

Rochester Financial Services

Fee-Only® Financial Management Services

Jeffrey Feldman Ph.D., CFP
Certified Financial Planner
Principal

September 3, 2011

Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Crude Oil	Gold
11,240	1,174	2,480	683	2.00%	8.09%	\$1,877	\$86.45



Investment Strategy Report

Stocks Experience "Mini Crash" Before Recovering. Fate of Europe Remains the Key

The S&P 500 ended July at 1292. Seven trading days later, on August 9th, it reached a level of 1101, a drop of 14.8%, one of its most precipitous declines ever. It then reversed course and ended the day at 1173, a 6.4% recovery from its intra-day bottom. But the volatility did not end there. That week of August 8th turned out to be the most volatile week ever for the stock market. The Dow was down 635 points on Monday, up 430 points on Tuesday, down 520 points on Wednesday, and up 423 points on Thursday in a week of unprecedented turmoil. Never before had the Dow moved 400 points up or down on four consecutive days. What caused this upheaval in the markets? As I mentioned in last month's letter, the anxiety over the debt ceiling debate and the subsequent downgrade of US debt from AAA status was a sideshow to the main event - the economic showdown in Europe.

As is very often the case, the stock market is in a schizophrenic state. If the Eurozone doesn't undergo an economic collapse, then it is very likely that the stock market has overreacted to the downside. In this weekend's *Barrons*, 10 Wall Street strategists were interviewed and asked to give their year end forecast. On average, they predict that the S&P 500 would end the year at 1300, a little more than 10% higher than Friday's close. For the most part, they cite profit estimates to justify their projections. They estimate that the S&P 500 companies will earn \$100 per share for 2012, which, at its current level of 1174, would give the S&P a forward Price/Earnings ratio of 11.7. This is a very low level. Historically it has averaged closer to 15. That would make their estimate for a price target of 1300 for year end 2011 and still higher for 2012 a real possibility. What makes their estimates even more compelling is the fact that interest rates are at record low levels. When an investor decides to invest in stocks, he has to weigh the alternative - investing in bonds. Currently, someone investing \$1,000 in an S&P 500 index fund would be investing in companies that would be producing \$80.90 in profits this coming year (see data at top, which assumes \$95 of profits divided by the current S&P 500 price of 1174). If this same investor invested \$1,000 in Treasuries, he would expect to earn \$20 per year in interest in a 10 year Treasury, \$8.70 from a 5 year Treasury, and \$2 from a 2 year Treasury! This disparity in stock market yield vs. Treasury yields is the widest ever as far as I can tell, which argues for a reversal at some point from the presumed safety of Treasuries, to higher yielding equities, when investors no longer have a sense of panic and a need to invest in safe havens.

Which brings us to the potential of financial Armageddon in Europe. We have been watching the crisis over there beginning in early 2010 when Greece first showed signs of trouble. It has since spread to the larger countries, Italy and Spain, as well as to the French and German banks that have invested in these countries. This Wednesday, Sept. 7th is a key date. Germany's high court will rule on whether it is constitutionally legal for the German government to help bail out Greece. It is being likened to the situation here in the Fall of 2008 when Congress was asked to approve the Government TARP program which was used to bail out the banks. Even if the court says yes, which at this point looks doubtful, there still does not seem to be any viable solutions to the European debt crisis. And the fear that we can see a contagion effect a la 2008 is a very real one. As the markets try to sort out the positives and negatives, I will continue to maintain a defensive position and wait until the market volatility decreases and a clearer picture emerges.

Market Sectors - 1) Gold continues to outperform stocks and has helped to cushion our performance during August's big slide. 2) The emerging markets in general and my largest holding specifically, performed about in line with the averages, which is a plus considering their recent outperformance and their tendency to be more volatile. 3) Our biotech fund got hit hard during the initial sell-off but then recovered nicely. I still expect this sector to outperform but will wait until the market uptrend continues to see if this pans out. 4) Interest rates plummeted this month when the Fed pledged to hold short term rates near zero for 2 more years. However, since most analysts, including the strategists referenced above, are calling for rates to shoot higher in the next few months, I feel that having at least some hedge against rising rates to be important. Maintaining a balanced approach with both traditional and non-traditional bond funds should serve us well going forward.

Jeff Feldman

Tel: 585 / 442-7580

Fax: 585 / 473-9947

Email: jmfeld@aol.com

7 Hastings Circle, Pittsford, NY 14534

<http://www.rochesterfinancial.com>



Registered Investment Advisor with the United States Securities and Exchange Commission