

Market Outlook:

Data undressed

Score this round for the negativists.

As investors lick their wounds over some heavy volatility and precipitous price declines last week, reports on economic data and fundamental market analytics also regressed just enough to take a little steam out of the bull rally. We witnessed some serious earnings disappointments, there is still terrorism in the Mid East, a regional outbreak of the ebola virus shook the global medical community, European growth prospects suddenly turned sour, and domestic housing starts slowed. There is obviously enough concern built-in to equity price advances that negative news, or even *inferences* about negative news, can disrupt momentum, confidence, and valuations.

And there is more to go around. Is the real estate/housing boom sustainable? Can we build earnings growth across the board in a low wage environment? Is energy *really* in plentiful supply as the experts tell us...enough so that prices for this depleting natural resource should regress to levels of five years ago? Will the Fed ever get around to releasing interest rates?

And who is watching suppressed inflation data on food and discretionary spending costs?

I believe the build-up in pricing pressure for agriculture, energy, healthcare, and housing is much underestimated in the current data, and will become an economic sticking point, particularly if employment data continue to do better but wages are not commensurately rising.

In that vein, all sectors in recent weeks have been impacted by a rush out the door of investment capital. While it is generally accepted that the cyclical and industrials are more immediately affected by nuance in the short-term, even the most strongly performing sectors (non-cyclicals, utilities) witnessed capital losses in the past few weeks.

Hold the fort

An interesting confusion will arise for equity investors if/when interest rates *do* begin to rise. Whether or not to retreat from hard-won gains and to redeploy wealth into more secure/less volatile instruments is a difficult reality to confront. One cannot, of course, try to "time" the market, but we know intuitively what's coming. **The question is whether the stock markets not only do *now*, but will in the future, offer an appealing blend of capital gains exposure along with balanced risk aversion.** I believe the fourth quarter will offer a glimpse into how that question will be answered. Thus far, it appears that investor's appetite for risk exposure is waning, as more money seems to be coming out of stock funds than going in. Last week was a kaleidoscope of emotions, cash flow, capital gains and losses, and portfolio angst.

More likely is that we are witnessing the origins of a new cycle calibration, one in which sector rebalancing and portfolio allocation takes on a more conservative bias. Our asset allocation models are becoming more skewed towards resetting the stronger/fewer earnings performers against a backdrop of disappointing expectations. Besides, two weeks doesn't make a trend. There is still the completion of this right half of the parabola to experience. Traders call this "backing and filling"; clients call it a "slow water torture".

Is there really any relevance to this capitulation? That answer depends upon your preparedness. We knew it was coming....just not when. One should have already positioned for its eventual occurrence. A careful re-read of my previous missives will show that I have been describing this distribution pattern for several months, but by no means is this a repeat of 2008. We are still solidly in a bull expansion, both for stocks and the economy-at-large. **The problem is that everyone is impatient for something extraordinary to happen, that magic moment, even though the markets are travelling at their own pace.**

Pullbacks make great drama, but it takes a more sustained period of time to wreck a secular uptrend. That kind of full-bore erosion is not happening now, despite the fact that pullbacks are so darned frightful, so we suggest to clients that they refrain from the hourly log-in price checks, the daily market stock quotes, and monthly statement perusals, and rely on the fact that money generally follows the longer term trend.

In which case, the longer term uptrend is still intact.

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