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CT stocks show strengths, weaknesses amid market turbulence

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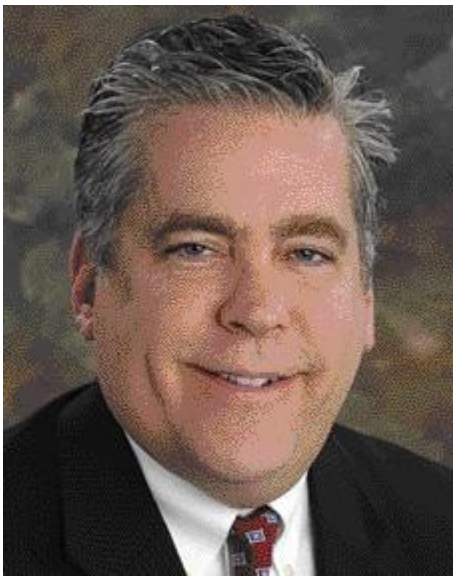

Joseph Matthews

Over the past month or so, the stock market increased by roughly 5 percent — after dropping more than 4 percent days earlier. What a roller coaster!

Will it continue? What about industries with a heavy presence in Connecticut? What's in their future?

The initial bump, as widely reported, resulted from a signaling by the Federal Reserve that a change in its interest rate policy is on the horizon. That made investors nervous and uncertain as to the future — two key elements that traditionally send investors to the sidelines.

The financial markets, for the most part at this point, have digested the Federal Reserve's decision to begin the slow process of reducing its monetary stimulus. In fact, this tapering process, as it is dubbed in the media, can be taken as a positive sign for the economy as a whole. Without continued improvement, the Fed would not be easing off the monetary "gas pedal."

It is important to note that the Fed has not suddenly reversed course — just signaled that the improving economy means it can begin to slowly reduce efforts to move us out of the financial doldrums.

In fact, Fed Chairman Bernanke recently told the Senate Banking Committee he doesn't expect to halt the Fed's stimulus program known as Quantitative Easing (QE) until mid-year 2014.

As the nature of this “tapering” has become clear and investors understand that the Fed has not simply turned off the money spigot, we have seen the stock market regain strength — investor nervousness and uncertainty has subsided. The economy is improving, perhaps not as quickly as we would like, but improving nonetheless.

So what's next? There is no crystal ball, so caution remains in order. Nevertheless, there are opportunities for those willing to do their homework.

The bond market, in particular, has responded to the idea of higher interest rates with its feet. Money has begun to flow out of mutual funds invested in bonds. History has shown that rising interest rate environments tend to hit the longest duration and highest quality bonds the hardest.

I believe that means, for the time being, shorter durations deserve priority consideration.

Three industries with a heavy presence in Connecticut are worthy to note: two because they are gaining strength and a third because it is not.

Health care and biotech stocks, for example, have done well recently. There are more drugs in the late development pipeline than ever before, a strong positive for this industry and a significant catalyst for these equities when (if) new medicines are approved. Additionally, many blockbuster drugs came off patent last year, so the effect of losing sales to the generics has been reduced.

The insurance industry also has done well, aided by rising premiums and interest rates that are starting to head higher. Most insurers earn a large portion of their profits from investing the cash paid as policy premiums.

As interest rates trend higher, insurance companies can expect to generate greater amounts of interest income from their investments. Certainly, large natural disasters can put a crimp on the profits of property-casualty insurers, but, for the most part, these companies have considerable funds in reserve — funds that will benefit from higher interest rates.

The defense industry, on the other hand, has experienced a few bumps in the road with a series of announced layoffs in Connecticut already highlighting the problem.

While some of the defense industry's contraction may have to do with so-called sequestration, the winding down of the war in Afghanistan also is a significant factor.

These pressures on the defense industry could result in as many as 36,000 Connecticut jobs lost, according to one study.

Investing in the defense industry clearly has greater risks than some other sectors, particularly with defense spending so heavily dependent upon worldwide political events, let alone domestic budgetary issues.

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