NOYES CAPITAL MANAGEMENT®, LLC

Wealth Management for Changing Markets
17 Village Road, New Vernon, NJ 07976-0271
973-267-8120

October 7, 2013

The Trend is Your Friend... Until it is Not
By Scott P. Noyes, CFA® CFP®

The trend is your friend…until it is not. The S&P 500 has gained 19.7% in 2013 on the heels of a 15.8% increase in 2012. This uptrend has occurred amid a wall of worry and has overcome a host of fears along the way: tax increases, European economic crises, Middle Eastern unrest, a housing crisis, rising inflation, and decelerating growth in China to name a few. Now we are supposed to be worried about Washington politicians looking for attention by defaulting on the debt. Sorry, I don't buy it!

The Dow Jones Industrial Average (DJIA) has been in a clear uptrend since March of 2009. While there have been several moderate corrections, it has paid to remain fully invested throughout this period. As seen in the chart below, this uptrend is approaching resistance at 16,000. A move above 16,000 would indicate upside potential of 23% to 18,500. The stock market could dip as low as 14,000 and remain in a long-term bullish trend. If the Dow broke support at 14,000, the chart would project a 30% decline to 10,500. I am using the 14,000 area as a stop-out level from which we would reduce stock market exposure substantially. Based upon solid economic fundamentals and global central bank support, I remain optimistic that the stock market will break out to the upside over the next twelve months. Until then, let patience prevail.

