

Market Outlook:

Top, or not?

A devastating sequence of sequential triple-digit down days in the Dow last week illustrates emerging trends that are becoming more clear, as business indicators from China, and around the globe, imply that a lackluster period of moderate-to-shallow growth is the best we might hope for. Without question, a dissipation in market confidence is the end result of a slowdown in global earnings acceleration. Valuations of stock prices simply don't have much room for expansion to the upside. Many analysts are looking at the S&P as a time bomb waiting to go off.

Our work also indicates the probability of continued weakness, like the kind of sell-offs we had last week, but not a full bore reversal, or a repudiation of any data that are confirming economic recovery. One must be careful to separate *the markets* from *the economy-at-large*, and realize that they sometimes execute in tandem, but sometimes not. **In other words, the upside magnitude of stock and asset expansion might have hit a temporary lull, while significant economic measurements, overall, are showing improvements.**

It's the short term market performance, however, to which we need to pay attention.

It's almost as if the goalposts keep being moved further back, even as we drive successfully downfield.

My forecasts for equity capital appreciation remain unvarying despite the recent roadblocks of price resistance/overhead supply, earnings weakness, and psychological discomfort. A further reversion to the mean would not necessarily suggest, at least not yet, a failure of the market to follow through on its bull run.

The world's epicenter has been moving from West to East. Even though we spent much of the early summer fixating upon Greece and the Eurozone, the past few weeks have morphed into a cacophony of Asian statistics. A global recovery keeps advancing even as equity market softness results in portfolio distribution and decline. We are monitoring closely to see if a disruption/slowdown in Chinese capital markets, or debt issues on the European continent, potentially pose enduringly negative spillover consequences for stock price movement.

Typically, data are strong at market peaks.....until they are not any longer!! Therefore, it is not always possible to discern the difference between a *market top* and a *correction*. Although the terms are similar, what matters most is gauging the probability of the severity (magnitude) of any capitulation.

Patterns

The markets have been trading "in neutral" for several months, neither helped nor hurt by global exogenous noise or current events. Were a correction to occur, we do not believe it would represent the end of a bull rally, but rather an opportunity to buy shares at a more attractive price than when they were trading at their pinnacle.

In fact, our portfolios have maintained roughly a 25-30 percent allocation to cash during the quarter as a buttress for just such an occasion. Remarkably, the pattern of new highs followed by trading selloffs has netted zero return in the S&P as well as most global bourses for the year, despite an improvement in most fundamental measurements.

What I find most interesting is the flight from commodities shares during the cyclic advance. There is a strong probability of a rebound in those equities during the next few years. I am always reminding clients that the markets are "fluid", parabolic in nature, and not, by definition, linear. One can be "long" stocks in a down market and still make money. **Outperformance is simply overweighting those sectors which are working while underweighting the laggards.**

Critical fundamentals still align to the plus-side, in particular a low level of interest rates as well as overall strength of the US dollar. Those factors alone should enhance performance in Utilities, Consumer Cyclical, Financials, Technology, and Industrials...roughly 75 percent of the global sectors we review.

Whereas we acknowledge that profits are tough to come by, the real key to growing share price valuations is consumer demand. The elements which most predict demand are *wage growth* and *job satisfaction/security*. Neither element is in large supply right now, or likely to improve dramatically in the next few months despite modest, "*tip-toe*" improvements in consumer confidence. Right now, though, we continue to favor equity participation. But one must recognize that traditions, like trends, are parabolic and are frequently influenced by events outside of our control. It is much too early to predict a bear market, but not too early to recognize factors which might help to push aside confidence and resolve.

An old golfer's pre-shot maxim states: "*hope for the best; prepare for the worst*".

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