

Martone Capital Management: Weekly Investment Commentary (8/21/2012)

One of the factors underlying the upturn in stock prices over the past couple of months has been a modestly improving trend in US economic data. Last week, retail sales advanced 0.8%, well ahead of expectations. This was the first increase in four months, which suggests that while households remain generally cautious, spending levels are beginning to tick higher. We also saw a slight increase in unemployment claims last week, but the longer-term trend on this front has been positive. The August employment data will be released in a couple of weeks and the recent improvements in unemployment claims should bode well for those figures. Additionally, as we have pointed out before, the US housing market has been showing signs of recovery and while we expect that segment of the economy to recover slowly, we do believe that housing has turned a corner.

With recent economic data being better than expected, the next steps for the Federal Reserve look unclear. The Fed has been clear that additional easing measures would be contingent on the direction of the data, so at this point the odds of additional easing measures appear to be somewhat reduced. A new round of easing (i.e., QE3) is hardly off of the table, but should economic growth continue to improve its likelihood would diminish.

Historically, August tends to be a quiet month for the markets, but there have been some significant exceptions. Last year, for example, saw heightened levels of volatility sparked by the Standard & Poor's decision to downgrade the rating of US debt in the midst of a political crisis. This year, there are also some undercurrents that could have the potential to cause some disruption in the markets. The European Central Bank's bond buying program has been greeted with relative quiet, but that could change quickly. Food prices have been rising, which could cause political instability, particularly in emerging markets. China is in the midst of a leadership change that could have a number of unforeseen consequences. And, of course, the US political backdrop and the related fiscal crisis has the potential to spark higher levels of uncertainty. We have been relatively constructive toward the markets for some time, but we acknowledge that these risks plus the fact that the rally has come so far so quickly could mean that stocks are poised for a pullback.

