

Market Outlook:

Under the radar

In stealth fashion, consumer prices are surging at their fastest pace in almost a decade. Although energy is the most visible culprit, gains in food, retail, transportation, and leisure products cut deeply into our standard of living. As previously noted in other missives, just about the only things not going up due to inflation are wages and savings, both of which have experienced slight declines in the past couple of years.

The news on inflation, however, has not kept a lid on stock market activity, which again had a muddled path last week. Thanks to comments made by Fed Chair Janet Yellen, investors found themselves caught in a squeeze between limited economic expansion and the promise of monetary policy designed both to stimulate and protect concurrently. No wonder we got bounced around during the week.

My analysis concludes that these ambiguous data could spell trouble for our expectations of unabated capital gains. The elements are in place for a more conservative orientation in our balanced accounts management. Even as the economy continues to show improvement, investors are skeptical about their institutions and their lack of initiative in dealing with fiscal, social, and moral issues.

To be sure, there is earnings growth, valuation expansion, and economic revival. There is also geo-political uncertainty and commodities volatility driven by world trouble spots. Ukraine is dominating the news, as well as the violent clashes between Israel and militants in Gaza. Determining how long divergent pieces of news might coexist without exploding into "something else" is the essence of the art of managing our client's portfolio risk. For the moment, I perceive upside market expansion as possible, but tightly range-bound. Current events are the wildcard.

Your choice

Stocks played a game of *one step forward, two steps back* last week, as concerns over regional war, poor consumer confidence, and light summertime trading suspended market direction and exuberance. As I have written previously, stretched valuations in many sectors only made the declines that much more predictable and, perhaps, less onerous psychologically because they were expected.

It is important to pay attention at this juncture because any news or exogenous event might be a strong catalyst for severe magnitudinal response. Irrespective of capitalization or geography, global bourses are quite vulnerable to a pullback at these levels, and certainly much less likely to show any significant upside acceleration.

We have witnessed how low interest rates can spur stock purchases, and how a constant flow of mundane economic data has yet to dampen investor's appetite for risk-taking. However, despite a strong first half, major indices are still susceptible to valuation risk if the slightest hint of economic regression or global conflagration is perceived. Complacency is simply not an option for portfolio managers at this juncture... and neither is an unabated all-in asset allocation.

No doubt, there are improvements in the data. **But I believe that expansions (recoveries) are typically measured in years, generations even, and not the stuff of 24 hour news-cycle responses.** It is no surprise, then, that market participants seem to be divided into two camps: (1) those with wealth who wish to avoid catastrophic valuation declines and (2) those who seek to maximize short-term opportunity to bank (or make) their fortune while the getting is good...quickly!!

It also divides market metrics into two additional boxes: (1) how much is enough or (2) how fast do you need to "make up" your perceived shortfall?

Unfortunately, the reality of simply surviving today is becoming more expensive and forcing those in box 2, of both subsets, to become more risk oriented. If you think you're poor, or behind the curve, you are more likely to act aggressively financially to "recover" a status position.

As a result, a large percentage of market trading activity is now subject to a collectively shared volatility imposed upon us by a risk orientation, as opposed to a long-term investment philosophy. A certain measure of gratuitous greed has accelerated our expectation timeline from *"a lifetime of good deeds"* to *"I want it...yesterday!!"*

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