[Martone Capital Management: Weekly Investment Commentary (8/20/2014)]

Last week's stock gains can be partly attributed to a perception that geopolitical risks in Ukraine and the Middle East were abating - at least until Friday when the border tension in Ukraine delivered a dose of reality.

However, investors also bid up stocks on the back of generally weak economic data, including another soft U.S. retail sales number, stagnating growth in the eurozone and slowing loan growth in China. The common theme in all of these instances was optimism for either more aggressive monetary and/or fiscal stimulus or, at the very least, a continuation of already easy monetary policy. One specific case in point: U.S. stocks rose sharply on Wednesday amid weak U.S. retail sales. Investors, it seems, thought the news might reduce the odds of an early Federal Reserve rate hike.

Also helping to support stocks is the fact that interest rates have been grinding lower, contrary to all expectations. The drop in rates can be partially explained by the still-uneven nature of the U.S. recovery. While the broad economy is improving, there are persistent pockets of weakness, such as household spending.

But beyond the challenges facing the U.S. economy, rates are also being suppressed by softness in other countries. Ongoing economic weakness and the lingering threat of deflation have pushed down European bond yields; German Bund yields traded below 1% last week, an all-time low. With lower European yields making the United States more attractive in comparison, Europe's slowdown is contributing to the persistence of low rates in the U.S. In turn, low rates are helping to support stocks, as investors have little choice but to search for return, and even income, in other asset classes.