The Commerce Department's initial reading on US third quarter GDP shows an annualized gain of 2.8%, better than the 2.0% expectation and the second quarter's 2.5%.

In a surprise move, the European Central Bank cuts its key interest rate from 0.50% to 0.25%. The President of the ECB stated that there could be a prolonged period of low inflation, and the reduction was viewed by investors as a possible sign of weakness in the eurozone. There is little doubt that the recovery in Europe will take some time, and the situation is similar across many developed countries.

S&P downgraded France' debt rating, due to concerns about growth potential.

A popular IPO is usually interesting to track: Twitter debuted at a price of $26 and quickly opened at $45 per share. Morningstar estimates are for a floor of $15, fair value of $26, and potential upside of $50. IPOs are always difficult to obtain for individual investors, which is usually a blessing in disguise. Fund companies have not been quick to obtain TWTR, as a wait-and-see approach is typically prudent in expectation of a falling share price toward closer to fair value. The first funds to own the stock will be 2 ETFs on Nov 13.

Municipal Bonds

Municipal bond yields relative to Treasuries were recently at 77%, 94%, and 110% for 5, 10, and 30-year bonds. Demand has remained highest for the short-term side, despite being the most expensive since February 2012. The longer-term yields are attractive, but the specter of interest rate risk looms large. However, for long-term investors we are at a reasonable buy-in point for munis. Somewhat surprisingly, municipal bonds have had outflows for 24 consecutive weeks.

Europe

Inflation in October was 0.7%, the lowest level in 4 years, down from 1.1% in Sept, and well below the goal of 2%. There are signs that the recovery is being held back by low inflation, a strong euro, and strict bank lending. Slowing growth in some emerging markets, US tapering, and financial market volatility are also negatives for Europe.

The European Commission reduced its growth forecast to 1.1% from 1.2% and increased their unemployment forecast from 12.1% to 12.2%. There are expectations for the recovery to continue and accelerate next year.

In the UK, the third quarter was the fastest growth rate (0.8%, and 1.5% year-over-year) in 3 years.

Valuations

Despite ongoing recovery and concerns, European stocks are no longer a deep value, having gained significantly in recent months. The price:fair-value ratio for European stocks covered by Morningstar is 1.05, slightly higher than the 1.04 average for their total coverage universe. Emerging markets are cheaper, at 1.01 currently. European stocks are at their highest level since 2006, a price:earnings ratio of 15, which still compared favorably to US equities.

We are now at a point where there are few pockets of deep value in equities. Just 2 years ago, US stocks were available at 20% discounts to their fair value, which was a great safety margin. While I still expect equities to continue gaining, risk is correspondingly higher as valuations increase. I expect the Fed's potential taper-date of Mar 2014 to be a possible change in market behavior. The first quarter 2014 may be a time to consider moving back into traditional bond sectors, reducing equity allocations to focus more on value sectors and large-caps, and relatively high international stock exposure.

Indices continue to evolve

Russell pioneered stock indices in 1984 with their large- and small-cap indices, the Russell 1000 and Russell 2000. Not long after they coined the growth and value style types. Now they have a new characteristic to define equities by: stability. By classifying stocks into dynamic and defensive types, based on quality and volatility, we gain another basis for portfolio construction and analysis.

Defensive stocks are defined as high quality and low volatility. The best example of the difference in the types is given by recent performance: In 2008 defensive stocks lost 29% compared to dynamic stocks' loss of 46%. In the 2009 recovery, defensive stocks gained just 18.6% while dynamic stocks gained 41%.

It is too soon to say how useful this new categorization may be, and whether it will be of additional use beyond the common growth/value classification. We will probably see funds that seek to track these indices, which may have appeal.

Emerging Markets, US stocks, earnings

Richard Bernstein recently showed a different take on the US and emerging markets sectors. He remains confident that the US is in one of the best bull markets of most investors' lifetimes, and that emerging markets may disappoint.

Earnings are rising faster in the US and developed markets than in emerging markets, and inflation is an issue in many emerging countries.

He likes the small- and mid-cap industrial & manufacturing sectors in the US, and believes large-cap is less attractive due to its dependence on emerging economies.

I agree that US stocks still have great upside, but consider value the biggest factor in emerging markets. Regardless of other concerns (inflation), being able to buy stocks/sectors at a good value (such as low price:earnings ratio) is a great indicator of long-term investing success.

Frontier Markets vs Emerging
The Frontier Markets index is up 18.5% this year, compared to an Emerging Markets index that is down 3.8% (although some actively-managed emerging markets funds are up as high as 5-6% YTD).

During the past 3 months the tides have changed, as emerging markets are up 6.1%, 3-times that of frontier markets. The outlook for frontier markets had turned negative with the outlook for Kuwait and Qatar, which make up 44% of the index.

The run-up in middle east stocks means there is less potential upside now, and, additionally, Qatar and United Arab Emirates have been upgraded to 'emerging' status and will not be part of the frontier index next year. Greece will also be in the emerging class next year, another potential benefit to the sector.

Roth IRA vs Roth 401(k), differences
While these accounts are similar, there are important differences. One is conversion: A traditional IRA to Roth conversion can be reversed, but a 401(k) conversion cannot.

Another applies to RMDs: RMDs still apply to Roth 401(k) accounts, but not Roth IRAs; so the way around RMDs is to rollover the Roth 401(k) to a Roth IRA. The only risk here is that 401(k)s are better protected from creditors, if that is a concern.

The 5-year rule (money must be in the Roth IRA for 5 years to be eligible for a tax-free withdrawal) applies to Roth IRAs at rollover; the time spent in the Roth 401(k) does not count toward the 5 years. However, if the individual had made a Roth IRA contribution at some time in the past, that counts toward the 5 years, rendering this a non-issue.

Index returns as of Nov 07: 1 week, year-to-date:
S&P 500 (large-cap stocks): -0.45%, 24.74%
Russell 2000 (small-cap stocks): -1.89%, 28.43%
Barclays US aggregate Bond: -0.24%, -1.33%
MSCI World Stock excluding US: -1.12%, 17.17%

Have a good weekend-
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