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Market Outlook:

A matter of trust

Even as the market averages sit atop their highest valuation in more than a decade, many investors are still expressing to me that they are quite uncomfortable with betting that this is the "real deal". Having recently returned from a few days travelling to meet clients, I am convinced that the "average investor" has come to view the stock market as extremely volatile and highly explosive. Given the breadth of changes many have experienced over the past few years about their investing, the dramatic cascade of emotional and financial highs and lows, it is not surprising that there is a healthy skepticism about the data that supports current stock market speculation.

With good reason. The Federal Reserve itself has difficulty assessing the overall economic landscape, first tightening monetary policy to avert a disaster, then proclaiming that, despite a catastrophe averted, they might schedule additional rounds of intervention for the foreseeable future.

That lack of clarity in delivering their message spells additional trouble for people who simply want to know what the experts think and what they're going to do about it. Unfortunately, the "experts" don't really know what they purport to know, and are loathe to go on record saying so.

As the economic numbers improve...and they are...optimism and confidence unfortunately lags behind. It seems there are many more questions than answers, and not a lot of confidence in either. While the jobs numbers are increasing, wages and purchasing power are falling dramatically behind. Despite robust surges in economic statistics, corporations are having to offer incentives, discounts, and rebates to potential clients just to get them in the door. Profits are adversely affected by these measures, and certainly not growing consistent with a "booming" economic environment.

Prices, too, are caught between a rock and a hard place. Anecdotally, we all are aware of rising costs in day-to-day items, and yet those aforementioned "inducements" are placing downward pressure on prices in other areas.

The point is that no clear-cut trend is emerging despite the rhetoric and hyperbole ascribed to the stock market's remarkable uptrend.

New normal

We are trapped in what unfortunately has become a "new normal", a period of ill defined growth and opportunity, higher inflation in home goods, lower prices in corporate services, and a moral climate that forces many to "hold on" to what is theirs simply to survive without too much concern for the other guy.

By definition, that is *not* an economic renaissance, that's a warning signal that something's not quite right with our economic equilibrium.

When these disparate forces collide, tectonic shifts erupt between purchasing power and economic stability. The premium we are paying for stocks is much too high, even as relative strength integers continue to expand beyond several standard deviations during the past few months.

This is where asset allocation becomes critical. As you all know, I believe that portfolio asset allocation plays a greater role in the probability of investment success than does any individual security within that portfolio. Portfolio management is a *process* of evaluating risk-versus-reward, both micro trends and larger secular themes. There are times when one must simply accept defensiveness in the face of obtuse or conflicting data.

And, lastly, one's risk assessment must be consistent with the emotional (and financial) implications of the probability of taking losses. My recent travels and conversations reveal that there is a strong correlation between higher equity valuations and consumer uneasiness.

That is the new normal for the first half of 2014.