.86

Investment Strategy Report

Tug Of War Between Growth and Value, and Rising Interest Rates: Themes For 2021

As many of you have come to learn, trying to forecast stock market returns based on newspaper headlines or by watching the nightly news is a losing proposition. Back in the Fall, we experienced a surge in new covid cases as families gathered together for the holidays. The horrific news continued into the new year. Yet the stock market saw terrific gains to end the year and has continued higher in 2021. As we have also come to learn, the stock market looks ahead 6 to 12 months and is more concerned with the direction of change: going from bad to less bad is a positive. And in the last few weeks, the direction of change is certainly taking a turn for the better. More Americans have now been vaccinated and the number of new hospitalizations has plummeted. There are definitely more reasons now to be hopeful, to begin to see the light at the end of the tunnel. So is it time to signal the all clear sign for stock market investors?

No. Back in February 2002, I was quoted in the issue of Journal of Financial Planning saying "…we'll never have a time in the stock market where there is a clear path to take". That is because there always will be concerns. One big concern today is whether we have come too far too fast. The S&P 500 is up over 70% since its March 2020 bottom. Has the market already accounted for the economic recovery? Is there no more "juice" left to power the market higher? Or has the surge in interest rates presented us with a head wind for stock prices? The yield on the 10 year Treasury began the year at 0.92%. It now stands at 1.48%, a 60% increase. A third issue is about the leadership of the market. Growth stocks, which have led the market for years, had a stellar year last year as the "old" economy closed up and technology helped the new economy make life more manageable. However now, as the severity of the pandemic lessens, will value stocks like financials, energy, and travel and leisure take over the leadership mantel?

Steve Sjuggerud answered the first question (too far, too fast) in his Feb. 4th issue of True Wealth Systems (StansberryResearch). He looked at every similar rally in the S&P 500 since 1950 and found that approximately one third of them continued their uptrend before suffering a 10% correction, and one fifth of them went on to greater than 100% gains. His conclusion is that while you can say that we are due for a correction, a gain of 70% is not a reason in itself for the rally to stall. And of course, when everyone is expecting a pull back, the likelihood of one occurring diminishes. Steve feels that we are still in the middle of a "melt-up" and that the biggest gains can occur in the final stages of these bull markets. With the economy set to strongly rebound as the reopening moves ahead, he feels strongly that the uptrend can continue.

The second issue that I brought up, rising interest rates, is something that some of you have called me about, since you have read about the deleterious effects that rising rates have on bonds. This is true, not only for bonds but for stocks as well, since bonds compete with stocks for investor money, and higher bond interest rates can siphon money away from stocks and into bonds. For the first concern, I have already positioned our bond portfolios for the possibility of rising interest rates. I have combined traditional bond funds with short term bond funds (to lessen the effects of rising rates) and with multi-sector bond funds. The latter funds have an allocation to lower credit quality bonds that will benefit from a recovering economy. Year-to-date, the cumulative performance of our bond funds is slightly positive (i.e., no losses but now having a higher yield) while more traditional bond funds are seeing significant losses (e.g., Vanguard Total Return Bond fund, VBMFX is down 2.4%). As for higher yields having a negative effect on stocks, a 1.5% 10 year yield is still very low by historical comparisons and shouldn't have an impact on stocks unless they move substantially higher.

And as far as growth vs. value, this is the next portfolio decision that I will be making during the next few weeks and months. As I mentioned last month, I have already begun to add small cap funds, as small businesses are making significant recovery efforts. I still feel that growth companies will have strong earnings, which can be more dependable as the economy reopens with fits and starts. However, adding value funds can help to balance out performance as the markets seek direction. *Jeff Feldman*