SMS Capital Management, LLC

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By Steven M. Sheldon, CFA

About SMS Capital Management

SMS provides investment management services to individual investors desiring to preserve and build long-term wealth. As a fee-based firm, SMS has an independent, objective and sound approach to portfolio management. The firm is a Registered Investment Adviser.

About the Author

Steven Sheldon has more than thirteen years of professional experience analyzing and managing investments. Prior to founding SMS, Mr. Sheldon worked as a senior member of a corporate principal investments group. Mr. Sheldon has an MBA from Tulane University and a BBA from The University of Texas. In addition, he is a CFA charterholder and a member of both the CFA Institute and the Houston Society of Financial Analysts (HSFA).

A Better End to Trying Year?

For what is traditionally one of the stock market's strongest months of the year, November did not live up to its reputation. During the month, the major U.S. stock indexes tumbled. The financial sector which has been absolutely toxic this year led the decline, taking the rest of the market down with it. Unrelenting headlines of billions of dollars of losses related to the deteriorating U.S. housing market proved too much for this tiring bull market to handle. After hitting an all time high this year, the S&P 500 recorded its first official 10% correction (from peak to high) in almost five years.

The market's drop may be forecasting that more trouble lies ahead as banks, reacting to big losses, restrict their lending to both consumers and businesses. Credit is the lifeblood of the economy. If it slows or gets squeezed, the impact on the economy and ultimately corporate earnings can be significant.

Despite all the gloom and a bad start to December, there is still room for some near-term optimism as we head towards the close of this rather tumultuous year.

Where We Go From Here

While this bull market is proving to have more staying power than most investors expected, there is reason to believe that it's end might still be a bit further off than November's dismal performance would suggest. According to the Wall Street Journal, there have been 18 corrections in the Dow (a drop of 10% to 19.9%) within a bull market since 1950. Of those, 10 have turned into full-fledged bear markets (or drops of 20% or more). While a bear market is certainly a possibility, the most recent correction does not mean that one is imminent.

In an effort to keep the economy expanding, the Federal Reserve has embarked on an interest rate cutting campaign to reduce the adverse impact of the housing slowdown and credit crisis. While not necessarily a precursor to higher stock returns, Fed interest rate cuts are usually a plus for the market. Investors, anticipating the reacceleration of economic growth and corporate profits as a result of the more stimulative monetary policy, buy stocks.

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On December 11th, the Fed will decide whether or not to reduce interest rates once again. Given the upheaval that has hit many of our nations' largest financial institutions it is likely that the Fed will cut interest rates by at least another 25 basis points. A cut would bring some welcome relief to the oversold market. Of course, if the Fed does not deliver a rate cut, the market would likely react negatively as it has already bounced back from its November lows largely in anticipation of more Fed action.

Another positive for the market is that financial services stocks (which make up the largest component of the market's value) have already been hit pretty hard. The sector may already be pricing in a recession. Therefore, anything less than a recession at this point could be viewed as a positive and benefit banks and other financial players' stock prices. Furthermore, despite the losses in the financial sector, corporate earnings have been pretty good, particularly for those export oriented companies benefiting from the stronger global economy and cheap dollar.

Lastly, another reason for some optimism this December comes in the form of an historical technical perspective. According to the Stock Traders Almanac, since 1950 there has never been an up year for the S&P 500 that had consecutive monthly losses in November and December. Furthermore, during this time period, there has not been a loss in December large enough to turn an otherwise up year into a negative one. Given that the market is positive going into December and that November was negative, it would be a first (since 1950) for December to be negative as well. Let's leave setting records to another year.

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