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Market Outlook:

What's next?

A surprisingly steady climb in market valuations has me wondering whether interest rates might be the next asset segment to begin a consistent rise. If so, this would provide a significant counterbalance to a market gone wild with an insatiable appetite for stocks.

And if, in fact, rates were to rise it would be emblematic of an economic recovery that had turned a corner from moribund to robust.

Many investors seem convinced that the stock market's recovery is for real. They must also conclude, therefore, that the economy is showing signs of sustainability, also.

Last week, the averages hovered near their "new" all time highs, looking quite powerful and resilient. As I wrote recently, my quantitative integers are indicating nearly "full capacity", foreshadowing a potential pause in valuation expansion both for individual stocks and the averages overall. But one doesn't willingly stand in front of a tidal wave. While I might *expect* a market pullback, I'm certainly preparing portfolios for a continuation in capital gains opportunities while they still exist.

At the same time, though, one must recognize that if these valuation numbers are to be believed, then economic activity must be concurrently accelerating. And if those expectations for growth are to become reality, then the next momentum play must surely be in interest rates. **If the intent of our analytical processes is to identify inflection point developments as they occur, then a reversion of capital flow from equities to laddered bond maturities might provide us the next systematic asset allocation realignment opportunity.**

Forever young

Since all investments involve risk and opportunity at the same time, I perceive this gradual portfolio shift as a seismic event, considering our one-dimensional fascination with stocks during the past half-decade. One must consider that inflation in wages, employment increases, and manufacturing growth could transition the economic (and market) landscape from *deleveraging* to *programmed consumption*.

Be aware that these trends do not occur overnight, nor are they without their own peculiar risks. Any transition from stock speculation to exuberant consumerism requires a change in asset allocation, market discipline, and investor's mindset.

I am aware that the first crack in our capital appreciation fixation will be reflected by a redistribution of funds from equities to fixed income. How simple, and how inviting, might it be to "lock in" a baseline rate of return using bonds and to build capital gains (equity allocation) upon that buttress within our portfolios?

Assuming demand for capital goods increases, we would also expect an increase in the demand for credit, followed by a buildup in inventories...each a harbinger of expanding Gross Domestic Product (GDP). To date, government policies have been oriented around tighter spending and budget austerity. Let's see if a new mindset might begin to permeate throughout fiscal and monetary policies over the next few months. The question of which comes first, demand or "easy money", is a complex issue. But given a gradual shift from *close-to-the-vest* to *pricing power*, reflation (inflation) could become the next trend to score highly in my market analytics.

There are many demographic themes from which to select (alternative energy, infrastructure, biosciences and healthcare, agricultural sustainability, ecology, etc.) to try and earn a capital gains advantage within this next market phase. Transitioning from cyclical recession to a growth economy implies many fits and starts, and a reevaluation of our own moral and economic modeling.

Change is inevitable. Changing our attitudes about change is the hard part. If the purpose of portfolio management is to identify viable and sustainable investment opportunity...and to mitigate risk in the process... then I believe we need to wean ourselves from our "new high" fixations and start to fall in love with the unknown realities that the future might be holding for us.