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Investment Strategy

"Ashes to Ashes"

The phrase "ashes to ashes, dust to dust" is derived from the Biblical text of *Genesis 3:19* and was adapted to its present form at an old English burial service. Last week I repeated those words as I scattered my father's ashes next to my mother's in the memorial garden of the church they loved so much in Richmond, Virginia. Indeed, my week was spent in Richmond, Washington D.C., and Baltimore seeing institutional accounts, consulting with political types, and speaking at various events for our financial advisors and their clients. Other than my dad's service, the highlight of the week was D.C. because of the drama currently playing inside the Beltway. I think the "budget" charade ends this coming weekend for the reasons stated in last Monday's missive. To wit, politics is all about political interests and survival. To that point, the President is not up for election ever again, the Senators and Congress folks are. It's pretty easy to figure out who wins that game of chicken. Moreover, the budget deficit is collapsing at a much faster rate than even the non-partisan CBO suggested. That reduces support for tax increases and spending cuts. More importantly, the Republicans have ceased bargaining their budgetary votes away in exchange for tax and spending cuts. Their "cry" now is to repeal/defund Obamacare, which I have repeatedly stated is a flawed strategy. While one can argue it is the principal of the thing, in the real world Obamacare is here to stay, although it could be tweaked to be more practical. As one governmental insider told me (as paraphrased):

The proof of whether Obamacare is going to work will be seen over the next three months. How many uninsured will sign up? My guess is that half, at the most, will sign up even though the legislation was clearly designed to benefit them with federal subsidies to make insurance affordable for them. I will bet three-fourths of the uninsured don't even understand the details. What will the Obamacare advocates say when only one third of the uninsured sign up? The goal was to make available health insurance for all Americans, but what happens when the uninsured don't play ball? Even young, healthy Americans might defer buying insurance because they are in a mental-complacency rut and have other interests for the way they spend their money. We could learn from other societies; Singapore, which is one of the most dynamic business communities in the world, requires all workers to have their own personal health care fund, and each person must contribute to it each month. QED . . .

This week I will be in Boca Raton speaking at a national conference and seeing accounts, followed by a speaking tour in Michigan. Interestingly, individual investors want to know what the professional money managers I have been seeing are doing, while the money managers want to know what individual investors are doing. In regards to the latter question, individual investors seem to be "frozen" like deer in the headlights, believing that you need to have a feel good environment to have a secular bull market. The reality of the matter is that when you finally get that "feel good" environment, it tends to be pretty late in the overall scheme of things. To be sure, it was very easy to buy tech stocks in 1999, but that proved to be a flawed strategy. Over the past few years it has been pretty easy to buy "bonds," but that too has proven to be a flawed strategy since the bond bull market appears to have ended. Manifestly, I think you should be very careful with the fixed income allocation of your portfolio at this point. Indeed, since July of last year interest rates have doubled, with a concurrent decline in most bond funds. As a sidebar, bond funds are not fixed income since bond funds have no maturity date. If you disagree, just look at how most bond funds have performed over the last few months. The exception has been the only bond fund that I currently own, and have recommended numerous times in these missives, namely the Putnam Diversified Income Trust (PDINX/$7.78). I still advise you to consider PDINX for the fixed income allocation of your portfolio.

As for the equity markets, I think the budgetary charade ends this coming weekend. To me, the only question is if we get a post-weekend stock market "let down," since Friday's Fling (+76.10 points) seemed to be all about hopes for a budgetary agreement over the weekend. Interestingly, while the D-J Industrial Average (INDU/15072.58) and the S&P 500 (SPX/1690.50) were both lower last week, the small and mid-cap indices were virtually unchanged. Indeed, of all the indices I monitor only those two, and the D-J Utility Index, were down for the week. This suggests the equity markets' primary trend remains "up." This view is also confirmed by the Advance/Decline figures, as well as the Buying Power/Selling Pressure indicators. Surprisingly, the NASDAQ Computer Index, and the NASDAQ Financial Index, resisted the decline of the past week, which potentially means those two sectors could assume more leadership when the overall stock market regains its footing. To the relative strength point, the S&P 400 MidCap Index and the S&P 600 SmallCap made new bull market highs last week, which is certainly good for Raymond James' universe of research names. As for the S&P 500's 10 macro sectors, only

