Scotty C. George
Chief Investment Strategist

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Market Outlook:

No stopping

Recent market volatility has definitely put a scare into investors who might have thought that the crash of 2008 was the worst they had seen in recent memory. Obviously, when stocks are rising, as they had been since the credit crisis was "solved" by fiscal and monetary intervention, it is hard to focus on what could possibly go wrong (?), particularly when portfolios had been achieving record setting performance in the last two years.

Enter China, the Federal Reserve, and the energy markets.

Downdrafts from these uncertain factors eroded nearly three to four percent in the averages *daily*, aggravating an already tenuous situation created when stocks accelerated so long, so fast to "the top". Unfortunately, also, the magnitude of the integers themselves made people nervous: no one likes the look of triple-digit market moves, especially to the downside!!

In spite of all the woes pushing sentiment and performance into negative territory, *market breadth of participation* and *relative strength integers (RSI)* held up relatively well, all things considered. The economic recovery and the "bull trend line" took a punch to the jaw, but did not fall to the mat.

It is yet to be determined if the data supports or refutes an omen of doom that pervades financial conversation. I contend that equity direction and economic direction are becoming inversely correlated, particularly as the stock markets take a pause to digest their linear advance...and retreat...during the past few months. We cannot, nor should we, conflate the activity of stocks with the positive direction of economic statistics.

In fact, *when* (not if) the Fed raises interest rates, they will set in motion an alternative investment scenario (bond buying) that can only improve equity performance by stabilizing the degree of speculation occurring in stocks bought on margin, and by helping to build cash reserves and savings for investors looking for something other than stock market participation.

The only people who would be negatively impacted by a higher cost of money would be those who borrow above their means to pay back the loan.

Besides, the Fed would only raise rates if they had confidence in the strength of the economic recovery across the board, and if they believed that the surge was magnifying too quickly. That's the *good* news. Others argue, however, that a rate rise has not yet been factored into equity prices and that its deleterious effects might be significant. I disagree with the latter point of view.

From the maze

I expect that the extraordinary volatility of the last month will lead to a logical sector rotation that identifies a new paradigm of asset allocation, one which is different than an "anything goes", throw-a-dart type of mentality. That shift should relate to inflation plays, yield opportunity, and a resurgence in tangible asset equities. There is further opportunity for earnings expansion in consumer brands, multinational companies, infrastructure development, biotech research, alternative energy, and water-related ecology.

Although the extreme regression in portfolio valuation is discomforting, the worst I observe is that expectations and baseline performance metrics must be recalibrated. We have *not* begun a new bear market, nor a bear phase.

There is, however, a strong possibility of uncertainty in the next few weeks...October has historically been a "queasy" kind of month. But signs are building that the data are transitioning into an inflection opportunity, a new and vibrant period of accumulation in equities trading well below their previous high water mark. Now is not the time to give up or give in to hesitation and fear.

As quickly and as violently as upside short cycles can regress, so too can they initiate recycling back up again. This, then, is a new reality in portfolio management for the foreseeable future. Fasten up your seatbelt. This looks like an E ticket kind of ride.