

Market Outlook:

Paying the piper

I'm sure that many of you are noticing the "frothiness", the churning, taking place in the markets recently. After all, isn't it to be expected that after propelling for so long and at such acceleration that the markets would be primed for profit taking and capitulation? While "cheap money" might have been the impetus for stock valuations to grow initially, the out-sized gains of the past two years leave little room for upside expansion in the short-term. Whether you are a bull or a bear, it is impossible to expect double-digit portfolio performance indefinitely.

How, then, to plan for the inevitable volatility in stocks? Asset allocation.

For those of you who haven't heard my admonition often enough, let me repeat that **asset allocation plays a greater role in the probability of portfolio capital gains than does any individual security within that portfolio.**

But asset allocation alone does not offer a panacea for making money, nor a guarantee of not losing. Remember that investing involves *risk*. Markets are capricious, subject to volatility and changes that are sometimes outside the boundaries of traditional fundamental analytics. Markets are also *cyclical*, meaning that even in good times valuations reach an apex and then revert back to the mean, once again creating an opportunity "entry point" at the nadir of the cycle.

Investing is not like burying money in a tin can in the backyard. But neither does that tin can offer capital appreciation potential. It is vital that any investment program begin with a top-down, overarching view of a portfolio time frame, theme, demographic, and belief system. These are the factors which make investing interesting, fun, and rewarding.

Prognosis negative

Because earnings acceleration is the truest barometer of future equity performance, one might conclude that the first quarter is so far shaping up as a mixed bag of disappointing expectations. At its best, the global equity markets are a compendium of new highs and short-term capital gains. Without question, as I have suggested in earlier writings, there is much to like about the new renaissance in stocks and the economy.

On the other hand, there are more negative divergences and deceleration in stochastic tops than should ordinarily be expected in a "bull" market. Some are saying that the rally is sustained by "smoke and mirrors", that we should notice more stocks are receding than advancing. Rallies are shallower in breadth of participation. A market this long-in-the-tooth appears to be getting weary as it pushes through new highs, and a "Bull" in name only. The news is dominated by factors which confirm a widening confidence gap, and a tightening of expectations about equity performance ahead.

My relative strength integers (RSI) show a declining series of tops, perhaps a harbinger of the pullback we are currently experiencing.

Although a preponderance of evidence suggests that we have turned a corner in the global monetary condition, the stresses that are placed on individual companies because consumers are not spending aggressively are too vast to ignore. **A common theme I see is the reluctance of the average investor/consumer to trust that things are as good as the data and "experts" suggest.** For example, empirical evidence is now confirming our earlier suspicions that despite rising employment numbers, wages are not increasing commensurately. This causes a hesitation for consumers about abandoning caution, or to start spending indiscriminately. This is also evidenced, for example, by the much heralded decline in energy prices which, unfortunately, has not translated into the financial "windfall" that many had predicted, but rather a paying down of debt or new deposits into saving accounts, instead.

We have a demand problem at present, not a supply shortage.

Economics is not a "phantom" science, it is the essence of what affects you and me within the "four walls" of our home and workplace. Complacent, fearful, or unresponsive consumers can portend the undoing of any potential economic revival.

We will monitor closely whether the current choppiness in stocks is reflective of a normal contraction at the top, or a more nefarious indication of an economy about to go into hiding.

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