MV Capital Management Midweek Market Commentary

Flirting With the Bulls

February 7, 2013

As of the February 6 close the S&P 500 was about 6% higher for the year to date in terms of price appreciation. The Dow Jones Industrial Average was ahead by 6.7% for the same time period. Interestingly, both averages are very close to their all-time high water marks. And both are flirting with big round numbers; the S&P 500 oscillates around the 1,500 mark while the Dow plays footsie with 14,000. It may sound silly, but historical patterns show that these big round numbers actually can be formidable support or resistance levels. Call it irrational investor psychology – but that's what the numbers say. So at this juncture a few questions are in order. Does this rally have the legs to carry us into macro growth market territory? What are the risks that could keep things lurching along around these resistance levels for awhile? Could things get really bad again – are investors too blithely complacent about potential X-factors that could send things heading sharply south?

Those all-time high water marks (14,164 for the Dow, 1,565 for the S&P 500) are fueling lots of chatter about the so-called "Great Rotation" – a structural shift from fixed income into equities. One could ask, is the Great Rotation any more real than the Great Pumpkin of "Peanuts" fame? Perhaps. Or perhaps not. The bulls point to the $11.3 billion net inflows that came tumbling into US equity funds in the first two weeks of 2013. That's the biggest fortnightly inflow since April 2000. The bears say…yeah, April 2000. Remember what happened after that? Ouch.

But market conditions today are hardly like they were in that last dizzying month of the dot-com bubble. Equity valuations are much more modest – maybe not screaming bargains but not wildly overpriced either. And, lest we forget, the yield on the 10-year Treasury was over 6% in the first quarter of 2000. If anything could drive frustrated yield-seekers out of bonds and into equities, then the fact that in inflation-adjusted terms you actually have to pay to own the 10-year Treasury – surely that should be at the top of the list of reasons, no?

Great Rotation or not, we do believe that the landscape looks reasonably promising for equities in 2013. But we also don't think it's going to be a one-way joyride upward. The market still moves more to the utterances (or non-utterances) of Ben Bernanke or Mario Draghi on any given day than it does to factors more directly pertinent to the business value of the companies that make up the indexes. The 10-year yield is still mostly below 2%, meaning that any Great Rotation money that's out there still has one foot planted in the bond market while it gingerly treads further into equities. And brisk rallies like the one we've seen since the beginning of the year – especially when contending with macro-trend resistance levels – are vulnerable to significant corrections before they finally succeed in scaling the wall. We have to be prepared for perhaps a bit more volatility than we've had to deal with for awhile.

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MVCM 2013 0009
DOFU: February 2013

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