The Dow Jones Industrial Average has a Clearly Defined Range

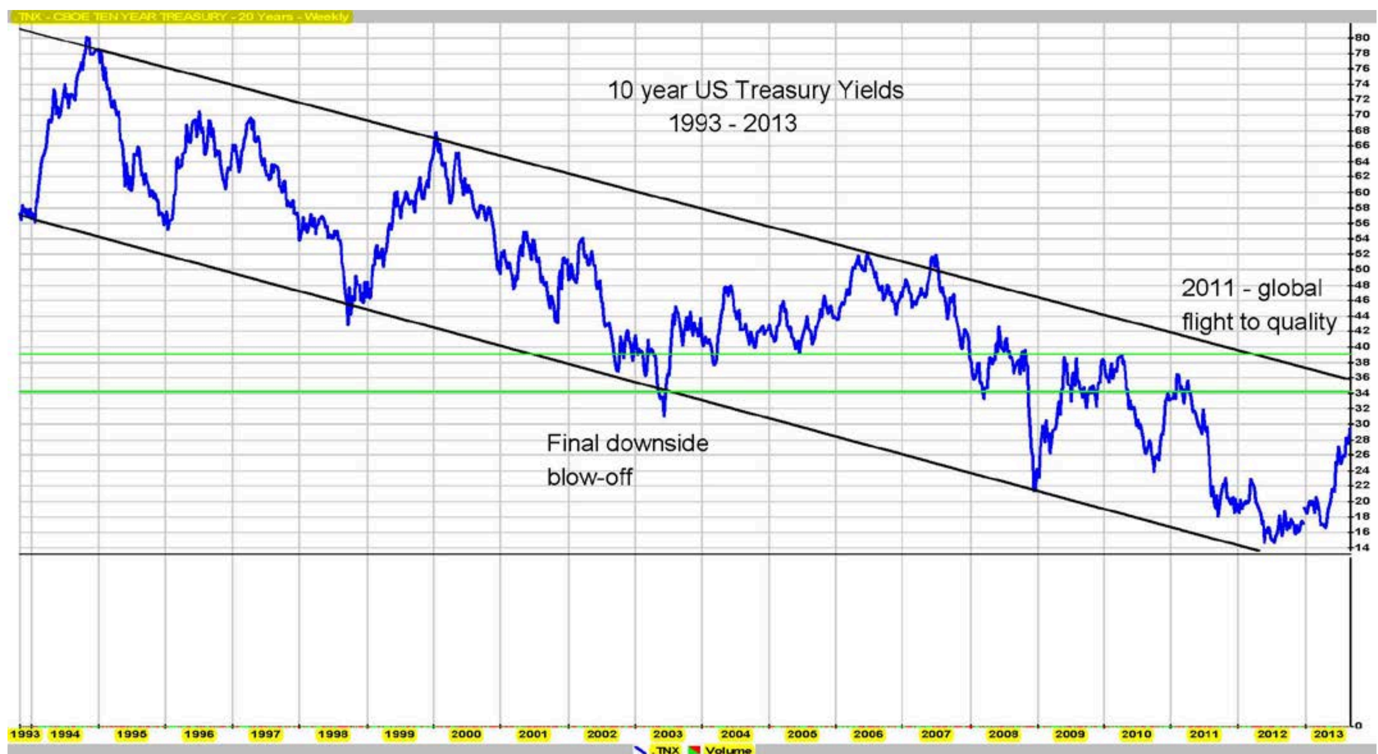
Washington - A Solution will be Found

The current budget crisis in Washington is artificial and designed to get people's attention and promote fundraising from both parties' bases. I believe the Republicans made a minor mistake by fighting the Affordable Care Act rather than entitlement reform as the Democrats are unlikely to permit changes. It is still possible that negotiations will shift from defunding Obamacare to entitlement reform and sequester modification. Reducing long-term entitlement spending would be seen as a major positive by the majority of the public and financial markets. If this happens, it could be a winning solution for both the stock and bond markets. I remain very hopeful that our fearless leaders will solve this artificial problem just in the nick of time.

Interest Rates Have Made a Major Low

The other key investment chart is that of the 10 year U.S. Treasury yield. Interest rates have been in a broadly declining trend since 1980. The lowest 10 year yields were recorded in 2012 at 1.41% and again in May of 2013 at 1.62%. Over the past summer 10 year yields peaked at nearly 3.0% and have settled back to 2.6% recently. Rates are going to increase as the Federal Reserve starts to remove its Quantitative Easing subsidy and as a result of an improving economy. However, without inflation or robust economic growth, the downward channel will remain intact and 10 year rates should not exceed the 3.6% upper limit.

Ten-Year Treasury Bond Yields Aren't Likely To Exceed 3.6%



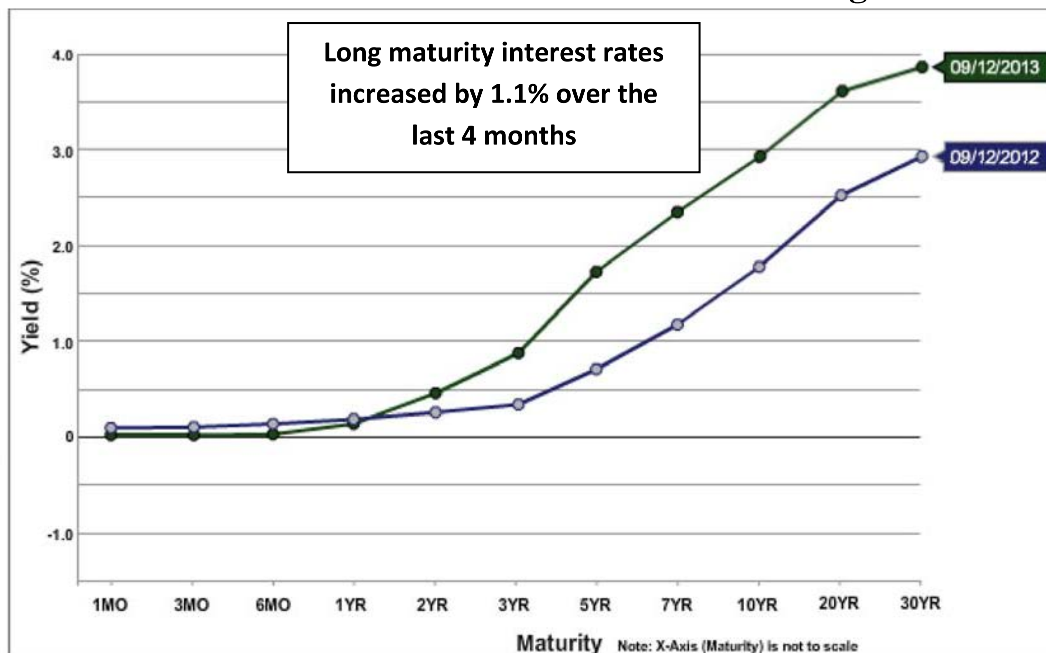
Fed Postpones Tapering of Quantitative Easing Program

