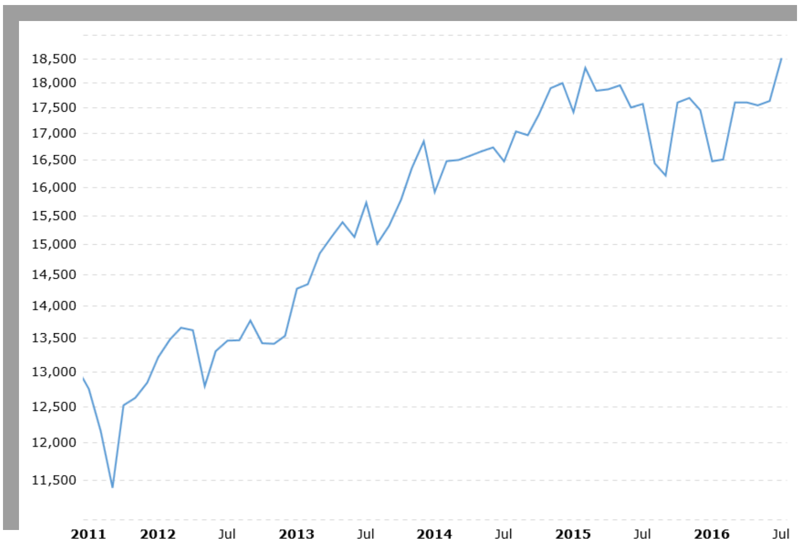
How About Some Good News - for a Change: Record Highs for the DOW and S&P 500!

By Bob Deitrick, ChFC, CEO
Tuesday, July 26th, 2016

Over the past four weeks since the Brexit speedbump, the market has shown great resilience as we've seen a considerable rebound. Since Brexit we witnessed an impressive employment result on July 8th adding 287K new jobs to the domestic payrolls in June. Auto sales were solid last month and the manufacturing (ISM) index has now been above 50 for 4 consecutive months - indicative of positive sales growth. Earnings for the 2nd quarter, starting with Alcoa, have been positive – far better than expected. We are also beginning to see top line revenue growth improving, profit margins are high, and overall US companies are doing very well. Inflation is in check as gas prices are lower than last summer, and the summer before that in 2014 as well... We believe all of these data points demonstrate a growing economy in 2016 and a market that will move forward.

Investors have been piling into the U.S. stocks over the past four weeks since the Brexit vote of June 23rd. In fact, last Friday the S&P 500 and the DOW hit all-time highs and were in record territory once again. We are watching this market very closely as we approach the peak in this investment cycle. But, in our view, we are not there yet. August looks tricky this year, but after Labor Day we believe a rally may be in store for the domestic markets as we close out the year.

The necessary conditions to create an appreciating stock market include solid earnings and a sustained low VIX rating. Good earnings, should lead us to new highs and a little more good news on the macro front may act as a sub-catalyst to move this market forward as well. Steven and I suspect, despite the very tumultuous start to this year, that we will likely be higher in December than we are today. The S&P 500 eclipsed its record high from May of 2015 last week and the Dow Jones Industrial Average stands at 18,570 as we write this newsletter and the S&P closed at a record 2,175:



There are six fundamental reasons why we believe this market can and will likely grind forward in 2016 and beyond:

- ***First, the bottom of the earnings recession was in the first quarter of this year with what was the second correction we had seen in six months...***
- ***Second, oil is no longer declining and the dollar is no longer going up ... therefore earnings are likely to surprise to the upside in the 2nd quarter as they did last week.***
- ***Third, it is probable that we are going to have positive earnings results in the 3rd and 4th quarters as well.***
- ***Fourth, low bond yields and low interest rates make stocks the preferred choice. Today, two-thirds of the stocks in the S&P are producing a higher yield than the 10-year Treasury note and more than a third of US stocks are higher than our 30-year Treasury bond yield.***
- ***Fifth, over the last three weeks, small and mid-cap stocks have been outperforming their large cap counterparts, which is indicative of expansion - not recession.***
- ***Sixth, the VIX or the volatility rating which we watch very closely was now down to 12.15 as of Friday which means that we are in the sweet spot for the market to have a greater probability to appreciate. The lower the VIX the more stable the market.***

We believe these six reasons are why the domestic equity markets are probable and likely to move higher as we close out the year. *Of course, nothing is set in stone and as all of you know, market fundamentals can change, but* ***our outlook for the balance of 2016 - through the election cycle - remains positive.***

For the naysayers whom you will see on TV consistently who proclaim this rally is about the central banks - we disavow their non-sense. They are fools who are not looking at the broader narrative. U.S. Companies are performing well, profit margins are high, and our economy is showing signs of real life. The Fed is secondary to what is taking place in our economy in real time.

Jobless claims, which Steven and I watch very closely, fell last Thursday to a near-historic low of 253K, close to the 50 year low of 248K reached in April. Labor market strength, characterized by very low layoffs and a solid pace of hiring, is boosting consumer confidence and spending, which in turn is providing a lift to economic growth. According to a Reuters survey of economists, the government is expected to report next week that the economy grew at a 2.6 percent annualized rate in the 2nd quarter - an acceleration from the 1.1 percent pace logged in the first quarter of the year. The good news is that this rally is not over yet. We look forward to the 2nd half of this year.

On another note, we have two client events in September. Please check them out on our website:

http://www.polarisfinancial.net/event.html

We hope to see you at one of both of these upcoming events. Have a terrific summer and please reach out to us with any questions or concerns.

Bob Deitrick and Steven Morgan