Lindisfarne Investments, LLC

An island of safety in a sea of risk

Market Update
August 9, 2013

"Full of sound and fury, signifying nothing", Macbeth (Act 5, Scene 5)

And that has been the story of the market since our last report. We closed Friday at 1691 on the S&P 500 which is exactly where we were two weeks ago. In between, we went down 0.4% and up 1.1% from that level. We stated that we thought that the market wanted to go up, but it seemed to be "catching its breath".

As we see below, the overall trend is still up. But there are certainly worries and concerns on the market's mind.

S&P 500 … 9 Month Chart

The good news is that we are within 1% of the all time market high which is now our final technical resistance point. Once the market clears that level, it is once again in uncharted territory and has no technical barriers to going to whatever level it wants to. The next chart shows this along with all the technical support levels that lie below the current price.

There has been a bit of press that the market has drawn a line in the sand at the 1700 level. In fact, that has been the predictions made by several well know analysts at the beginning of the year. We are currently dancing around that 1700 mark.

S&P 500 9 -- Month Chart

Probably the major issue weighing on the market continues to be the “tapering” of the Fed’s QE III bond purchase program. As you recall, Ben Bernanke first hinted near the end of May that the Fed could soon decrease its buying of $85 billion of bonds. Since then, the market has essentially moved sideways, gaining only 1.3%. On one hand, this is good news as they think that the economy is recovering and that it doesn’t need as much “life support”. On the other hand, it suggests that bond yields will rise in response and therefore, bond prices will fall.

To me, the fact that we have had the various bond purchase programs (QE I, QE II, Operation Twist and QE III) points the finger directly at our current gridlock in D.C. Our government has not addressed balancing the budget (or even passing one), reducing the governmental debt levels, creating jobs, etc., etc., etc. But with “tapering”, the pigeons could be about to come home to roost.

When will this reduction is bond buying by the Fed begin? Several Fed governors are pushing for this to start at the next Fed meeting in September. Time will tell, but it will begin.

Meantime, I believe that tapering has been pretty much already built into the market. Let's say that the Fed reduces its bond buying from the $85 billion/month down to $70 billion or so. I believe that nothing major will happen. And when that does, there will be a big sigh of relief in the market. Remember: the one thing that the market hates the most is uncertainty. And when they see the Fed become adaptive on the amount of bond purchases, sometimes buying more, sometimes buying less, the "fear" will be dissipate.

The final chart shows a longer term view on the 10 year treasury yield. The long term downtrend line is currently near 3.9% vs. the current yield at 2.6%. A move to that level would cause a lot of heartburn, not only for individual investors but also for the US government. Why the latter? Because the interest payments that they would need to make on their new bond purchases would increase dramatically and be a real headwind, driving the country further into debt. Why for investors? Well, money market interest payments would increase, but for those holding bonds and bond funds, the value of their holdings would fall.

Note that there is a major resistance band slight above the downtrend line. This band roughly goes from the 4% to the 5% interest rate levels.

The important item here is to continue to watch these events and the market's response closely and be ready to react to any negative or positive developments.

Yield on 10 Year Treasuries

Please feel free to pass this update on to anyone that you think might be interested in it. If they wish to be on the mailing list or would like more information about the services of Lindisfarne Investments, we can be contacted by phone at (440) 623-0775 or by email at bill@lindisfarneinvestments.com .