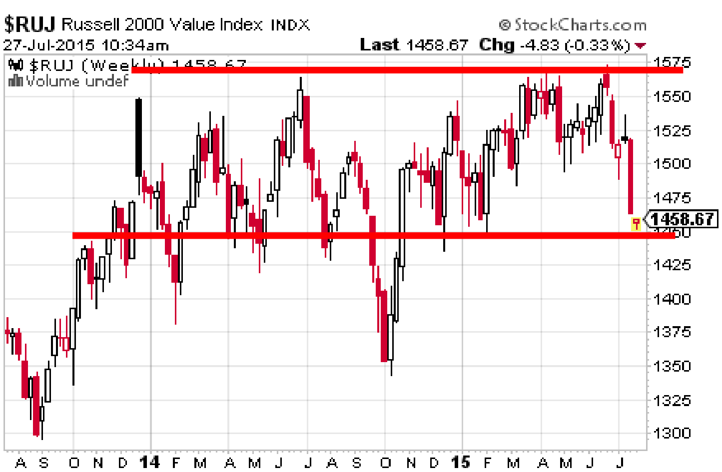
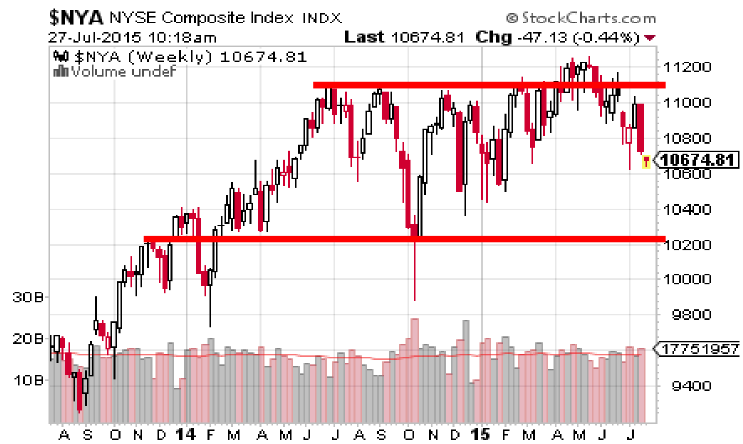
Treading Water

Get the feeling your investments have been going nowhere? You are not the only one. A look at a few of the major averages shows that the market has been in a sideways trading range for some time.

The chart below is the Russell 2000 Value Index. Except for a few breakouts above and below the red trendlines, this index of 2000 companies has been going sideways for almost 2 years. (The Russell 2000 Growth index has not been going sideways however.) Investors looking for Value and dividends are more likely to invest in this arena, not growth stocks that normally do not pay a dividend.



But, broadening out the view to the entire New York Stock Exchange (NYSE), the chart below shows it has been going sideways for over 18 months. This index includes both growth and value stocks.

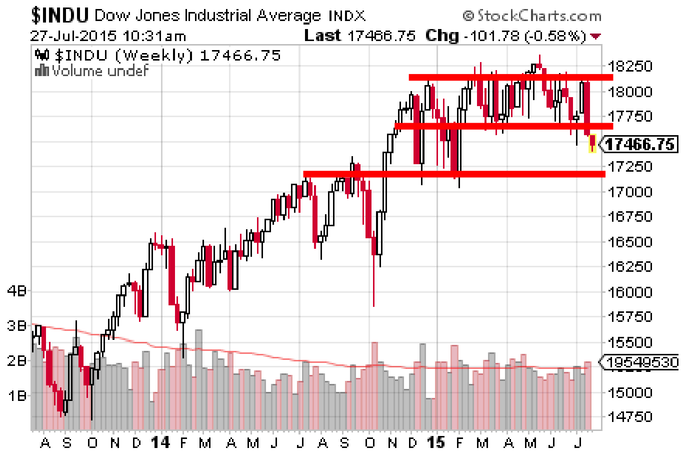


Many times when a market is peaking, or running out of steam, as this one is, money gets focused into a select group of stocks, while the rest languish. These stocks can get pushed to overvaluation levels that give nosebleeds. We see this in the Dow Jones Industrial Average and the S&P 500. They are the focus of investor cash while, as we saw on the previous page, the rest of the market languishes.

Unfortunately for investors, the concentration of money into a few stocks can be the sign of a top, and pre-cursor to a major decline. This is what happened in 2007 and 1999, right before major bear markets.

As you can see from the chart below, the Dow Jones Industrials may have already peaked. It has been trading sideways since November of 2014.

