viewpoint

MARSHALL & SULLIVAN

Marshall & Sullivan, Inc. / Registered Investment Advisor

After Greece

After hitting all-time highs in May, both the S&P500 and the Dow Jones Industrial Average took a breather. Both indexes ended the second quarter of this year slightly negative and both are up very little year to date. Last quarter was the first down quarter for either index in over 2 years.

On the other hand, both the NASDAQ and Russell 2000 (small US companies) were up for the quarter. The difference between these indexes and the S&P500 and Dow Jones Industrial Average are twofold. First, the NASDAQ and Russell 2000 contain faster growing companies with earnings growth propelling these indexes higher. Second, the S&P500 and Dow Jones Industrial hold many more dividend paying companies. Companies in the S&P500 and Dow Jones Industrial have gone up a little faster than their earnings growth as investors chased yields in this low interest rate environment.

None of this comes as a shock to investors who follow the US markets. What might surprise you is that the EAFE (index of Large International companies) was up for the quarter and has returned almost three times the S&P500 and Dow Jones so far this year. For many, it is hard to believe that international markets are up with Greece defaulting on its debt. The default has had little impact on the EAFE. The index did drop 3% the day of the news. We see the fall on the day of the default as more of an emotional reaction to the news. If we had seen a larger emotional reaction to the news we would have looked at it as a buying opportunity.

In the past, market pull backs of 10% or more have generally not been a time to sell, but a time to buy. You can see this in 1987 with black Monday, in 2008 with our debt crisis and the 2010 flash crash just to name a few.

It did not come as a surprise that the EAFE has done so well this year or that it did not drop further on the news of the Greek default. There are a number of reasons Greece has not affected the EAFE more negatively. The size of the Greek economy being the obvious one. One thing that many investors don't consider is that the market is forward looking. The issues in Greece are well known. With the Greek debt crisis officially starting over 5 years ago, International companies and governments have had a long time to prepare and have been making moves to protect themselves.

We think the Euro will survive and going forward the debt crisis will become an interesting case study about taxes, governments and debt. This will cause news to become more about solving Greece's economic issues and focus on how it is affecting people and the government. The EAFE should continue it's out performance since it had underperformed other indexes over the last few years. (See our Winter 2015 newsletter.)

Back in the States… On average, the S&P500 goes up 4 out of every 5 quarters. A down quarter after 9 up quarters can be expected, especially with the economy slowing in the second quarter and the threat of rising interest rates. We think that the summer will be much the same as the last quarter. On good news, we will get a quick run up and with bad news, a quick pull back. Once the summer ends and 3rd quarter earnings reports show companies earnings are continuing to grow we feel the market will start moving up again.

With the Federal Reserve expected to raise rates later this year or early next year we feel the current trend will continue. Investors will remain focused on price earnings ratios and earnings growth instead of dividends. This will cause dividend paying slower growth companies to underperform companies with faster earnings growth.

With economies slowly growing in both the US and abroad, this is an important time to have a well-diversified portfolio and to stay invested. If you don't, it will be easy to miss out as markets continue their fitful and slow rise. This is not to say that we will not sell something that becomes overvalued or has a lower quarter of earnings. Sticking to our strict buy and sell disciplines is even more important in a slow growth economy.

Greg Robinson, President
greg@msinvest.com

Davis Miracle, Vice President
davis@msinvest.com