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Market Outlook:

Uncomfortable itch

One should be increasingly concerned by an almost rabid inter-day obsession with manic market swings that are poor surrogates for fundamental analysis or strict portfolio methodology. In what, on its surface, appears to be complete ignorance of traditional analytics, investors now appear more eager to milk capital gains out of any stone not yet turned, for any reason that they can justify. And yet, few really profess to being *"comfortable"* with the financial markets at this juncture.

Despite a confirmed bull in global equity bourses, and a nascent bloom on the economic rose, the data offers a mild rebuttal: earnings appreciation patterns are regressing; corporations are hoarding cash; turmoil in emerging markets inhibits export potential; employee wages have not kept pace with annual cost of living increases; and trader's confidence in the market's direction is reserved, at best. The only one getting pummeled with this wet towel of depressing news is the consumer, the hoped-for savior of economic growth.

What troubles me more is that relative strength integers, although quite a bit lower today than at their peak at the end of 2013, are still within "mid-range" of completing a short term consolidation cycle, an indication that we have further to go before price declines might be completed. As markets digest this mid-cycle slowdown, sentiment indicators offer a clue that things indeed might be improving, but are not as rosy as last year's bull market surge might suggest. As a quantitative strategist. I see everything as a set of "inverse mathematical probabilities", therefore I cast a selective and somewhat skeptical shadow over last year's hyperbolic equity performance. **And yet, since good news *is* good news, I also see little liability from this price correction or its overall long term effect upon the direction and duration of the bull trend.** The market needs a digestion configuration consisting both of upcycles and capitulation down-cycles. In my conversations with clients and colleagues we are always cognizant of balancing the temptation for the "need for speed"...keeping pace with intraday price movements... versus a slow and steady acknowledgement of secular, long-term themes. There is *always* something to buy. The mastery is to know how to use purchasing power wisely enough to mitigate the potential for disruptive (downside) volatility to each portfolio's unique risk/reward tolerances. Thus, you go from simply being a consumer of financial securities to being a portfolio manager with a defined discipline.

Profit only?

History has shown us that the scenario that works best for stocks is when consumer confidence not only buoys equity *prices*, but also equity (corporate) *expectations*. Such a landscape requires secular patterns of positive momentum in the unemployment rate; savings rate; wage fairness; cost constraints (low inflation); and an accomodative confluence of monetary, fiscal, and social reforms. **In other words, if the consumer feels handcuffed by his circumstances, he becomes loathe to spend. On the other hand, when he looks around and sees his neighbor doing well, his hometown doing well, his region doing well, and feels as if *he* is doing well, it accelerates a dynamism which unleashes a sustainable optimism not just for himself but for the broader economic picture as a whole.**

In turn, specific sector expansion does not happen on its own. There are magnitudinal guideposts that determine what parts of the economy will thrive and which will lag behind. Sector *disaffection* lessens the economic potential of certain geographies and governments from doing well. Witness, for example, how the Middle East and other global petroleum-rich regions gyrate to a different drumbeat within the context of their own political and economic disruptions. In today's tenuous equilibrium, themes that reflect household values seem to have market traction, namely healthcare and biosciences, affordable energy, technology, agriculture (foodstuffs), and environmental (pollution) control. Lagging significantly are Basic Materials and Cyclicals.

The question that persists during this market's acceleration/contraction period is not *"why"* the market pulled back last week, but "*for how long, and to what degree?"* While nobody really knows that answer, we can infer certain things from what we see, and have seen in the past. We are, unfortunately, paying the piper for a market gorging wildly on low interest rates and small imagination. **Profits built by alchemic balance sheet machinations are not real profits, in my lexicon, until they derive from consumer demand or from building a "better mousetrap".** The effect upon investor's psyche of seeing equity prices bid up without restraint might strengthen the magnitude and duration of the market's upside trajectory, but it serves as a harbinger of a sloppy downside capitulation with unexpected psychological consequences.

Diminishing consumer expectations and hopes produces diminishing rates of equity return. What the market is really searching for (beyond the obvious daily stock picks) is a set of economic and moral principles that can sustain the original thesis for investing: making money and serving the greater good.

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