Lazy Days of Summer

July Market Review From Your Portfolio Management Team—August 9, 2013

In most parts of the country, summer is a time to stay out of the heat, slow things down, and enjoy a calmer pace of life. That also seems to sum up what we often see in the markets around this time of year. After a sizzling first half of the year, culminating with a 5% rally in July, the U.S. stock markets are poised to spend the remainder of the summer digesting these gains and looking for the next catalyst to send prices even higher. Stocks have been on a resilient uptrend so far this year, with U.S. equity funds posting a record inflow in the month of July alone, according to TrimTabs. This has been a welcome change as investors had been favoring bond funds as opposed to stock funds, even though stocks have made a strong recovery since the depths of the financial crisis in early 2009. Nevertheless, in spite of the strong results in July, stocks remain only 1% higher than the levels first hit in late May—maybe it's fair to say that the lazy days of summer extended back into the spring.

On the other hand, the bond market (which had been on a tear for several years), appears to have taken a vacation for the whole year. It has been the worst first half of the year for bonds since 1994 (another period of rising interest rates), with most segments of the bond market in negative territory or barely positive for the year. Those losses in values are having an effect on fund flows, as well, with TrimTabs reporting heavy outflows from bond mutual funds and exchange-traded funds (ETFs). In July, most of these funds stabilized, and their next direction is uncertain.

Interestingly, while some of the recent outflow from bond funds went towards stock funds, much of the outflow went to money market funds. So, cash still sits on the sidelines, waiting for either the next big catalyst to power the continued upward movement in equities or for clues as to where to go next.

So, where have your accounts been? While that depends on the specific strategy in which your accounts are invested, FSA has generally been reducing bond fund holdings and increasing exposure to equity funds. The bond fund positions we did hold onto during the recent sell-off were funds that held up relatively well, such as high yield corporate bond funds, or floating rate funds, which tend to do well in an environment of rising interest rates. Most bond funds are very close to their FSA Safety Nets®, so any further weakness will result in those remaining positions being sold.

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It is important to keep in mind that how portfolios look today might be very different from how they will look in a few months or even weeks from now. What might change? There are numerous looming headlines that could quickly turn the boring days of August into volatile ones, as was the case two years ago. Headline-making news, especially of the unexpected variety, can appear out of nowhere, providing a jolt to a side-ways moving market. The result could either be a market that breaks to new highs or corrects.

During these relatively calm, dull days of the summer market, it is perhaps even more important for FSA to remain ever vigilant. It is far easier to miss something looming under the surface of calm seas than it is when those seas are raging with turbulent waters, churning up whatever lies hidden beneath.

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