Manager Perspective

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TANDEM
WEALTH ADVISORS

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On Friday, June 1, the US equity market experienced the pain of a broad selloff with some of the biggest declines this year. A disappointing US jobs report for the month of May, coupled with ongoing market corrections in Europe, drove US markets lower. The last several weeks have been challenging in US equity markets after the best first quarter in a decade. While painful to witness, we believe it is prudent to step back and analyze the overall investing environment.

China and Europe continue to face economic pressures while the US seeks solid direction in its own recovery. Investors remain wary with the knowledge that during the past two summers we have seen broad market pullbacks followed by recoveries over the next several months.

While the US economic data remains mixed, the Federal Reserve is likely considering another round of quantitative easing. In some regard it has already occurred. The extensive buying of US Treasuries by private investors (both domestic and international) has pushed long rates even lower than the Fed had pushed them. This is very beneficial to the Fed because it does not require them to print dollars to buy the bonds. Yet, the recent market declines make it more likely the Fed will enter a third round of quantitative easing that would drive investment dollars toward riskier assets such as equities. We await the June Fed meeting, and we believe the global backdrop may warrant action by the Fed.

At the moment, we wish to share the following thoughts to help put the media chatter in perspective:

1) The US economy is still growing – slowly and unevenly, but it is growing which is more than we can say for Europe.

2) The reason US bond rates are at 65 year lows is because people around the world believe in the strength and safety of the US.

3) With bond rates now below a 1.5% yield and bonds having massively outperformed stocks in the current quarter, pension funds and institutional investors are set for a big asset reallocation at the end of the quarter/early-July (as they will be overweight in bonds and underweight in stocks versus their asset allocations).

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4) With interest rates so low and actuarial assumptions for pensions still around the 6-7% rate, the only way to get a higher expected return is to increase equities.

5) As of early June, 26 of the 30 stocks in the Dow had a higher yield than the 10-year Treasury. Stocks are yielding (90 basis points) more than the 10-year Treasury and can grow both dividends and earnings. Buying a 10-year bond at a 1.5% yield or less almost guarantees an after-inflation loss for the next decade.

6) Quality companies worldwide, and particularly in the US are extremely inexpensive. Ex.) Apple at 12x earnings, Corning at 8x earnings, TEVA at 6.5x earnings, Ford at 7x earnings, Kohl's at 11x earnings, Exxon at 9x earnings, Caterpillar at 8x earnings, etc. The world's great companies are on sale waiting for investors to realize and commit capital.

When Tandem rebalanced portfolios in early-2012, we were near the end of the strong equity rally which led us to slightly overweight fixed income relative to our normal asset allocations. After the turmoil of the past several weeks we are beginning to unwind this positioning and slowly move some fixed income monies back into equities at current valuations. The defensive positioning has benefitted client portfolios during the past few months.

Patience with an ability to stay focused on a longer term perspective will reward investors. As always, please contact us if you have any questions or concerns.

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