July 25, 2014

Q2 2014 Commentary: Market keeps rolling along

The good times keep rolling along for US financial markets. Market volatility is very low and a rising market continues to defy expectations for some sort of correction. It has now been more than 1000 days since the last time the S&P 500 fell more than 10% from their high. This is the fourth longest period since 1984. It would appear that the US economy has survived the winter polar vortex and continues to grow moderately. In the 2nd quarter the S&P 500 rose 5.2%. Sasser Investment Management's stock portfolios have generally exceeded the market's return for the first half of the year. The bond market continued to defy expectations that interest rates will rise. In the second quarter the ten year US Treasury bond yield fell from 2.72% to 2.51%. Consequently, the bond market had another solid quarter returning 2.0%.

The most direct evidence of the nasty impact winter's weather had on the economy was the downward spiral in the first quarter's reported economic growth. The initial GDP report in late April was for a measly 0.1% expansion. However, the final number published in late June showed that GDP fell by a whopping 2.9%. Much of the poor result can be explained away by the weather, one-time events and inventory numbers. These apparently dismal numbers were generally ignored because they were not corroborated by most other economic data. Currently, we prefer to keep our eye on the employment numbers as a critical signpost for the economy. Indeed, the employment situation is decidedly more upbeat. In June, the Department of Labor announced the US added 288,000 jobs and revised the total for the previous two months higher as well. The average monthly increase in jobs over the previous three months is 272,000, which is the highest since May of 2006. The lone caveat to the employment picture is that many of the new jobs are only part time, but the employment situation is still improving and keeps us positive about the economy and financial markets.

Our investment process relies heavily on a contrarian strategy in which we find companies that are cheap because they are out of favor. Investors with short-term investment horizons sell stocks en masse when short term problems arise. Stock prices then tumble and opportunity is created. A very good and recent example of this kind of situation comes straight off the cover of the July 14th Barron's which exclaims – "Retail on Sale."

It has been a difficult period for retailers in general. According to Barron's the six worst performing stocks in the S&P 500 in 2014 are retailers. In addition, comments from Wal-Mart's CEO explicitly stated that job growth is not translating to retail sales. Many retail stocks have badly lagged the market. At some point, however, job growth must spur consumer spending. Now is the time to position for the rebound. One candidate for the turnaround is Target. Over the past year persistent problems with its expansion into Canada, a large credit card data breach and a generally weak retail sales environment pushed the stock price from $73 to the mid-50's; that is retail on sale. At its current price the stock yields 3.6%. Eventually Target will get it right in Canada and operations will improve. At 20% off, Target is the epitome of a name brand on sale. There are still enough stocks like Target out there to be found and that makes us confident about our portfolios going forward.