FISCAL CLIFF and SEQUESTER and BUDGET TALKS – OH, MY!

February Market Review From Your Portfolio Management Team—March 8, 2013

If bad news is what sells, then the media must be raking it in these days, and it's been enough to make you want to turn off the news. Yet, like watching an approaching train wreck in slow motion, consumers can't seem to turn away. On March 1st, the government spending cuts, known as the "sequester," kicked in without any successful action by the White House or Congress to stop it. From fewer food safety inspections, to less security personnel at airports, to teachers losing their jobs, to our weakened national defense, the media outlets would have you believe that the world, once again, was about to end on March 1st. Politicians on both sides of the aisle have been all too happy to echo that sentiment with dire predictions of what would happen if the other side didn't budge.

But it's been quite the tale of two cities, one being Washington and the other being Wall Street. Due to our proximity to our nation's capital, we tend to be more cognizant of Washington's bickering and how striking it is when Wall Street appears to turn a deaf ear. Indeed, it might surprise you that as of Feb. 28, the S&P 500 Total Return Index was down less than 1% from its 52-week closing high reached a little more than a week earlier. For the month of February, the S&P 500 Total Return Index was actually up 1.3%.

One would think, with all that was at stake with the looming sequester, the market would behave as expected, give a good pullback, and Wall Street would be breaking down the doors of congressional leaders to demand action. But the market doesn't always act as conventional wisdom would say it should. While the markets did experience some rocky days the last week leading up to the sequester deadline, it wasn't because of what you might expect. Rather, Europe, and in particular Italy, was the culprit. On D-Day, March 1st, the DOW and S&P 500 actually ended up, albeit slightly, after a morning swoon. What sequester, you might say?

So why has the market been showing such resilience? Do investors have their heads buried in the sand, hoping that whatever happens, the great and powerful Oz (i.e., Fed and company) will come to the rescue? Or could it be that while across-the-board spending cuts may not be the best way to go about it, investors know this is much-needed medicine in order to get our fiscal house in order? It could also be that investors are looking beyond the background noise coming out of Washington and focusing on an improving economy. Finally, it could just be that time of year.

Here's a statistic cited on CNBC: *Since 1950, March and April have been positive months for the Dow, with average gains greater than a percent. April, in particular, has been the best month of the year, posting an average monthly increase of 2.7 percent in the last 20 years and 1.97 percent since 1950.*

As we all know, history isn't always an accurate barometer of what is to come. Since markets are forward-looking, the sequester may well be in the rearview mirror by now, with other "bigger picture" issues coming down the pike, such as a government shutdown near the end of March, a budget battle, and possible downgrade of U.S. debt over the summer. These events might do more to get Wall Street's attention and nerves rattled.

Regardless, there is no denying that the recent trend of the stock market is up, and we want to participate. With all of the uncertainty on the horizon, however, our preference is to "ease" into the equity markets rather than throwing caution to the wind and diving in head first. As such, we have slightly reduced bond positions in certain strategies to allow for more equity exposure, and in others, we have initiated an inverse high yield position as a buffer against a decline in the price of high yield bond funds.

Will the equity markets continue to show resiliency against formidable political headwinds, not to mention geo-political risks such as those between Israel and Iran, or will the markets relent and give the correction that almost every market guru is calling for? Like a rebellious teenager, the markets have a tendency to do the opposite of what conventional wisdom might dictate. In either case, know that FSA remains vigilant in our search for opportunities regardless of which way the wind blows.

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