Starfox Financial Services, LLC

Market Update

GIOVANNIELLO & MICHELS 401K PLAN

March 2014

MARKET SNAPSHOT	
DJIA	**16065**
Nasdaq	**4245**
S&P 500	**1841**
Comex GOLD	**$1379**

(closing values March 14, 2014)

5 Reasons we think the stock market is risky.

We continually review more than 60 indicators from various sources to assist us tactically adjusting our portfolios. Many of these indicators appear to be meaningless 'noise' by themselves but when combined with other indicators a startlingly clear picture begins to emerge. Here is an example of how five individual indicators can paint a pretty clear picture.

Rydex Money market assets are at a historic low. Multiple common indicators of money market volume and flow indicate money has been flowing out of money market and now stands at a level that has not been seen since the market highs of 1999-2000. While it is possible some of the assets previously held in money market have been used to purchase other asset classes such as gold, real estate and bonds, it appears a good amount has flowed into stock funds. With so little left on the sidelines we might wonder how much higher can optimistic investors push the market.

Margin debt is at record highs. Traders are borrowing more than ever to leverage up their equity exposure. While it is possible the extremely easy money provided by the Fed has spurred this number artificially higher, the fact remains, the amount of margin debt is higher than it has ever been. The use of borrowed money to purchase stock is likely part of the reason the market has grown as high as it has. Since the amount of margin debt available is tied to the value of stocks, a normal market correction could be a catalyst for n unwinding of margin debt causing an even deeper market decline. When the amount of margin debt begins to decrease it the amount of market decline would likely be in the double digits

Investor sentiment is very bullish. Several different indicators are used to establish investor sentiment including actual surveys and bull/bear asset ratios. All indicators confirm a highly bullish investor sentiment and some even indicate the bears are becoming less bearish (yes there are indicators that track HOW bearish, the bears are). Sentiment readings are often considered to be a contrarian indicator; meaning swings to the bullish side usually result in a decline in stock values. What we have been seeing over the past year is a trend to higher bullish readings before market values decline. In other words, bulls getting more bullish and bears becoming more neutral.

Almost three and a half years of growth without a 10% correction. The current rally has gone more than 885 days without a 10% correction. In other words, the market has risen 69% without a significant challenge. We have had only two other times in history that we have gone longer (Oct 1990– Oct 1997 and March 2003—October 2007). On average we experience a correction of 10% or more once per year, the longer we go without a correction the more likely one seems.

The Cyclically Adjusted Price to Earnings Ratio (CAPE Ratio a.k.a Shiller P/E or P/E 10) is almost 26x. The CAPE Ratio is based on average inflation-adjusted earnings for the past ten years and is considered by many to be a more accurate measure of P/E since it is less prone to wild swings. While the current value of 25.50x is not the highest it has been, history seems to suggest problems occur when the CAPE Ratio is above 26x.

Individually these indicators don't scream excess stock market risk, they may even appear to indicate possible strength, but taken together we feel they suggest a top may be near. It seems the market hinges on Investor sentiment, as it almost always does. The low volume of assets held in money market and the high level of margin debt mean that not only are investor optimistic, they are willing to take on more risk. Unfortunately, the fact that investors appear so optimistic they are willing to deplete their sidelines reserves (money they have stashed since they sold in 2009...at the bottom) and even leverage their portfolio in order to buy more, is also an indicator we believe points to an unstable market top.

Of course, other factors such as geopolitical tensions, mid-term election politics and "black swan" style events may ultimately get the blame for what ever correction does occur. We believe the market is ready for a correction what ever the cause.

Current Recommendations

Given the increased potential for a stock market correction we recommend maintaining a reduced exposure (30%-50%) to equities pending a 10% or greater correction.

Given the current near zero rate environment, potential actions by the Federal Reserve and because a return to 'normal' interest rate will put price pressure on longer duration bond holding, we recommend owning quality low duration fixed income and floating rate funds. Target total portfolio duration should be 4-6yrs or less.

***Risks to our recommendations include loss of growth potential due to limited exposure to stocks and potential credit risk when utilizing floating rate funds. Lower duration investments may not provide sufficient income from current interest to meet income needs.**

***Please contact us if you would like to discuss how our recommendations may apply to your specific situation.**

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