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summaries

SIGMA INVESTMENT COUNSELORS

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# Investing (again) at Equity Market Highs and Low Bond Yields

As I begin to write our quarterly market update, I am finding it difficult to avoid being redundant. Not because the topic of new equity market highs is once again upon us, but rather because much of our collective thoughts on the current markets have been reflected in recent Sigma blogs, notably by my prolific colleagues. Below is a blog Bob Bilkie posted on June 9th:

***Put Your Money (and the Dow Jones Industrial Average) Where Your Mouth Is:***

*"I was having breakfast with a companion this past Saturday, when he asked me, "Would you invest right now if you had cash?" I chuckled and directed him to the blog my colleague wrote earlier in the week covering just that subject: http://sigmainvestments.com/invest-now-or-wait-for-a-correction/, with an answer in the affirmative.*

*He then asked, "Where do you think the Dow Jones Industrial Average is headed?" Once again, I directed him to my blog of May 30, 2014 (http://sigmainvestments.com/bubbles-bull-and-bears/). He read it and said, "You suggest that the Dow Jones Industrials are in the midst of a secular bull market, but you don't provide a forecast." True enough. So, Scott, here is my forecast: The Dow Jones Industrial Average should reach a level of 28,000 by 2021. This is not a "Johnny come lately" outlook. In our blog of August 27, 2010, we declared the bear market over and a new bull market beginning: (http://sigmainvestments.com/im-getting-tired-pick-up-the-pace/)."*

While this may seem merely a shameless opportunity to promote our blog, there is a method to my madness. At Sigma Investment Counselors, we use our blog as a tool to communicate, on an ongoing basis, our thoughts regarding issues of the day and how those issues may impact our thinking about financial planning and markets. Typically, we post two to three blogs per week on timely topics. My colleagues are well read. Their written word demonstrates the art of synthesizing the volume of information they take in each day and articulate completed thoughts – a difficult task to say the least.

The blogs are insightful, succinct and easy to read. The posts provide original thought on a broad range of issues that affect investment portfolios and planning strategies. On several occasions, our ideas and thoughts surface in the popular financial press one or two days later, as the rest of the world catches up. Sigma's Investment Committee consists of independent thinkers, who possess diverse perspectives and opinions, and who are not shy about suggesting original thought. This is what makes it fun to come to work each day. Rarely is there a dull debate in our daily investment meetings.

While my perspective about our blog is clearly biased, I am quite proud of the material we produce, and the consistency with which we provide guidance to our readers. As trusted advisors to our clients, the most critical of skills we must "bring to the table" is creative, original thought. Otherwise, what would separate us from other advisors? Our blogs are one way to illustrate what "*Thoughtful Investing*" means to us: being value added thought leaders. While Walter Kirchberger and Bob Bilkie are the primary writers, we all share our thoughts from time to time. For those of you who heretofore have not visited, or signed up to receive our blog, I highly recommend it: http://www.sigmainvestments.com/blog.

## Market Outlook

Thus far, the old adage, "*sell in May and go away*" has not applied. After weak performance in the first quarter, the equity markets, (both domestic and international) have had solid gains, from late May into early June. As equity markets climbed higher over the last 6-12 months, many well known advisors and market pundits have remained on the sidelines with cash, waiting for the "pull back". Recently, as markets again reach new highs, we have seen many of these same people changing their outlook for the equity markets, and increasing their equity exposures. In contrast, it is no secret that Sigma's Investment Committee has remained consistently optimistic about equity markets over the past few years. As the market continued to climb the wall of worry and hit new highs, we remained steadfast in our commitment to equities in client portfolios, keeping equity exposures at the upper end of their allowed ranges.

We continue to believe equity markets offer the most rewarding valuations, relative to other asset classes at this point in time. While domestic equity valuations overall are no longer as compelling, neither are they overvalued. Domestic markets now trade in a range we would consider approaching fair value. However, we believe upside opportunity still exists as cash on the sidelines (in part from the institutional managers who had been on the sidelines and are now stepping in) will continue to provide support for the equity markets.