CIS

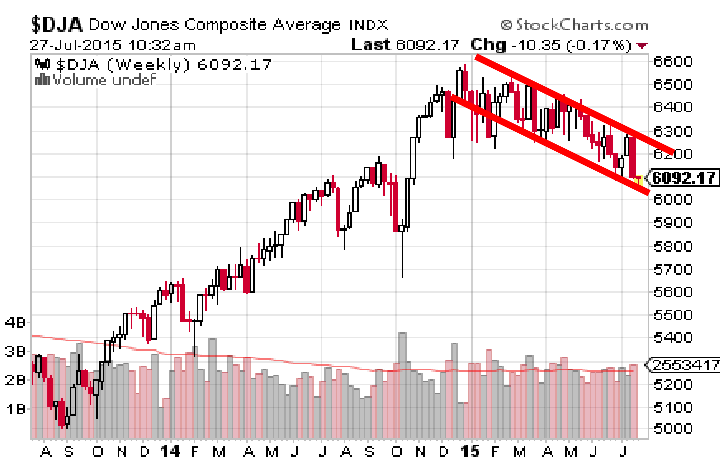


For the past several years, the market has advanced based on little more than the Fed's money pump and hope that it works. As the charts on the previous pages show, at any point in the past 2 years, the market could have started the inevitable bear market decline. Instead though, it would recover, continue in a sideways pattern with quick declines and quick recoveries. These quick recoveries have lulled investors into a false sense of security.

But here is where the cracks are showing up. While the broad averages have been trading sideways for over 18 months, and the Dow Jones Industrials has possibly peaked and has been sideways for over 6 months, the Dow Jones Composite has been declining.

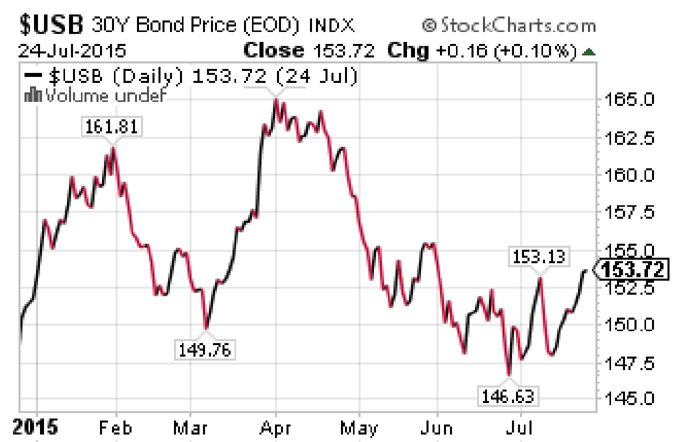
The Dow Jones Composite is made up of 64 companies that trade on the NYSE and NASDAQ. Names like Apple, Coca Cola, GE, JP Morgan, Intel, Microsoft, Nike, Pfizer and Verizon. Heavyweights.

Yet the Dow Jones Composite is heading lower. It may be the canary in the coal mine that is giving an early warning.



Is the recent selloff any different than the selloffs over the past couple of years? Maybe. This one has several differences.

1 - The bond market has started to sell off. From its peak to the low this year, the 30 yr Treasury dropped 11%, forcing long term rates higher. This is important, as it shows bond traders may be front running the Fed on higher rates.



2 - Higher overvaluation. Recent reports from CIS have shown the market is at or near the 2nd highest overvaluation in history. Anyone that is waiting for it to become the most overvalued before acting to protect themselves may be making a grave error.

CIS

3 - China - The selloff in China is remarkable in that it has turned what up until this point was a very serious and methodical administration in China into the keystone cops. They seem to not know which end is up over there and whatever they try to stop the selloff only seems to add fuel to the fire.

4 - Europe - The deal with Greece was misguided. Adding more debt to solve a debt problem has never worked. The Greeks are already protesting the deal and the Germans are already protesting. Harmony was needed and instead there is more discord. If it lasts a year I will be shocked.

5 - Iran - As Jackie Mason said on the Aaron Klein Investigative Radio show last week, its harder to inspect the Iranian nuke sites than it is a deli in NYC. “You can surprise any [NYC] restaurant without notice that you can walk in and inspect them… So we are protected in this city from a bad tuna fish. We’re not protected from a bomb, but we’re protected from a bad quality of a tuna fish," ‘Nuff said.

6 - Interest rates are too low. Historically the Fed is able to lower rates when a recession/bear market hits. Today, with S/T rates still near zero, they have no room to lower them.

7 - Slowing Global Growth and oil - Several agencies including the IMF and World Bank have reduced Global economic growth forecasts in recent weeks. But you need only look at the price of oil to see the prospects of higher Global GDP growth have slowed. As oil’s price declines, you would think it would be a catalyst for higher growth. But that is how much trouble the Developed Economies are in. Even lower oil prices cannot kick start them. And the Fed wants to raise rates…?

We have said it before and we will say it again, we do not trust the Fed to keep out of this. We believe the Fed will step in and either delay raising rates or start printing money again. Bailing out the stock market is not the Fed’s job. We are not calling for them to do something, but like a bad parent that gives a spoiled child anything it wants, that is how we see the Fed and the market.

But like the Chinese have shown, sometimes even the best central planners can do nothing about a bear market. The bear market that is due might be more than the Fed can handle. They failed in 2007/2008. A regression to the mean valuation on the market would be a substantial decline.

Our strategy continues to be to have plenty of cash to pick up opportunities that present themselves, but to not get fooled into believing that everything is alright when it is not.

245 Waterman St. Ste. 301
Providence, RI 02906

info@cornerstoneri.com
www.cornerstoneri.com

Tel: 1 (888) 277. 5968

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