The Investors' Newsletter

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INSIDE THIS ISSUE

"An increase in interest rates too soon could further slow demand and push prices lower."

Perspectives

2015 is ramping up to be the year of limbo. Investors are stuck waiting on the next catalyst to move the market and with each release of economic data, the picture isn't any more focused. The S&P 500 is up 0.92% through the end of this past week. After three months and two days, the Dow Jones Industrial Average is up only 0.27%. Trading volume on the exchanges has fallen well below average and even has the hedge funds' algorithms at a loss for what to buy or sell on any given day.

Much of the delay in consensus comes from the question over when the Federal Reserve will raise interest rates. The Fed's dual mandate is to work for maximum employment and stable prices (i.e. an inflation rate of 2%). As Fed Chair Janet Yellen has repeatedly said, the decision of when to raise rates will be "data dependent". The employment picture has steadily improved for the past few years, pushing the national unemployment rate down to 5.5% and weekly unemployment claims below 300,000. The employment picture has become clear. The need for emergency level, near 0% interest rates, has passed. While not at "maximum employment" yet, the US is no longer in a panic situation. The current employment trends justify beginning the path towards normalizing rates.

The challenge comes from the other half of the dual mandate. Recent Consumer and Producer Price Index readings have shown a decline in prices. These deflationary signals are major influences in why the Fed has delayed raising rates. The cause of these price declines is often debated. The drop in the price of oil has lowered input costs for manufacturers and some of these savings are being passed along to consumers. On the other hand, consumers have not been using the extra cash they save from lower oil prices to spend more, but instead are saving more. The result is lower demand for products and services. Prices decrease when demand falls below supply. An increase in interest rates too soon could further slow demand and push prices lower and this uncertainty is why the Fed has continued to postpone changing its rate policy.

If oil's influence is a major factor in price declines, it will be transitory. While the price for a barrel of oil could continue its slide over the next few months (especially now that storage capacity for oil is at its limits), prices will revert to the mean at some point and will have a reverse effect on inflation. As I mentioned in the January newsletter, investors should expect a rate increase in September if economic data maintains its current trends. The Fed needs to take the first steps on the path to managing where inflation will be in the coming years and not simply focus on how it has been recently due to fleeting stimuli.

Raising rates in June could be too soon. First quarter economic data has shown that growth is slowing and needs more time to adjust to the strength in the US dollar. GDP is growing at a much slower pace than previous reports and the Fed needs to be careful not to apply the brakes too soon. It could be that September will be viewed as too soon still, but the negative effects of low interest rates will do more harm than good eventually. Small and measured increases in interest rates starting this fall will offer a sign to businesses and consumers that the economy is strong enough to withstand the change.

Stock prices are based on expected future earnings. Investors should not anticipate much upside movement until expectations of how the future will play out get past the interest rate fog. Outside of the market's obsession with interest rates, earnings announcements are approaching starting this week. As other economic input are mixed, corporate earnings reports could be the catalyst investors have been waiting for. The more tangible data pulled from these reports will be more important than the potential for what could happen when a rate hike happens.