On June 16, in anticipation of an improving economy, Fed Chairman Bernanke announced that the U.S. Federal Reserve would likely start a gradual reduction of bond purchases related to quantitative easing: the policy of keeping interest rates artificially low. Most market participants expected the Federal Reserve to start reducing bond purchases in September and continue through 2014. However, at the September 18 Federal Open Market Committee (FOMC) meeting, the Federal Reserve hesitated and did not initiate the "taper" as expected. Their reasons were insufficient improvement in the economy, too low inflation and expectation of a budget impasse in Washington. Most believe that tapering has only been postponed and will start before year-end.

Little Hope for Higher Short-Term Interest Rates

During the recent rise in interest rates, all of the action has occurred in bond maturities beyond three years. The chart below shows the rise in interest rates from September of 2012 to September of 2013. The increase ranges from 1.0% to 1.2%. For maturities inside of two years, interest rates have not risen at all. While long-term interest rates are expected to rise over the next twelve months, it is doubtful that short-term rates will increase until the Federal Reserve fully eliminates quantitative easing **and** starts to raise them intentionally. Most economists do not believe the Federal Reserve will raise short-term rates until 2015. This is bad news for conservative investors and buyers of CD's. There is nowhere to hide.

Recent Interest Rate Increases Have Occurred in Longer Maturities



The U.S. Economy Remains the Global Engine of Growth

The U.S economy is likely to grow at a rate of 2.0% to 2.5% during the second-half of this year and possibly improve to 3.0% next year. Even at this modest growth rate, it is the powerhouse for the world. Benefiting from low oil prices, globally soft commodity prices, improving consumer sentiment, expanding employment and rebounding real estate construction, the positive economic outlook should be on solid footing for at least the next 12 to 18 months. Last year's permanent tax law changes should help improve business certainty. One of the game changers for 2013 has been the improvement in the housing market and its resulting spillover into construction and employment.

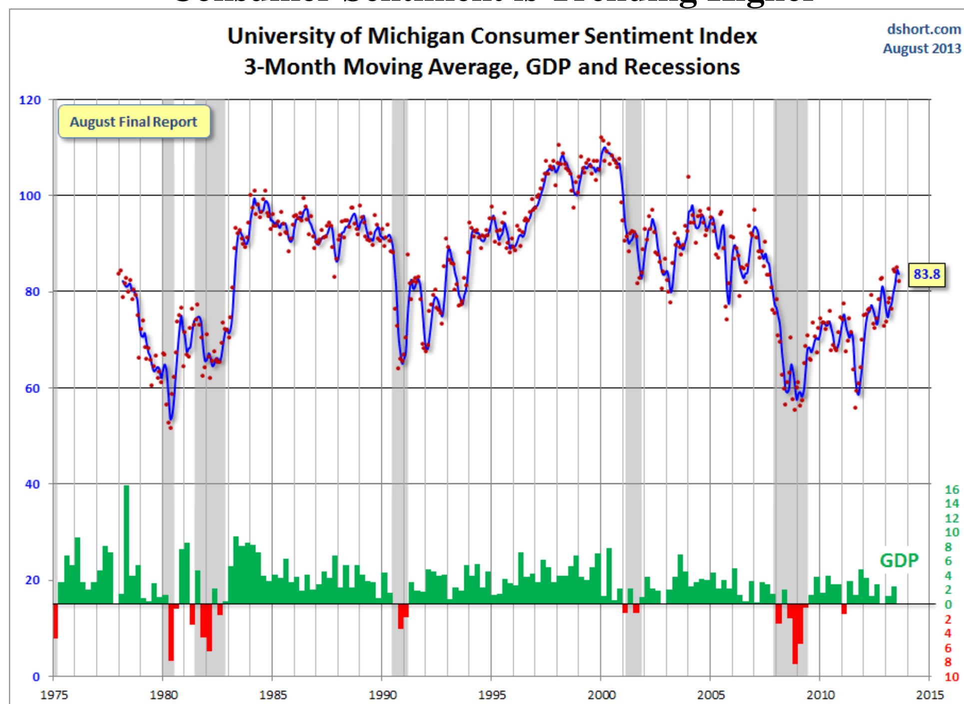
The Housing Recovery has Achieved Lift-off

National real estate prices have increased 12.2% on a year-over-year basis. As housing inventory normalizes, real estate values are projected to improve at a moderate rate for the foreseeable future. A recent survey by Zillow showed a 22% projected gain in real estate prices by 2017. The recent increase in mortgage rates may slow real estate sales in the short run but may force opportunistic buyers to commit sooner rather than face higher rates in the future. In my opinion, the bottom in real estate prices appears to have been established.

