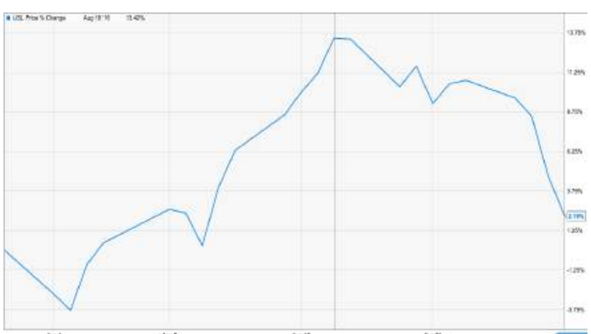
September 2, 2016

Overview

In August, the S&P's 500 total return index inched up .14% while the small cap Russell 2000 rose 1.8%. This compares to a slight loss of .24% for international developed markets (EPAC BMI index) and losses for commodities of 1.86% (DJCI). Fixed income securities were generally flat to negative for the month, except for the high yield sector that registered a gain of 2.14% (Bloomberg High Yield Index).

US equity markets progressed nicely during the month establishing new records up until the first Federal Reserve pronouncement on the 18th of the month, hinting at a rate hike, possibly as early as September 21.
That sent the dollar up, oil price and emerging markets down, reversing healthy gains earlier in the month. As a consequence most asset classes registered monthly performances close to the flat line.

Below is the chart of USL, the ETF that we use as a proxy for oil prices. The vertical line marks August 18, when Stanley Fischer, Vice Chairman of the Fed, woke up the market from its summer slumber with utterances of possible rate hike(s). The effect on oil prices was immediate.

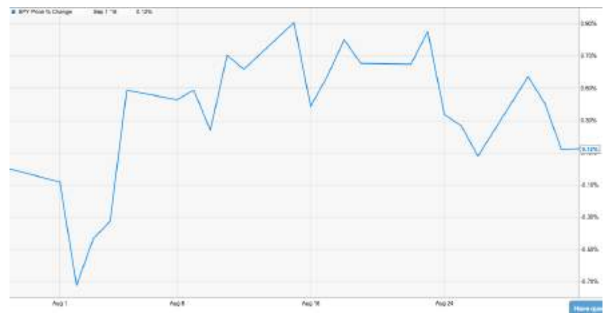


In August our client portfolios rose from .23% to .57%. Year to date (YTD) our internationally diversified portfolios are up from 4.66% to 7.51%, net of fees. This compares to YTD performance of 6.11% for a purely US-centric portfolio consisting of 50% SPY (ETF for the S&P's 500) and 50% BIV (US bond aggregate ETF proxy), over the same period.

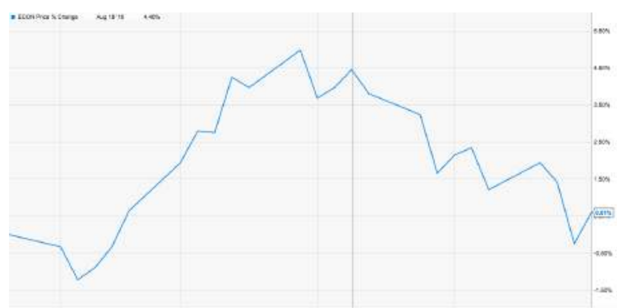
As a reminder, our allocation to equities currently varies from a minimum of 30% to a maximum of 60%, depending on the risk profile of each client.

Market developments

The month of August started with a strong employment report for the month of July. This set the tone for the first half of the month and pushed equities up to new records, if grudgingly. Below is the chart of SPY, the ETF proxy for the S&P's 500.



US Equities reversed their positive course mid-month to finish almost unchanged. Emerging markets followed the same trajectory, if with a more pronounced effect. See the chart below:



Also notable during the month were some sectorial dichotomies. US REITs suffered a 3.78% loss while US Financials rose a robust 3.52%. After flocking to dividend-paying equities, such as REITS and Utilities, for most of the year, the market seems to be taking a more rational look at valuations and rewarding previously disaffected sectors. This is a good sign for equities overall.

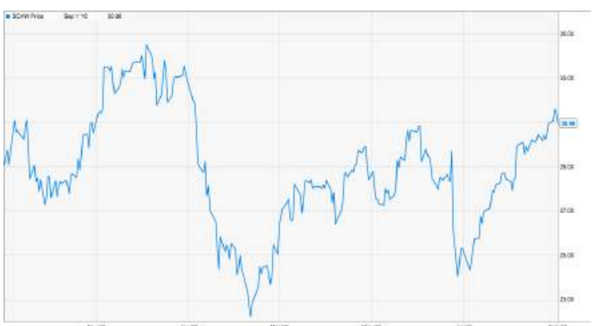
One of the disconcerting aspects of the current rally up to now had been how narrow its advance was. The uptick of the financial sector in August is a healthy development.

Tilts and allocations

Fed talk does have an effect on the market, particularly on financials. Any sign of a rate increase tends to push bank and brokerage equities up and to reverse course when that momentum fades, which has happened on several occasions this year. As a consequence, some of these equities have waxed and waned all years as the market mood, swayed by Fed officials, was going from bullish to bearish on rates and back again.

This has caused some equities in the sector to oscillate in an almost predictable range. We have taken advantage of this situation buying in February and selling in May. We did it again in the summer, buying financials shortly after the Brexit vote when the Fed indicated it would not yet budge on rates and selling in the last days of August after it signaled that after all it might do so sooner than anticipated.

Here is the YTD chart for Charles Schwab, a brokerage stock that we have followed for close to thirty years. We think we know it a bit! This is why we will tactically buy and sell it as we see opportunities. This is exceptional for us. We generally eschew single stock ownership. Sometimes, opportunities appear to be so compelling, that we adjust our approach.



In this case, whenever the stock goes into the low 20's we buy. When it gets to the low 30's we sell. It has paid off this year. That little trade may be over though. The shape of the last leg of the rebound is impressive. There may not be a retracement from the current level before a little while. We shall see.

Other than for this tactical trade, we did not alter our portfolio positions during the month.

Conclusion

The month of September is, statistically speaking, the only losing month of the year. This does not mean that it will register a negative performance this month but simply that it does more often than any other month in the year.

One thing is (almost) for sure: volatility will increase. It has been very tightly range-constrained in August and is expected to rise. With a slew of economic and political markers scheduled throughout the month, the ride may be bumpy. This will start today (Friday September 2) with the much anticipated and market moving employment number for August. Other than for the usual set of economic data that will follow, we can think of at least two other market-moving events: 1) The FED September 21 meeting, 2) The OPEC gathering around September 25. All of this will play out with the US Elections providing background noise and potential market disturbance.

With so many "spicy" ingredients in the mix, the flavor of this month could be particularly robust. This might generate a few investment opportunities. Although we do not currently see any obvious ones, some may materialize. No matter how investment-savvy or experienced one might be or think of himself/herself, the markets often find new ways to surprise us. When that happens, opportunities ensue. Staying humble will allow you to capitalize on them.

As usual, please feel free to reach out to me with any questions.

Thank you for your trust.

PS: I am leaving in a few hours for a short trip to Europe (back at work on the 12th). I apologize for any spelling or grammatical error the rush to JFK may have caused.