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"By The Way"

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"Sell in May and go away". The old adage got it half right; one didn't have to sell, but the going away part was a brilliant suggestion. Once the brief downdraft caused by the passage of Brexit was over, major indexes including the bellwether S&P 500, traded in a very tight range of 1-2% from the middle of July through Labor Day. In addition, volume was almost non-existent, and volatility as measured by the VIX collapsed. But now here we are in September, everyone is back from the cottage or the Hamptons and there is lots of potentially impactful news facing markets with the attendant "event risk".

First of all, volatility has returned as witnessed by the S&P being down 53½ points on Friday, up 31¼ on Monday, and down 32 Tuesday. Largely these moves were caused by the flip/flop in expectations about when the Federal Reserve would raise rates. A hawkish speech on Friday by Boston Fed President Eric Rosengarten seemed to suggest a rate increase could happen as soon as this month which sent the index lower. That was reversed on Monday when Federal Governor Lael Brainard practically assured everyone there would be no such increase. It makes one wonder if these are trial balloons meant to gauge the market's reaction to different potential Fed policy moves. Neither the Fed, nor ourselves, want to see a repeat of January's "tantrum", which occurred the last time the market expected a rise in rates. It is not in the mandate of the Fed to concern itself with asset prices, nevertheless it is now obvious the Board is concerned about and in fact focused on, the effect its actions have on financial markets. Take note of a recent interview with Vice Chair of the Fed, Dr. Stanley Fischer. In responding to a question about negative interest rates said "we have to make trade-offs….and the lower the interest rate the better it is for investors". Great news for stock markets and Wall Street (and keeps us bullish), but a body blow to savers, retirees, pension funds, and anyone else seeking income. There was a time not long ago that people were laughed at for suggesting central banks intervened in financial markets; today they do it with aplomb and are proud of it. The Central Banks policies of China, Europe, Japan and the U.K. will also affect markets. For the most part good economic news is still seen as a negative. Only this week, better than expected factory output and retail sales in China sent that stock market lower over concern the Peoples Bank would ease up on stimulus.

The second major short-term cause for concern and uncertainty is the U.S. election. There is much "shock and awe", but it is impossible to foresee where this all is leading us; who will win and what the real agenda will be once in office. My sense of uneasiness perhaps stems not from any particular policy of the two candidates but rather that there will be a certain unpredictability and inconsistency that will further impede the drive to make productive investments and grow the economy, which would inevitably impact markets. Don't ask me how, but someone actually attempts to measure such things (www.policyuncertainty.com), and the index they have created has moved from about 120 a year ago to 180 now. Regardless of its accuracy, this is a definite headwind to economic growth and would likely get worse under either a Clinton or Trump regime.

I assume someday, somehow, valuation metrics like economic and earnings growth will once again be the drivers of financial markets. There are certainly causes for concern in those areas. One of the most useful leading indicators of the economy is the Purchasing Managers Index and it has been at best lethargic recently. The Global PMI was down 0.9 points in August but still remained above the 50% mark indicating some expansion. The U.S. PMI in August was down 3.9% at 51%, not good for the supposed trendsetter for the rest of the world. In addition, world earnings per share, as measured by IBES, were down 3.2% in the 12 months ending in August. We will continue to track these indices in hope this is not a longer term trend.

Finally, and maybe most importantly, longer term interest rates need to be watched closely. In the last two months the yield on the 10 year U.S. Treasury Bond has risen from 1.46% to 1.72%. Much higher long rates could have a significant negative effect on economies and markets. But for now we trust in the "Fed Put" and stay the bullish course.

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