Martone Capital Management: Weekly Investment Commentary (3/31/2014)

Both stock and bond markets were little changed last week and, in fact, have remained in a relatively narrow trading range for the past couple of weeks.

Although the broad equity averages may not be moving much lately, we are witnessing a significant sector and style rotation. This shift suggests that glamorous, high-momentum types of stocks are less in vogue. It also speaks to the fact that the market appears to be experiencing a rotation away from growth and into value styles. Over the past month, large-cap value stocks have gained roughly 1.25%, while large-cap growth has lost over 2%. This rotation is being driven in part by the fading of the momentum trading theme (which favored growth styles), but it is also a result of a growing discrepancy in relative valuations. As of the end of last month, growth stocks were trading at nearly a 40% premium to value stocks, significantly higher than the 10-year average of around 25%.

Should this rotation continue, one of the beneficiaries would likely be U.S. large and mega-cap stocks, which are trading at a significant discount to small and mid-cap areas of the market.

A similar trend is evident in fixed income markets. Beneath the relatively calm surface of yield stability lurk some meaningful shifts. To restate an observation we have made before, last year investors would have done well to avoid long-duration Treasuries, but this year it is the short to middle part of the yield curve that appears vulnerable (specifically the two- to five-year segment).

Whereas the yield on the 10-year Treasury has barely moved over the past couple of weeks, the yield on the five-year Treasury has jumped from 1.53% to 1.73%. Looking ahead, we expect this area of the Treasury yield curve to experience the most volatility, and also to be the most sensitive to expectations of a potential increase in the federal funds rate.

William Martone is President and Senior Portfolio Manager of Martone Capital Management, Inc., which was founded in 1994. Bill has over 40 years of experience in the financial services industry and manages portfolios for both individual investors and pension funds using multiple investment strategies. Bill is a Chartered Financial

Consultant, Chartered Life Underwriter, and New York State Registered Investment Advisor. He is frequently quoted in the Westchester Journal Business News as well as other publications. Martone Capital Management was featured on CNNfn.