Summary of Indexes

Courtesy of Morningstar.com

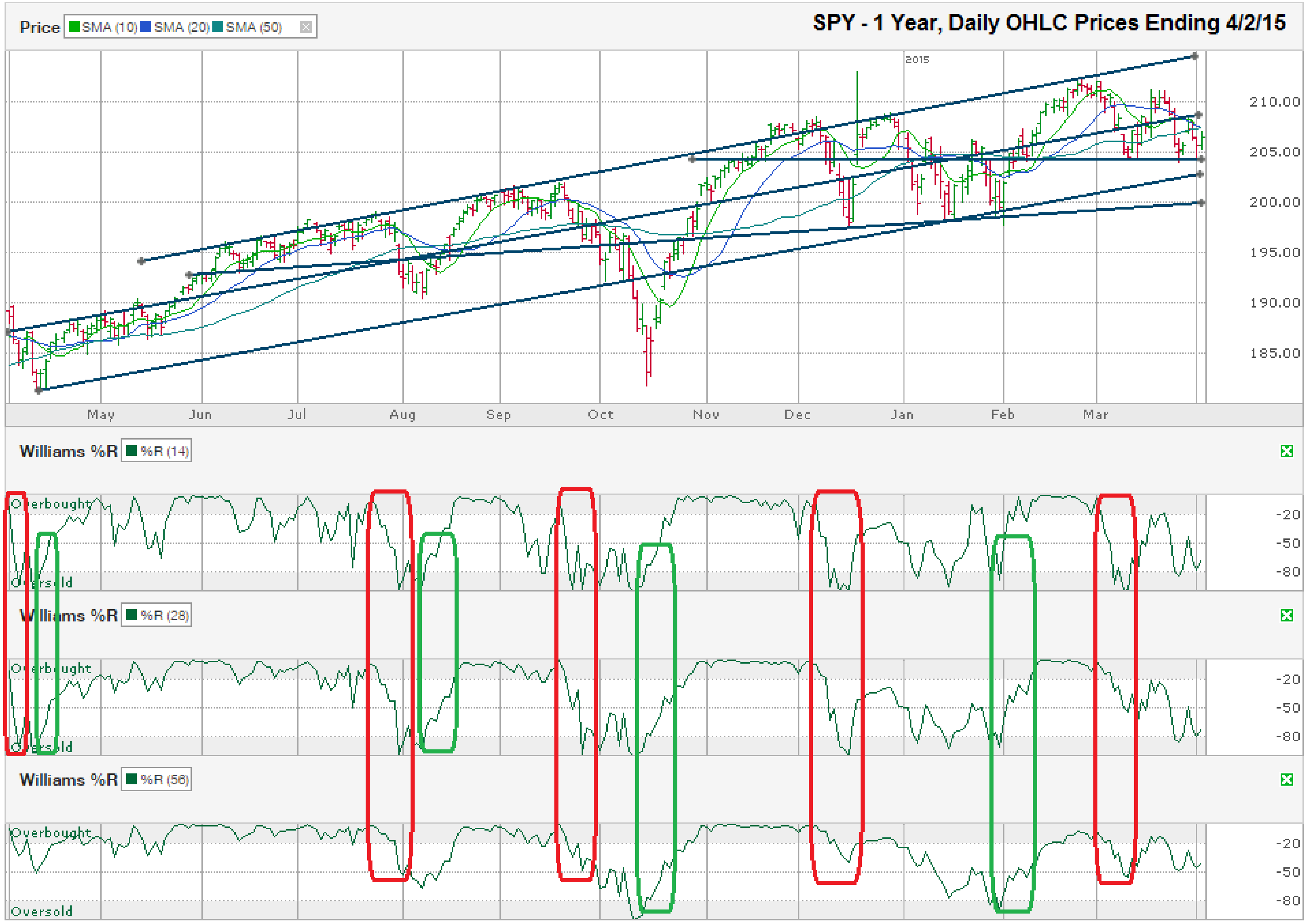
Name	As of Date	YTD	1-Year	3-Year	5-Year
US Stock Indexes					
DJ Industrial Average	4/2/2015	0.27	9.70	13.01	13.07
NASDAQ Composite	4/2/2015	3.19	14.28	16.14	15.26
Russell 2000	4/2/2015	4.56	6.66	15.88	14.44
S&P 500	4/2/2015	0.92	11.57	15.81	14.29
S&P MidCap 400	4/2/2015	5.31	10.89	16.84	15.50
Global Stock Indexes					
MSCI Emerging Markets	4/2/2015	3.82	-1.21	-1.78	-0.70
MSCI World, Excluding US	4/2/2015	5.09	-0.78	8.25	5.70
Bond Indexes					
Core Bond	4/2/2015	1.76	6.31	3.28	4.65
Intermediate Core Bond	4/2/2015	1.58	5.91	3.11	4.42
Long-Term Core Bond	4/2/2015	3.04	13.88	6.52	9.00
Short-Term Core Bond	4/2/2015	0.78	1.58	1.20	1.80

Fundamentals & Indicators

- The Empire Manufacturing Survey showed strength throughout the first quarter with three consecutive positive numbers. January registered a reading of 9.9 followed by 7.8 and 6.9 in February and March.
- The Philadelphia Fed's Business Outlook Survey echoed the strength from the Empire Survey with readings of 6.3 in January and 5.2 and 5.0 in February and March.
- Retail sales demonstrated that consumers have increased their saving rather than their spending. December retail sales fell 0.9%, while January and February declined 0.8% and 0.6% respectfully.
- The Producer prices index (PPI) highlighted the lack of pricing pressure in the producer pipeline. Such subdued pricing helps the Fed's case for delaying a rate hike. December producer prices dropped 0.2% followed by declines of 0.8% and 0.5% in January and February.
- The Consumer Price Index (CPI), one of the Fed's key indicators of inflation, dipped 0.3% in December, slipped another 0.7% in January and then rose 0.2% in February. Low inflationary numbers are a major influence for the Fed to maintain low interest rate.
- Housing starts rose 4.4% in December to 1.081 million and flattened in January with 1.081 million starts again before faltering in February with a decline to 897,000. Economists blame weather for the decline in February, which increases the expectations for a rebound in the March report. If the March report is not above trend, traders will have reason to worry about a slowing housing sector.
- Existing home sales wavered over the past three reports. The December report showed an increase of 2.4% to 5.04 million. The January report pointed to a 4.9% decrease to 4.82 million and the February reported rebounded by 1.2% to 4.88 million. On the positive side, the median existing home price increased 7.5% year-over-year in February, marking the 36th consecutive month of year-over-year price increases.
- New home sales began to accelerate recently. Since ending November with a 12-month average of 433,000, December improved to 479,000 new home sales followed by continued momentum in January and February with 500,000 and 539,000 new home sales.
- Pending home sales dropped in December by 3.7%, but resumed the positive trend in January and February with increases of 1.7% and 3.1%.
- The Case-Shiller 20-city Home Price Index confirmed the strength seen in other housing reports. The November and December reports showed increases of 4.3% and 4.5% in home prices followed by a much more robust 13.2% increase in January. The lack of supply has played a large role in rising housing prices. As demand has improved, supply has dropped and prices have been forced higher with fewer choices available for buyers.

