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Market Outlook:

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Excessive worry and volatility in the stock averages last week raises the question of whether there are true structural impediments to another bull run, or simply perceptions that the market is overbought. It also raises a time-worn question about whether stock markets, themselves, are snapshots of *current* information and valuations, or whether they are in fact a proposition of "baked-in" data regarding *future* expectations about business and the environment towards which they are flowing.

This important distinction resonates because the former should have you enthused about the longer term prospects for earnings expansion, whereas the latter might cause you to lose some sleep about how much further business and the markets might go.

Ten years after the collapse of investment bank Bear Stearns and the subsequent financial crisis that unfolded we find ourselves at the very nexus of what market statistics today might mean about the future.

We see no clear or imminent signs of economic reversal. We do acknowledge, however, that the *pace of growth* might possibly dissipate. With the Federal Reserve indicating their intentions to raise interest rates several times this year that notion takes on additional resonance.

In spite of exogenous noise and current events, we find that the seeds of expansion are firmly sown. There is a disconnect sometimes between fiscal policy and monetary policy, but the phase of market cyclicality is still only mid-course. Despite any contradictory anecdotal evidence, our research still finds that the global economy has sufficient staying power to avert any real reversal.

Indeed, GDP is finally showing signs of expanding, wages (for some) are rising, and inflation...the great bogey for the Federal Reserve....is nowhere near destructive or counterproductive levels. (We remain unconvinced, however, that the recently passed tax cut legislation will do anything but provide a temporary floor to the stock market, as corporations use their new-found largesse to buy back shares rather than initiate any new capital spending initiatives, expand hiring, or invest in research and development).

Following in that vein, the economy is not yet working for everyone. So far the biggest threat that the last decade's success poses to the economy is the ever widening gap between those who are doing well and those still struggling to achieve financial equilibrium. Whereas those gaps by themselves do not cause a recession, the issue sounds a clarion call for our legislators to do a better job in leveling off the playing field.

Our view is that stock prices today are nowhere near indicating an economy at full capacity. Quite the contrary, as mentioned above, the recovery is universally still quite tepid.

A strong, full employment economy should be the goal and would represent the best possible outcome from which innovation and entrepreneurship could flourish.

We recognize the potential headwinds and obstacles. But we are loathe to encourage additional "manipulation" or alchemy by the Fed or Congress to achieve unencumbered markets. The current bull began ten years ago with a healthy dose of central bank and political stimulus. The aftershocks are still being measured. It takes a fairly substantial amount of tax cuts, spending increases, and monetary intercession to effect a redirection in the throes of a recession. Thus, it would be prudent to maintain vigilance *without additional mediation* to get the true measure of where we are in making the economy stronger.

The hazard of tinkering with the expansion is that you run the risk of making it more difficult to quantify the exact pressures you alleviate or those which you exacerbate in the short run. Quantitative statisticians typically wait to apply metrics to the future because trends need time to develop. We are not in the business of gambling or speculating about whether things are changing....we actually wait until the changes are occurring to develop probability scales as to the magnitude and duration of the evolving situation. For example, upward pressure on wages is a statistical fact. However, the magnitude and breadth of the phenomenon is well below what economists might suggest is an effective force to change purchasing and savings rates for the labor force. If the data is to be believed....and its effect upon current financial markets....then aggregate consumer demand must project out more fully and more robust for the scenario to look much better.

To us, current stock market valuations are simply a snapshot of today's estimation of corporate conditions, and not yet a representation of what we believe to be economic growth still in the pipeline.

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