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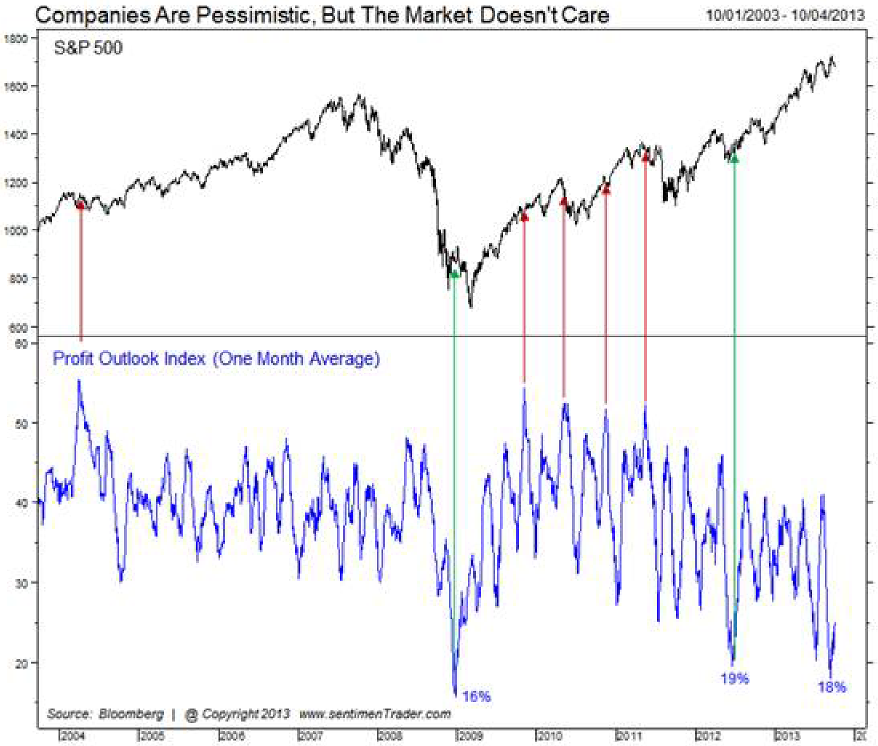
Consumer Discretionary (+0.21%), Healthcare (+0.94%), and Materials (+0.84) were positive for the week. I find that sector performance insightful because two of those sectors are economically sensitive, implying the economy should strengthen into 2014.

As for the negative article in last Friday's *Wall Street Journal* titled, "Companies Rush to Lower Earnings Bar," which so many clients have emailed me about, I would not put much emphasis on the cautionary tone U.S. companies are sounding about third quarter earnings. The article notes that there have been 89 negative preannouncements so far and only 19 positive ones for the S&P 500 companies. The *Journal* says, "That makes for a record-high ratio of 4.7 times." The article continues by stating:

"The ratio was even more skewed last quarter for the 111 companies that bothered to issue some type of explicit guidance, according to FactSet. Of those, 86% exceeded the number or range they had given themselves, while only 9% lagged behind. . . . [Therefore] negative guidance on its own probably isn't a worry for the market overall."

Not a worry indeed, because history shows such guidance is more of a contrary indicator. While it is not exactly the data set the *Journal* used, the chart on page 3 demonstrates the validity of this data set as a contrary indicator.

The call for this week: I think the budget conflagration turns into "ashes to ashes, dust to dust" by this time next week, allowing the equity markets to refocus on some of the good things that are occurring. Last week the SPX rallied back toward its overhead resistance at 1695 – 1710 and stalled with Friday's lift, caused by hopes for a budgetary deal over the weekend. With no deal, we should see another pullback toward my often mentioned 1684 "pivot point;" and, isn't it amazing how that level has acted as an attractor/repeller so many times. This morning our leaders remain intransigent on a budgetary compromise. That news, along with the World Bank's lowering of the expected growth rate for China, has the preopening SPX futures off 16 points. As I wrote in last week's Morning Tack, "1684 or fight!"



Source: sentimenTrader.com.

Modest improvement in the latest week, but still negative right at downtrend.

Source: Bespoke Investment Group.

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