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Market Outlook:

Conflation

I think it's high time that we all acknowledge how drastic a departure this past decade has been from "conventional" market analytics. Sometimes, investors take for granted the large tectonic shifts that naturally occur....in nature as well as in markets. And while I previously have said that I am loathe to verbalize that "it's different this time", there are things which just don't add up or meet the "smell test". Let me explain....

First, I believe we should agree that the stock market is *not* the same thing as the economy. Yes, there are convergences that meld the two nicely together. I even coined the term *parallel disconnect* years ago to describe two distinct phenomena (in this case stock markets and economies) moving in congruent directions but not necessarily items that are one and the same.

At the moment, they appear to be the same. The economy is growing, creating jobs and new investment capital. Similarly, the financial markets are rebounding off the lows of the Great Recession and are making sequentially higher-highs in the averages. A lot is good for each, and the consensus is not to rock the boat or over analyze but simply to bank the profits and hope for a perpetuation of these parallel vectors.

However, just as it is difficult to imagine rain when it is sunny, investors are pretending not to think about any decoupling between the market's steady linear progress and the inevitable cyclic phases of economic growth. Yet, every bear market, every "October surprise" has come without warning, even though quantitative signals may have indicated their evidence.

Investors only agree to acknowledge a shift in cycles *after* they have been in them awhile.

Agility

The art of prudent asset management, however, is to identify trends, whether rising or falling, as much before they occur....and the reasons for their occurrence...as possible. In other words, it is my job to worry for you.

Indeed, we are grateful for the past decade's portfolio performance and our stewardship of things such as asset allocation, sector rotation, security selection, and asset distribution. Our returns have been commensurate with or better than our client's risk tolerances and market benchmark's progress. We are sometimes chided for our vigilant levels of concern.

But giddy traders are the worst kind of investors. They bound along unwittingly and, oftentimes, un-scientifically. When, or if, market capitulations occur, these players act baffled when they have to absorb portfolio losses of 25 or 30 percent.

The rules of the game quantify slightly differently right now. Stocks are not as isolated from the potential for reversal as some would like you to believe. We are aware of the hiccups that can occur on an intraday basis, like the kind that happened mid-week last week, but don't believe that they are the initiation of a significant cyclical trend reversal. That also does not mean that the economy will violently cease its rebound, either. In fact, in a low interest rate marketplace, we still believe that there are sectors in the economy that will outperform our expectations (biotech, alternative energy, agriculture, water, technology, basic materials). We have to concede, however, that interest rates will begin to trend upwards, inflation will most likely begin to appear (if not clinically then at least anecdotally), and the *rate of appreciation* in corporate profits must at some point abate. We just want to avoid the kind of hubris and mental complacency in our asset allocation processes that sometimes accompanies success.

We are not bearish, nor contrarians. Any inference that we are is a misunderstanding of this tome. We remain fully allocated and will continue to do so until indicators direct us otherwise.

The landscape has shifted favorably for investors in the past half-decade. But the primary surge in prices has already occurred. Now it is incumbent on investors to know the difference between cautious optimism and awkward aggressiveness that leads to falling into an abyss.

There is plenty of the latter, and not enough of the former.