2.7.18

KABOOM! AN UNWELCOME GUEST

Prior to Friday's 666 point sell off in the Dow, we'd reduced our stock market exposure from 21% to 12%. On the bond side, we again shaved and liquidated positions that exposed us to undue interest rate risk. This Monday, markets looked positive early in the trading session but things turned decidedly worse in the afternoon. At 3:00PM, the Dow Jones Industrial Average, which was already 500 points, dropped by an eye-opening 800 points then rallied back just a few minutes later. It never fully recovered from that sudden drop and at day's end the overall decline was 1175 points. This drop of 4.6%, combined with Friday's 666 point decline, effectively erased all of the market's gains for the year.

When these types of massive swings happen during a short timespan – the Dow has dropped 8.5% over the last ten days – it is often a result of too many recent investments placed in stocks with the assumption that markets will continue forever upwards without a sensible and normal pullback. Many of these recent investors bought stocks on margin (with borrowed capital that has to be paid back immediately) and also aggressively leveraged their bets on stocks which only increased the intensity of the sell-off as the market reversed course.

Our portfolio now stands at the highest cash levels of the year as we were able to strongly minimize our losses and salvage gains in all the positions that were sold last week. We are watching for stock markets to possibly bottom out early in the week and bounce off near-term levels of support. In fact, on Tuesday we may have experienced just this scenario as markets opened down 600 points and wobbled between positive and negative throughout the day. To cap off the day, at 2:30PM stocks began a heady burst upward and closed the day up by 567 points!

This new volatility needs to be studied.
Big moves up could be greeted with wild bursts of selling.
We will wait for the best opportunities, which we feel are yet to come.

The unwelcome guest that precipitated the decline was substantially higher interest rates and a strengthening U.S. dollar. Not just the Dow, but all major stock indexes dropped between 3.5% to 4.1% last week and there were very few places to hide. Worrisome losses also hit the bond market, as interest rates rose from 2.41% to 2.84% in just a month's time. Portfolios that were diversified between stocks and bonds saw big losses on both sides of their lineup. For the first time in more than a year, investors were left scratching their heads, even though the issue at hand was quite simple to figure out. At this juncture all eyes will be on the 10-year treasury, as interest rates will need to stay lower in order for stocks to resume their march higher. If this doesn't happen, the easy gains of the past could potentially be carved off. We will also be watching the U.S. dollar, as it also broke trend last week gaining in strength vs. other world currencies.

For the last ten years, world stock markets have benefited enormously from artificially induced low interest rates. During this period, the underlying truth remained that economies sputtered while stock prices catapulted upward. Inexperienced investors looked smart as they rode a wave of momentum without understanding the backdrop. This week when interest rates on 10-year treasuries spiked above the psychological tolerance threshold of 2.7%, the stock markets wilted readily in the face of not only higher borrowing costs but an ever-increasing possibility of higher inflation. Other specters loomed as well, as over-arching debt both here and abroad may be reaching saturation levels and investors start wondering who will buy any newly issued debt, not only from the U.S. but from every developed country in the world.

The stock market is now moving without regard for improved economic fundamentals. Case in point… First quarter GDP was upgraded from 4.2% to 5.4% and the National Jobs Report revealed that employee wages were improving at a brisk pace. Rather than react to that good news, though, with every one point tick upward in interest rates, the stock market made an outsized move downwards.

It remains to be seen if the recent spurt in economic growth is due to consumers tapping credit cards while reducing their savings. In the recent government report on Personal Income and Spending, the internals again showed the savings rate dropping from 2.9% to 2.4% for December but more recent information from the Johnson Redbook Retail Sales Index shows retail sales in decline from December's torrid pace.

While some corporations are starting to come to the table with bonuses, boosting benefits, and increasing worker pay, there are still many other publicly traded corporations that back to their old trick of buying back their own stock. Just last week Altria, eBay, Mondelez and Visa were revealed to be investing in a combined $20 billion of stock buybacks.

Throughout the coming weeks we will be looking at strategic opportunities to take advantage of the recent sell-offs. In this landscape, a temporary increase of portfolio cash reserves will offer the best safety until more pertinent information becomes clear. Historic valuations still remain stubbornly high so trades will have to be of a quicker nature, as reversals in interest rates and stock prices may be short-lived.

Economic news this first full week in February is on the minimal side although pivotal reports from the Services Industry (ISM Services), consumer debt levels (Consumer Credit), and a look at a large component of Gross Domestic Product (Wholesale Inventories) will be of interest.

Earnings season continues this week with releases from Bristol-Myers, GM, Dunkin' Donuts, Hasbro, Twitter, CVS, and Kellogg's.

As always, we will continue posting articles that we believe to be of great informational value on our website, under the "Great Articles" tab, which is linked here:

http://summitplan.com/cgi-bin/htmlos.cgi/great_articles.html.

Additionally, the "Summit Planning Financial Hour" will be live this week on Radio 570-WSYR at 10AM on Saturday. Don't forget to tune in for a recap of the week's events. If you cannot tune in, check out our radio show archive on our website at http://summitplan.com/cgi-bin/htmlos.cgi/radio_shows.html.

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5. Investors FastTrack is the source for all quoted performance data.
6. The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings. Commodities include increased risks, such as political, economic, and currency instability, and may not be suitable for all investors.
7. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.
8. The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.
9. The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

10. The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index.
11. The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.
12. CBOE Volatility Index is a measure of the implied volatility of S&P 500 index options, calculated and published by the Chicago Board Options Exchange (CBOE).
13. All indices are unmanaged and cannot be invested in directly.