THE AHILIO MARKET VIEW

INVESTMENT INSIGHTS

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Main Street Gains as Wall Street Wanes

May 5, 2014

The much larger than expected gain in the April non-farm payroll report of 288,000 versus consensus expectations of 215,000 is a clear sign that companies and local governments are beginning to hire again. Not only was the April report stronger than expected, the March and February data was revised up by 36,000. A more sobering component of the employment report reveals that hours worked were unchanged as too were the average hourly earnings. In total, the April report was indicative of an improving labor market.

While Main Street may have solid reason to cheer, Wall Street is now sitting on the edge wondering where trading revenue is going to come from. The absence of volatility in the equity, foreign exchange and fixed income markets has caused JP Morgan to announce last Friday that second quarter trading revenue would likely fall by 20% in the second quarter. Citigroup also warned last Friday that trading revenue was expected to slide by 15%.

Main Street, having been on the economic sideline due to the grippingly severe winter, may eschew investing (during the second quarter) in favor of old fashion consumption. For the economy, this would be a welcomed increase in activity but for Wall Street, it would be an unwanted hit to revenues.

There are several factors that are also holding back volatility and therefore investor activity. First, many investors are simply unsure as to how much of the spring economic thaw is the beginning of an uptrend or simply a rebound from a weak fourth quarter. Second, the Fed's mantra of "holding interest rates low for a prolonged period of time" has sharply reduced the need to make necessary changes to portfolio construction. A less obvious factor impacting trading volume and trading revenue has been the increase of the use of passive investment vehicles. Whether in fixed income, commodities, foreign exchange or equities, ETFs have reduced (at the margin) the need for investors to trade individual stocks or bonds. The Ukrainian conflict has also caused a pause of investor activity.

Fundamentally, the economy is on the mend and employment appears to be gaining momentum. Interest rates also remain dangerously low in the US. Equity investors have the tail wind of knowing that fixed income investors either need to move to cash or to equities before interest rates paralyze portfolio restructuring because of price erosion. We believe that European yields have more scope to decline than US yields which raises yet another risk to the US bond market.

While stock indices have yet to breakout to new highs, the fundamental background and competitive value versus fixed income assets strongly suggests that equities will continue to outpace fixed income assets for the investor that holds a medium term view. It is time for Main Street to take center stage in a positive way.