July 2013 Market Commentary

The low volume levitation of the stock market continued in July, a pattern which has surprisingly been witnessed nearly every month of 2013 thus far. After a subdued start, the S&P futures rallied almost 100 points (or 6.1%) to the highs three weeks later. This strong, sustained rally came amidst a streak of 14 out of 15 days where the futures closed positive for the day (and the one down day in that timeframe was down only -0.38%). Such a rally is not based upon fundamentals which improve incrementally each and every day. Rather, it is a momentum-based rally where the market tends to climb not because of improving results from constituent companies, but the recent positive trend of the market overall. This strong rally caused the ratio put spreads held by the fund to expire worthless, resulting in the small loss for July.

A problem with this rally is that the economic fundamentals are deteriorating beneath the surface. Earnings for Q2 of 2013 are slated to decline 0.6% as compared to Q2 of 2012, and yet the market has climbed tremendously over that same timespan. On top of this, revenue growth is decelerating, setting the stage for further profit declines. Should this momentum fade and market participants take note of economic fundamentals, a choppy market could ensue. The positive side of a two-way market is that it can be conducive to hedge fund managers and stock pickers (i.e. active managers) and detrimental to ETFs and index investors (traditionally passive investments).

A possible "canary in the coal mine" is the bond market. After the "Taper Tantrum" in late June, stocks and bonds sold off aggressively. However, stocks (and other risk assets) regained (and surpassed) those prior levels, yet bond prices stayed near those lows. With stocks hitting new highs and bond yields not reverting to prior lows, those two markets are telling conflicting stories. In light of the slowing GDP growth, it appears that stocks might be pricing in an economic fantasy that most likely cannot come true.