- Total durable goods orders fluctuated widely over the past few reports. December saw a decline of 3.7%. January rose 1.9% and February fell 1.4%. Volatility from aircraft orders played a large role in the fluctuations while orders for nondefense capital goods, excluding aircraft, have declined for the past six months.
- The pace of Factory Orders declined by 3.5% in December and 0.7% in January, but rebounded slightly in February by 0.2%.
- The ISM Manufacturing Index remained in its expanding trend throughout the first quarter with readings of 53.5, 52.9 and 51.5 from January through March respectfully. While each reading remained above 50, the demarcation line between expansion and contraction, the rate of expansion has slipped and is an indication of slowing growth.
- The ISM Services index followed a different path with a steady expansion with readings from December through February of 56.5, 56.7 and 56.9. February was the 61st consecutive month of an expanding services (non-manufacturing) sector. March is forecast to continue the trend.
- Construction spending rose by 0.4% in December, but then slipped in January by 1.7% and by 0.1% in February.
- Gross Domestic Product (GDP) slowed in the fourth quarter after strong second and third quarter growth of 4.6% and 5.0%. The advanced estimate of fourth quarter GDP showed 2.6% growth, but the second and third estimates lowered the estimate to 2.2%.
- Weekly unemployment claims have been one of the economic bright spots over the past three months. The four-week average, which removes some volatility, remained below 300,000 for most of the first quarter. Economists view weekly claims below 400,000 as an indicator of a strong economy.
- The unemployment rate rose 0.1% to 5.7% in January and then fell to 5.5% where it remained for February and March.
- The U-6 unemployment rate that includes the total number of unemployed and those employed part-time, but seeking full-time employment and is viewed as a more realistic picture of total unemployment, rose 0.2% to 11.3% in January and eased to 11.0% in February and then fell to a new six-year low of 10.9% in March.
- The labor-force participation rate was little changed at 62.7% in March. Since April 2014, the participation rate has remained within a narrow range of 62.7% to 62.9%, at the bottom of its historic range.
- Non-farm payrolls beat expectations in January with 257,000 new jobs added in addition to another 147,000 in positive revisions to the November and December reports. February payrolls added 295,000 new jobs, but reduced the January count to 239,000. Only 126,000 new jobs were added in March, well below the consensus estimate of 243,000. Adding to the missed estimate, December and January figures were revised down by a combined 69,000.
- The average workweek was reported at 34.6 for January and February and slipped 0.1 hours to 34.5 in March.
- Average hourly earnings improved in each of the past three months. Earnings rose 0.5% in January, 0.1% in February and 0.3% in March to $24.86.

Index Chart & Analysis



The chart above shows the daily prices for the past year on SPY, an S&P 500 Index ETF, after the ETF closed the week at $206.44 on April 2, 2015. SPY has maintained a wide ascending trading channel for the past year with only one multi-day break beneath its trend line of higher lows. The majority of the daily prices fall within the upper half of the trading channel, but this trend has weakened over the past four months and prices have spent more time hovering in the lower half lately.

A horizontal trend line has emerged close to $204 that has acted as both support and resistance multiple times since mid-November. This horizontal line and the ascending trend line of higher lows are on a path to converge in April and should offer support for stocks. If both of these trend lines break support, the next area traders will be watching is the shorter trend line of higher lows. Most of the touch points for the trend line are from December and January, but the line actually started in late May as resistance and then became support in June. The shorter trend line is currently close to $200, only about 2% below the expected point of convergence for the trend lines mentioned above.

Traders need to be aware of the signals from the moving averages and Williams %R before relying too heavily on the trend lines. In a rare occurrence, the 10, 20 and 50-day moving averages have converged at the same point, just below $207.50. Bulls should be cautious when this happens while SPY is trading below this point. Unless SPY moves above $207.50 within the next two trading days, the 10-day moving average will make a bear cross below the 20-day moving average and both moving averages will strengthen the bears' case as they move below the 50-day moving average. On continued weakness, the influence from the moving averages will be enough to push SPY below its trend lines.

The Williams %R indicator offers another reason to be cautious. For the past year, in each break below the overbought area, SPY did not begin its recovery until at least the 14 and 28-day indicator bottomed deeply within the oversold area. Greater recoveries were seen when the 56-day indicator bottomed also. Since the latest break below overbought in early March, only the 14-day indicator reached an extreme level in the oversold area. The 28-day indicator touched oversold, but bounced immediately. The 56-day indicator has only made it to the halfway point, signally that the bears have not finished their turn at the reigns yet. Technicians will be in a wait-and-see mode until a clear direction is established again.

AF Capital Management, LLC
PO Box 566241
Sandy Springs, GA 31156

404-395-2752
alex@afcapitalmanagement.com

Twitter: @AlexRFoster
Facebook: AF Capital Management

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