Making Sense of Finance

Karagosian Financial Services | 4/15/2013 | Volume 16, Issue 2

First Quarter Review

STOCK MARKET

The U.S. stock market had a repeat performance of last year's first quarter and delighted investors by starting the year with a large gain. Both the S & P 500 and the Dow Jones Industrial Average recorded double digit percentage increases in the first three months of 2013 (10% and 11% respectively). Last April we stated that the forward P/E on the S & P 500 was only 12.9 (price divided by next 12 months earnings estimates); this year it is slightly higher, 14.1, but still below the average of 14.5. Given the extremely low interest rate environment, and therefore the lack of attractive alternative investments, the current forward P/E looks reasonable to us. The NASDAQ Composite also had a strong quarter but increased only 8%. Much of the reason for its lagging performance relative to the other major indices can be attributed to Apple. While Apple led the market in early 2012, the first three months of this year it has been a drag. The big question is where do we go from here? No two years are exactly alike, but since it is still fresh in our minds comparing 2013 to 2012 is tempting. After a huge first quarter, the S & P 500 went on to close out 2012 only 1.3% higher than how it ended in the first quarter of that year. Indices by their very nature are so diversified they may trade sideways, but individual stocks may behave very differently. That is when stock picking takes on greater importance. As mentioned previously in regards to Apple, the NASDAQ still found a way to rise even without the help of Apple so there must have been many other stocks doing really well to offset the oversized influence Apple has on this index.

The best performing sector last quarter was healthcare followed by consumer staples and utilities. All of these sectors are typically considered "defensive" which could mean that investors are still leery of the state of the economy, especially given that fourth quarter 2012 GDP final number came in at less than 1% real growth (0.4%). Materials and technology sectors were the laggards for the first quarter. Part of the attraction of the better performing stock groups was their dividends. Overall, 944 dividend increases were reported for the first quarter of 2013 in U.S. listed stocks (out of approximately 10,000 companies). Actual cash payments increased 12% from 2012's first quarter and the forward indicated dividend rate reached a new all-time high.

Making Sense of Finance

• • •

Everybody and their neighbor has an opinion. At Karagosian Financial Services, we have a combined 40 years of investment experience. We have seen the markets at their highest highs and lowest lows. Through this newsletter we attempt to convey our opinions on current events in the investment world and their likely outcomes. Forecasting is inherently difficult and our advice is more about making sensible and prudent choices based on logic and experience, and not on emotion.

Contributors:

Seaver T. Wang

Christine Terry

315 Fifth Avenue 704B

New York, NY 10016

www.toinvest.com

Representatives are registered through, and securities are sold through NPA Financial Services, Inc., Member FINRA/SIPC, located at 115 West Century Road, Suite 360, Paramus, NJ 07652. Investment advisory services are offered through Karagosian Financial Services. Insurance sold through licensed NPA Insurance Agency, Inc. NPA Financial Services, Inc. and Karagosian Financial Services are non-affiliated entities.

Foreign stock markets in general did not perform as well as our domestic market last quarter. The MSCI EAFE Index (developed markets excluding North America) gained 4.4% in the quarter. This performance was held back by some European stock markets such as Spain and Italy where the MSCI index for those countries declined 6.4% and 9.8%, respectively in the first three months of 2013 but also lagged due to the decline of the Euro versus the U.S. dollar over recent months. (MSCI indices are measured in U.S. dollars). However of the developed countries, markets such as Greece, Ireland and Japan did better in the first quarter than their U.S. counterparts, albeit after posting weak returns in 2012. Also, major emerging market countries had weak stock market performances to start the year such as the MSCI China index losing 4.5% last quarter.

BOND MARKET

Bond performance was relatively flat in the first quarter as a measure of a broad spectrum of bonds, the Barclays Capital U.S. Aggregate Bond Index, had a total return of -0.12%. Treasury yields rose slightly (bond prices declined) even though the Federal Reserve continued with their monthly Treasury bond and mortgage-backed security purchases in order to keep interest rates low. The Fed discussed at its latest meeting near the end of the quarter, the possibility of slowing or tapering off these purchases towards the end of the year. Several members thought "that if the outlook for the labor market conditions improves as anticipated it would probably be appropriate to slow purchases later in the year and stop them by year-end". If this were to happen, it is hard to say what would happen to bond prices after this very large buyer was taken out of the market, particularly for longer term maturities.

Although absolute yields are near all-time lows amidst record new issue volume, high yield (lower quality) bonds still managed to show a positive total return for the quarter given strong demand for this asset class. Investment grade bonds and municipal bonds were basically unchanged during the last quarter. The strong performance of the U.S. dollar caused dollar denominated foreign government bonds to be the weakest performing bond sector losing over 3% during the first quarter.

OUTLOOK

With stock market indices hitting new highs in April, one might feel a bit apprehensive about staying fully invested. However, if one considers that current market levels are about the same as those in 2007 and also the year 2000, we view the most recent rally as just catching up. Since the Internet and Real Estate busts, corporate balance sheets are healthier than in decades, corporate profits are, on the whole, at record highs without a booming economy, and very low interest rates make stocks much more attractive as an asset class. Looking at the picture, the Dow Jones Industrial Average was around 60 in the year 1900, versus about 14,480 points today. That is up 24,867% or about 250x and that doesn't even include dividends which would approximately double that return. You don't go from 60 to 14,800 by not hitting new highs. Our point is that it is more important to see why markets hit records rather than the record itself, and in our current environment there seems to be plenty of substance to support current prices, as opposed to the hopes and dreams of profits that were never realized or those who borrowed money with easy credit in hopes of finding a bigger sucker to flip real estate to.

In our previous newsletters we mentioned that a positive shift of funds going into stocks and a resurging in the U.S. economy would likely lead to good gains, and this has already happened in the past six months. I see two factors prolonging this bull market; a recovery in foreign markets, and a rise in interest rates. In the past we have stated that low interest rates make fixed income investments less desirable, but this does not mean fixed income investors are headed for disastrous results. We think interest rates could keep rising for the next five years but at a very gradual pace which would mitigate the interest rate risk involved. Interestingly, we think that rising rates will actually help boost the economy, initially. We predict that anyone on the fence about taking on debt would see that the days of rock-bottom interest rates are nearing an end and refinance or take out new loans immediately, which would spur greater investment in the economy. Of course, there will likely be another economic scare coming from a country like Cyprus, with a gross domestic product of $25 billion (about the same as the state of Vermont, smallest in the U.S.) that ignites a frenzy in world markets or when North Korea's military threats steals headlines; but for the most part, life goes on and markets stabilize when the world doesn't come to an end.

Representatives are registered through, and securities are sold through NPA Financial Services, Inc., Member FINRA/SIPC, located at 115 West Century Road, Suite 360, Paramus, NJ 07652. Investment advisory services are offered through Karagosian Financial Services. Insurance sold through licensed NPA Insurance Agency, Inc. NPA Financial Services, Inc. and Karagosian Financial Services are non-affiliated entities.