Will Stocks Stumble this Summer?

A bold start, a mid-year slump, and a superb finish... That was how the market played out in each of the past two years. Could the current year be shaping up to bring more of the same? The chart below shows the quarterly returns of the S&P in 2010, 2011, and YTD 2012.

Each year market gyrations were driven by massive shifts in Investor sentiment to relatively small changes in economic growth forecasts. Early in each year, the economy began to look a lot healthier, though by late spring, the economy steadily weaken. This year, the pattern has been amplified with a mild winter and early spring. In all cases, Investors eventually got spooked, and the sell-off accelerated into the summer until Investors realized that stocks had moved deep into bargain territory. A pattern of 'hope-to-despair-to hope' seems to be the 'new normal' market environment ever since the crash in 2008.

Are investors over reacting? Yes and No.
Yes, from the standpoint that a typical economic rebound is rarely linear but tends to be tenuous, strengthening in fits and starts. Thus, we will continue to see waves of strength and weakness. But as long as there is true economic growth, earnings and stock price momentum should remain positive. Also, the Fed and Central Banks around the world have pledge to do everything in their power to keep growth positive.

However, investors may not be over reacting when you consider that most have yet to recover from the real capital losses incurred in 2008. Still fresh in their minds is the gut- wrenching fall in value of their portfolio. In other words, investor confidence in the stock market remains quite tentative at best. Fear still rules with an iron fist. This fact is readily apparent in following both the flow of money and the level of interest rates. Inflows into Bond funds continue to set weekly records and the 7yr US Treasury rate fell to 1.2% yesterday, that is the lowest yield ever, as in ever in the history of the US Treasury issuance . Safety and capital preservation are still the top priority of investors.

Early Summer Forecast: **US Markets are probably range bound** (8-10% range)
Why?
1) US economy growth is slow but a solid 2+%
2) Corporate balance sheets are very healthy and Earnings still growing.
3) Small businesses are getting back on their feet and housing appears to have bottomed
4) Interest rates will remain at record lows for the foreseeable future
5) Election will insure the politicians will be on their best behavior (nothing negative for the economy)
4) Europe's is already in a recession
5) China (a key pillar of world growth) won't let growth slow too much
6) Summer Olympics- the world focus turns to something positive for a while
(Caveat: This all could be quickly derailed if Europe implodes. Not my forecast, but still a real consideration)

Of course as Autumn approaches, the Election and ensuing 2013 fiscal cliff will be center stage. The markets will have to contend with how to climb that wall of worry. But until then, a wide range-bound market is my best guess.

Investment Strategy: The market environment will continue to be choppy as sentiment is the primary driver causing speculators to shift quickly between risk-on assets (growth, emerging markets, small caps) and risk-off assets (value, large cap, and bonds). Portfolios are structured to grind out return through:

1) Income: Corporate, Foreign Sovereign, and Global High Yield Bonds (current high quality junk yields are 6-7%)
2) Growth: Large Cap, dividend stocks
3) Diversification: multiple asset classes including mid cap, Health care, global infrastructure,
4) Flexibility: Funds with dynamic global strategies.
5) Alternative: small portion of Gold as an alternative store of value