

Weekly Market Commentary

February 1, 2016

The Markets

How low can you go?

The Bank of Japan (BOJ) dove into the negative interest rate rabbit hole last week when it dropped its benchmark interest rate to minus 0.1 percent. If you've been following Japan's story, then you know the country has been struggling with deflation for almost two decades. The BOJ's goal is to push inflation up to 2 percent.^{1,2} *MarketWatch* explained the idea behind negative interest rates:¹

“Central banks use their deposit to influence how banks handle their reserves. In the case of negative rates, central banks want to dissuade lenders from parking cash with them. The hope is that they will use that money to lend to individuals and businesses which, in turn, will spend the money and boost the economy and contribute to inflation.”

If the idea of negative interest rates sounds familiar, it's probably because Europe has been delving into negative interest rate territory for a while. Several European central banks have adopted negative interest rate strategies, and about one-third of the bonds issued by governments in the eurozone offered negative yields at the end of 2015. It's an unusual state of affairs – offering investors bonds that pay less than nothing. If investors hold to maturity, they get back less than their investment amount.³

While negative rates may not be pleasing to bond buyers, U.S. stock markets were thrilled by the BOJ's surprise rate cut. Major indices rose by about 2 percent on Friday.⁴

Market performance was also boosted by a bad-news-is-good-news interpretation of weak fourth quarter U.S. gross domestic product (GDP) growth estimates. According to *Reuters*, slower growth in the U.S. economy raised investors' hopes the Federal Reserve would hold back on future rate hikes.⁴

Data as of 1/29/16	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	1.8%	-5.1%	-4.0%	8.8%	8.6%	4.2%
Dow Jones Global ex-U.S.	2.2	-7.0	-13.6	-3.8	-2.6	-0.7
10-year Treasury Note (Yield Only)	1.9	NA	1.8	2.0	3.4	4.5
Gold (per ounce)	1.4	4.7	-12.4	-12.6	-3.5	7.0
Bloomberg Commodity Index	2.6	-1.7	-21.8	-18.2	-14.0	-7.8
DJ Equity All REIT Total Return Index	1.1	-3.4	-8.2	7.5	10.1	6.3

S&P 500, Dow Jones Global ex-US, Gold, Bloomberg Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT Total Return Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable.

DOES THE STOCK MARKET OVERREACT? Some experts say it does. In 1985, Werner DeBondt, currently a professor of finance at DePaul University, and Richard Thaler, currently a

professor of behavioral science and economics at the University of Chicago, published an article titled, *Does The Stock Market Overreact?*⁵

The professors were among the first economists to study behavioral finance, which explores the ways in which psychology explains investors' behavior. Classic economic theory assumes all people make rational decisions all the time and always act in ways that optimize their benefits. Behavioral finance recognizes people don't always act in rational ways, and it tries to explain how irrational behavior affects markets.⁶

DeBontd and Thaler's research, which has been explored and disputed over the years,^{7-Conclusion} supported the idea that markets tend to overreact to "unexpected and dramatic news and events." The pair found people tend to give too much weight to new information. As a result, stock markets often are buffeted by bouts of optimism and bouts of pessimism, which push stock prices higher or lower than they deserve to be.^{5-Abstract}

In a recent memo, Oaktree Capital's Howard Marks reiterated his long-held opinion, "...In order to be successful, an investor has to understand not just finance, accounting, and economics, but also psychology."⁸ He makes a good point.

When markets become volatile, it's a good idea to remember the words of Benjamin Graham, author of *The Intelligent Investor*, who wrote, "By developing your discipline and courage, you can refuse to let other people's mood swings govern your financial destiny. In the end, how your investments behave is much less important than how you behave."⁹

Weekly Focus – Think About It

"Keep your eyes on the stars, and your feet on the ground."

--Theodore Roosevelt, 26th President of the United States¹⁰

Best regards,

Jim

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* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.

* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.

*Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.

* Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

* Consult your financial professional before making any investment decision.

* You cannot invest directly in an index.

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Sources:

¹ <http://www.marketwatch.com/story/what-you-need-to-know-about-the-bank-of-japan-and-negative-interest-rates-2016-01-29>

² <http://www.bbc.com/news/business-21137148>

³ <http://www.bloombergtake.com/quicktake/negative-interest-rates>

⁴ <http://www.reuters.com/article/us-usa-stocks-idUSKCN0V71PB>

⁵ <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.1985.tb05004.x/full>

⁶ <http://www.investopedia.com/terms/r/rational-choice-theory.asp>

⁷ <http://iosrjournals.org/iosr-jbm/papers/Vol16-issue4/Version-5/D016452532.pdf>

⁸ <https://www.oaktreecapital.com/docs/default-source/memos/on-the-couch.pdf?sfvrsn=4>

⁹ <http://www.stride.ws/blog/20-brilliant-quotes-and-insights-from-benjamin-grahams-the-intelligent-investor>

¹⁰ <http://www.brainyquote.com/quotes/quotes/t/theodorero136001.html>