

Market Outlook:

Live with it

As the markets continue their "non-selloff" selloff, the question is whether this dynamic is simply a *dip-to-buy* or a significant secular trend reversal. **Our view is that while the mania represents legitimate concerns about very serious short term current events, there is no need to adjust portfolio allocation to suggest that we are changing our conclusions about economic fundamentals.**

Most financial measurements are improving, not regressing, and certainly in line with projections for a sustained, albeit muted, bull market.

As I have written in previous missives, global economic trends are never expressed as straight line (linear) equations. Rather, they transition over time in parabolic cycles, and depending upon one's timeline of measurement, may take decades to bear fruit. The key to making money within those trends, however, is to maximize asset allocation into sectors which mirror money flow during short-term upside mini bursts or away from downside capitulations.

Having said that, it appears to me that there is increasing concern about the momentum and magnitude of many global exogenous influences. For example, the most recent stock market meltdown in early January (a by-product of steep energy price declines and geopolitical tensions) triggered a massive flight to safety into cash and short-term bonds. In fact, in some cases, as one client said to me last week, it nearly drove the "average investor" out of the market completely. **Wild price swings in stocks, commodities, and bonds develop a climate of mistrust about the market's ability accurately to parallel investor's interpretation about the economic recovery and their role in it.**

Or perhaps the recent two year run-up in the markets obscured a reality about that recovery: global growth is perilously and closely related to commodity sensitivities, and it should be inferred that there is more volatility ahead?

Interest rate casino

Global governments, treasuries, and money centers have had a hard time regulating policy about interest rates during the past seven years. During the height of the financial crisis, everything that could have been done to stave off collapse was tried, including opening the spigot on "free money" to get you, the consumer, back into a spending habit. A mismatch of low interest rates combined with more stringent lending practices by banks neither achieved the desired effect, nor held off the avarice and demons that brought the crisis upon us in the first place.

Money supply is, after all, the lifeblood of economic expansion. Since money must go somewhere, if it is not being used for consumption, manufacturing and the supply chain usually grinds to a halt. A sorry spiral of sympathetic outcomes thus paralyzes business and consumer sentiment (and their capital spending). That is the precipice upon which we sit today. Money without confidence is collateral wasted. Round after round of "quantitative easing", and cajoling, has not undone the major damage corporate and financial titans imposed upon themselves...namely, breaching the trust of their customers.

Now, despite a slow and steady climb out of a recession's abyss, the fear is that another bubble in financial assets might have been created. Despite price deflation in energy assets, that sector is now just another in a long line of business endeavors to collapse right before our eyes. Remember technology (dot.com), housing, fixed income (bonds), financial stocks, and retail stores (cyclicals)?

All of the "gloom" notwithstanding, the bull rally has deep roots and strong tailwinds, and is likely to continue for several more cycles ahead. Despite manic selling sprees that regrettably are going to happen, we think the outside influences that are driving today's panic selling are only temporary anomalies. However, to be fair to those with deep seated concerns about excessively high valuation and expectations for stocks, the wide ranging influence of the energy sector's decline has not yet been fully digested into the recovery conversation. In the long run, though, volatility in that sector might be a net-positive if it opens a dialogue about the role of sustainable energy for the future.

My lingering concern is to measure to what extent improving economic data actually might or might not influence consumer confidence and spending patterns for the near future. Remember, disasters are always front-loaded and preeminent in the collective psyche when they are occurring. But the back-end is always where the reward can be found.

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