Year-to-date, international markets, and emerging markets in particular, have performed much better than in 2013. The disparity in performance between the S&P 500 and the emerging markets is striking. For the three and five year period years ending 5/30/14, the annualized return was 15.15% and 18.40% respectively. For the emerging markets, the three and five year numbers are -1.77% and 5.12% respectively. Economic growth opportunities in the various emerging market countries are not created equal. However, in aggregate, the growth opportunity, combined with the valuation levels, have led to solid performance of the emerging market indexes thus far in 2014.

Given the huge disparity in performance and valuations, we have begun to build our core positions in international markets from very low levels last year. Albeit perhaps a little early, we believe the growth opportunities and current valuation levels set the stage for better international performance going forward.

At the time of this writing, the situation in Iraq is very fluid. We have compassion for those fighting for their freedom and losing loved ones, and cannot imagine what it might be like to be in their shoes. Our job as advisors is to monitor the situation from an investment perspective. To date, the response has been one of caution, with markets coming off slightly from recent highs. We are cautiously optimistic that the situation can be addressed fairly quickly. If that were to happen, oil prices would reverse their recent climb and energy markets would stabilize. However, the rise in oil prices has rapidly been felt by American consumers. Anyone who has filled their car up in the last few days will tell you that a gallon of gas has moved up significantly, and is once again approaching $4.00. If oil prices remain high for an extended period of time, this will not bode well for our consumer economy, as the rise in prices disproportionately affect those at the lower end of the income spectrum. We will continue to monitor the situation and adjust portfolios accordingly.

The bond market continues to surprise most investors, us included. Once again, rates have declined since the beginning of the year. Through May 31, the long term treasury and corporate markets have been the star asset classes, up 12.4% and 11.4% respectively. Despite this short term out performance, we continue to believe the risk over their longer term is to the downside, as rates rise. We have kept our bond portfolio maturities short and intermediate term, willing to give up shorter term gains of the longer bonds. We anticipate a market where rates will rise towards 3%, on the ten year treasury bond by year end. In his blog post of June 10th, our newest colleague, Tony Basalla, chronicled a quick history of the past 30 years in the bond market, and then closes by accurately summarizing our view on the bond market:

***Investing in Bonds: Where Do We go From Here?***

*"….While we do not profess to be in the interest rate predicting business, it is our contention that the current level of interest rates remain below average and is likely to trend higher as the Federal Reserve continues to taper, and as our economy grinds forward. All else remaining equal, as rates rise, bond prices tend to fall. While we are not predicting a radical increase in rates, we do believe interest rates will rise to more normalized levels over the long-term horizon.*

*During this transitional period, we believe maintaining a short to intermediate duration bond portfolio of* *high quality securities and high yield bonds. This is the appropriate strategy for most investors. This is also consistent with our belief that fixed income securities are held in one's portfolio to provide current income, asset protection, and to provide stability during uncertain times."*

As equity markets continue to make new highs, we believe that a disciplined approach to the asset allocation outlined in each client's Investment Policy Statement remains the key to long-term investment success. This theme, along with the other pieces of our meticulous approach, is illustrated in different ways, but is a consistent message in our blogs and Sigma Summaries. My colleague, Chris Kress, does an excellent job of articulating this in his blog of June 16th:

***Staying the Course***

*"If the market was predictable, which it is not, one might naively try to "buy low and sell high", and simply side-step these periods of market weakness. Unfortunately, it is nearly impossible to consistently time the market, and a misstep may lead to disastrous results over the longer term.*

*As a consequence, we strongly recommend that investors are intellectually and emotionally honest with themselves regarding their risk tolerance, and "stay the course". History has proven that this is a winning strategy." (http://sigmainvestments.com/staying-the-course/)*

All comments and questions are welcome.

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