Rotating from Momentum to Value

A big question has been answered early in 2016. Would a few momentum stocks rescue the market or would these high-flying stocks crack? Investors have heard the cracking sound loud and clear. Technology, where most of the highly-valued momentum stocks reside, has been the big loser. Year-to-date Amazon is down -29%, LinkedIn has plummeted by -51%, Netflix is off by -27% and Tesla has cratered by -39% just to name a few. Investors are defensive and putting their money into perceived safety –the Utility sector is up over 6% so far in 2016 (as of 2/6/2016).

The bull market that began in early 2009 reached full valuation in 2015 at the same time the Federal Reserve (FED) started to take the punch bowl away by ending quantitative easing and raising interest rates in December. Since 2009 there have been several pullbacks in the bull session but none yet classified as bear markets, at least as far as the popular indices are concerned. 2011 was a significant decline nearing 20% until a rescue by an injection of FED stimulus. The current decline as measured by most common market indices has fallen less than 15%, but the damage internally in some areas is much higher. The biggest damage has occurred to the energy and commodity sectors. However, small stocks, equal-weighted indices, and international stocks have retreated well over 20% and are looking attractive.

Declines of 20% or More in Key Indexes

From 2014-15 Highs (through Feb. 2 2016)

© 2016 The Leuthold Group	Index	Bull Market High	Correction Low (To Date)	Pct. Loss
U.S. STOCK INDEXES	Dow Jones Transports	December 29, 2014	January 20, 2016	-28.10%
	Russell 2000	June 23, 2015	January 19, 2016	-23.2
	Russell 2000 Equal Weighted	April 15, 2015	January 19, 2016	-28.6
	NYSE Financials	June 23, 2015	January 25, 2016	-20
	NASDAQ Transports	March 20, 2015	January 19, 2016	-25.5
	Value Line Arithmetic	April 15, 2015	January 20, 2016	-21.8
	Russell 2000 Growth	June 23, 2015	January 28, 2016	-24.4
	S&P 500 High Beta Index	April 23, 2015	January 20, 2016	-32.2
S&P 500 SECTORS	Energy	June 23, 2014	January 20, 2016	-47.3
	Materials	February 24, 2015	January 25, 2016	-28.1
WORLD STOCKS (In USD)	MSCI World Ex	July 3, 2014	January 20, 2016	-25.7
	MSCI AC World Ex USA	July 3, 2014	January 20, 2016	-27.7
	MSCI World Small Caps	June 23, 2015	January 21, 2016	-20.3
	MSCI EAFE	July 3, 2014	January 20, 2016	-23.9
	MSCI Emerging Markets	September 3, 2014	January 21, 2016	-37.5
	MSCI Frontier Markets	July 30, 2014	January 20, 2016	-36.2
EUROPE (Local Currency)	EURO STOXX 50	April 13, 2015	January 20, 2016	-24.7
	STOXX Europe 600	April 15, 2015	January 20, 2016	-22.2
	FTSE 100	April 27, 2015	January 20, 2016	-20.1
	CAC 40	April 27, 2015	January 20, 2016	-21.7
	DAX	April 10, 2015	January 20, 2016	-24.1
ASIA/PACIFIC (Local Currency)	Nikkei 225	June 24, 2015	January 21, 2016	-23.2
	Hang Seng	April 28, 2015	January 21, 2016	-34.8
	Shanghai Composite	June 12, 2015	January 28, 2016	-48.6

At the end of 2015 we began to take small positions in some companies that we considered were trading **below** intrinsic value. **Our focus is on stocks that are already in bear markets, have strong balance sheets, are profitable, and in most cases pay a healthy dividend.** The first deep value stock we purchased in December, Apollo Education, just received a buyout offer from a private equity group 32% above our purchase price. To us this is a positive sign that there are good values to be had, and it is wise to dollar cost average our way into these opportunities while the market settles on the appropriate price level for stocks.

However, market action is still cautioning us to move slowly since the correction does not appear to be over. While value stocks in general have started to outperform, the banking sector has been very weak this year, not just in the U.S. but globally as well. This action is not a good sign and could be signaling more fragility in the world economy than is currently expected.

Since we raised cash in advance of this correction ultimately the portfolios will be better off as we reinvest in lower priced stocks. We expect volatility to continue and for markets to settle at a lower level, but more importantly, provide investors good opportunities for long-term appreciation once the correction has run its course.

We are more active in our stock research currently than we've been in a long time and expect to gradually add high-quality stocks to the portfolios. Please contact us if you have any questions. Best wishes.

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