L. Roy Papp & Associates, LLP
Investment Counsel

2201 East Camelback Road, Suite 227B
Phoenix, Arizona 85016
(602) 956-0980
FAX: (602) 956-7053

VIEWS FROM CAMELBACK MOUNTAIN
A Brief Correction . . . . . More Volatility Ahead

The U.S. stock market has finally stumbled a bit after going virtually straight up for the past seven months. The Dow Jones Industrial Average has not had a 5% decline over the past 218 calendar days until the recent decline that began on May 22. The last time the market went up more than 218 days without a 5% decline was in 2006/2007. Often market moves are hard to explain and it can be difficult to ascertain the cause of market behavior. This time it is crystal clear that the correction was sparked by comments from Federal Reserve Chairman, Ben Bernanke, that “tapering” might begin later this year. To be clear, the Federal Reserve Board is NOT talking about raising interest rates any time soon and they aren’t talking about ending their quantitative easing program immediately. They are currently buying $85 billion dollars a month of bonds in order to hold down longer term interest rates. Specifically, he talked about reducing the amount of monthly purchases, which is widely interpreted to mean reducing monthly buys from $85 billion dollars to $65 billion dollars a month. Obviously, this would still be considered powerful, stimulative monetary policy.

Interest rates have spiked upward almost 1% on the 10-year treasury from 1.6% two months ago to 2.67% in response to Bernanke’s comments. Rates have backed off a little bit and are currently at 2.48%. The stock market measured by the Dow Jones Industrial Average declined approximately 5% from its previous peak but it has since recovered somewhat. We believe that this is a normal correction and that the bull market conditions remain intact.

In our New Year’s letter we talked about investors beginning to rotate out of bonds into stocks. This rotation began to occur around the first of this year. The spike up in interest rates in reaction to the Federal Reserve’s comments has caused sharp losses in bond funds, which we believe will eventually accelerate the rotation from bonds into stocks by investors.

The markets are also experiencing concerns about monetary and fiscal policy, particularly in China and Japan. This has created volatility and considerable weakness in emerging markets. Most European economies remain stagnant at best. Against this backdrop we are happy to be concentrated in stocks of American companies. While many of our companies do have global exposure, we are being particularly careful to select companies with more exposure to Asia-Pacific than to Europe.

In the months ahead we will all read about speculation as to who will replace Ben Bernanke as Federal Reserve Chairman when his term ends on January 31, 2014. We will be surprised if his successor is not Janet Yellen, the current Vice-Chairman. She is likely to be at least as accommodative as Ben Bernanke.

Best regards,

Harry Papp
Managing Partner
June 28, 2013