Weekly Market Commentary

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Summer Rentals

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Highlights

A number of end-of-summer or beginning-of-fall events have the potential to lead to a change in the investment environment and alter the course of the markets.

How do you invest over the next few months leading up to these events — in other words, what investments do you rent for the summer?

Summer rentals for your portfolio may include: an overweight to U.S. stocks, high-quality bonds, and cash & hedges.

Memorial Day weekend kicks off the summer season in sunny destinations across the country as city dwellers and others seek to escape the heat and enjoy some natural beauty and relaxation. But like unwanted guests crowding a cabin or a cottage, a lot of unwelcome events that impact the markets can really ruin a summer vacation. So far, however, the calendar for investors appears clear of major events until the end of the summer and beginning of fall.

These end-of-summer/beginning-of-fall events include:

- The Federal Reserve's (Fed) annual economic policy symposium in Jackson Hole, WY may reveal the next step in the Fed's bond-buying program.
- Congress must address the debt ceiling and end of the Continuing Resolution funding the federal government, which could result in more tax increases and spending cuts.
- The German elections will take place with implications for the path of growth and stability in Europe.

These events have the potential to lead to a change in the investment environment and alter the course of the markets. But how do you invest over the next few months leading up to these events — in other words, what investments do you rent for the summer? Summer rentals for your portfolio may include:

- **Overweight U.S. Stocks** – Soft global economic growth (See today's *Weekly Economic Commentary* for an update on global economic growth in 2013 and 2014) and a strong US dollar favors U.S. stocks over European stocks. Outside the United States, aggressive policy stimulus and improving economic data favor Japanese stocks. But it may be that after the German elections in September, the increased European fiscal policy flexibility — coupled with signs that Europe is beginning to emerge from recession — could favor buying European stocks and reducing U.S. stock exposure ahead of the debt ceiling battle looming in October.
- **High-Quality Bonds** – While the Fed has two meetings this summer (June 19 and July 31), it is unlikely they will signal a major change until around late August. During the last three years, Fed Chairman Bernanke's speeches at Jackson Hole have been closely watched by investors for signs of changes in policy. Bernanke, whose second term as Chairman is up at the end of January 2014, has let it be known this year he will not be attending the Jackson Hole symposium, signaling changes in message

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and delivery may be taking place. Bond yields have already moved back up to the highs of the year as they adjusted to the Fed's message that when it comes to slowing bond purchases, it is only a question of when, not if. So it may not be until around the end of the summer that yields begin another move higher, leaving a little more time to rent high-quality bonds before dumping them for less interest rate-sensitive income-producing investments.

- Cash & Hedges – Should stocks go from a gallop to a grind higher this summer, they run a risk of a 5–10% pullback along the way—especially since they have gone over 190 days without a 5% or more pullback, a record for this bull market. So it may make sense to rent a small position in cash, or another hedge in your portfolio, until a stock market pullback, then abandon that rental and buy stocks. Think of it as a little portfolio sunscreen to keep you from getting burned after the nearly 25% rally just since mid-November 2012.

While unscheduled events may arise and alter the investing environment this summer, it may be that the next major event is not until around the end of the summer. While it can be hard work and what may be perfect for you may not be right for someone else, finding your perfect summer rental can be well worth the effort. ■