

The Fortnighter

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As most of you know, I'm just back from holidays. It's been my (somewhat cynical) observation over the years that most of the times I leave the office for a week or two something calamitous happens in the markets.

Well, this year the markets have surprised to the upside. The past few months has seen quite a strong rally in the equity markets – especially in the United States.

It's a bit of a puzzle what is driving this. Yes, the news out of Europe has been less bad than usual. But the main explanation seems to be another round of "Quantitative Easing" by the U.S. Federal Reserve. This is largely a program by the U.S. government to purchase Mortgage Backed Securities in the open market, thereby providing support (demand) for these financial instruments and pushing long-term interest rates down. In theory, lower mortgage rates will encourage U.S. consumers to purchase homes and provide a boost to the moribund U.S. housing market.

Most market pundits, however, question how much of an effect this round of quantitative easing is going to have (this version is now "QE3"). Each bout

does seem to provide some sort of boost to the markets, but the effects appear to be less and less pronounced each time. And will U.S. consumers really be induced to get back into the housing market by the measly reduction in rates that these programs tend to produce (at most a few 10ths of a percent)? I think not. The U.S. housing market is a long way from a meaningful turnaround.

This latest rally has me leaning towards a cautious stance on the equity markets. I recommend that investors not stray from their long-term portfolio asset allocation or be overly swayed by the optimism (seemingly) generated by this latest round of Fed easing. This appears to me, in fact, to be a good time to hedge portfolios – not by raising large amounts of idle cash, but by focusing on less cyclical companies with healthy, consistent earnings and utilizing strategies such as writing covered call options on select stocks held in portfolios.

I'll comment more on the options strategy in the next issue of the Fortnighter. In the mean time, feel free to contact me if you would like to learn more.

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