Consumer Sentiment is Improving

Helped by the wealth effect from a rising stock market and increasing real estate values, measures of consumer sentiment have also shown improvement and should continue this upward trend for the balance of the year. However, there may be some cause for concern as consumer sentiment for upper income brackets is improving at a much faster rate than for lower income brackets indicating that economic recovery is not reaching all segments of the population equally.

Consumer Sentiment is Trending Higher



Improved Europe and Japan May Be the Surprises of 2013

In Germany, Angela Merkel has been re-elected by a strong margin. While she will still need to form a coalition government, she will remain a positive unifying force for the European Union. With unemployment reaching 12% in many key countries as a result of austerity policies that raised taxes and reduced spending, European policy makers have concluded that the public will no longer buy their austerity model. Politicians have made restoration of growth the new priority. The European Central Bank is likely to continue its expansive monetary policy in support of growth and the Germans are going to have to tolerate the resulting larger budget deficits in Spain, France and Italy. Europe is likely to muddle through the recent crisis and European stocks may represent surprising values.

Japan has been the biggest surprise of 2013. Prime Minister Abe has implemented a three-pronged growth strategy designed to end deflation, decrease the value of the Yen and improve business conditions. So far, his "Abenomics" strategy is working. His plan has created confidence among Japanese businesses and they have benefited from increased exports and spending on fixed investments. The Japanese stock market is up close to 60% on the year.

Equities Remain the Best Choice

I remain cautious on bonds and optimistic about equities into 2014. The trend remains our friend. However, a 5% to 10% correction in the stock market is very possible and well within normal volatility. As the markets move from denial to acceptance of a better economy, business investment should also improve on a global basis. Outside of a significant shock, I maintain a positive outlook for 2014.

The increase in interest rates and Washington impasse is not necessarily bad for all stocks. The most likely scenario is that the current bull market is in a consolidation phase, gaining energy for the next leg higher. I expect that consumer, healthcare, industrials and recently the financial services sectors will continue to lead the market. The biggest laggards should continue to be basic materials, utilities, and energy stocks due to slack global demand. Mid-cap and small-cap equities, with a growth bias, have been the leading stock market styles and should be carefully watched for signs of weakness. I am hopeful that foreign stock markets rebound from a disappointing first half and catch up to U.S. markets. Stock and sector selection should be quite important in the later stages of a bull market.

Please call me if you have any questions at 973-267-8120.

Scott P. Noyes, CFA®, CFP® is the President of Noyes Capital Management®, LLC, an independent fee-only wealth management firm based in New Vernon, New Jersey. www.noyescapital.com

---

This newsletter is limited to the dissemination of general information pertaining to investment advisory services of Noyes Capital Management®, LLC ("Noyes Capital"). No portion of this commentary is to be construed as a solicitation to buy or sell a security, or the rendering of personalized investment, tax or legal advice. Any reference to a market index is included for illustrative purposes only, as an index is not a security in which an investment can be made. Past performance is no guarantee of future results, as there is no assurance that the views and opinions expressed herein will come to pass.

Noyes Capital Management®, LLC ("Noyes Capital") is a state registered investment advisor with a principal place of business in the State of New Jersey. Noyes Capital and its representatives are in compliance with the current registration requirements imposed upon registered investment advisors by those states in which Noyes Capital maintains clients. Noyes Capital may only transact business in those states in which it is registered, or qualifies for an exemption or exclusion from registration requirements. Any subsequent, direct communication by Noyes Capital with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For additional information, please consult Noyes Capital's Form ADV disclosure documents, the most recent versions of which are available on the SEC's Investment Adviser Public Disclosure website (www.adviserinfo.sec.gov) and may otherwise be made available upon written request.