

Market Outlook:

Focus

The likelihood that the Federal Reserve will soon begin to raise short-term interest rates has created a psychological and fiscal schizophrenia that intensified to the max by the US stock market last week. While it's not unusual now to see 200 point swings in the Dow Jones average, it is highly divisive when that magnitude of change occurs intra-day as it did several times last week. While one obviously cannot say with certainty what might occur with future market conduct, our research has uncovered quite an interesting parallel to previous Federal Reserve "inflection" moments. We have observed, for example, that more than a dozen times in the last 50 years the Fed was faced with secular "tightening" circumstances and in each case the stock market had an *annual gain* after the rate increase. In fact, in the ensuing two years post-rise the markets continued their rallies.

Intuitively, one might infer that borrowing rates only rise as a result of increasing and sustainable economic activity. It's not easy being predictors of monetary policy, in general, nor Federal Reserve-watchers, in particular. However, cyclical patterns in interest rates are almost always accurate in predicting the trend of economic and monetary movement. Following the recession of 2008-2009, and with the benefit of austerity measures that seem finally to be bearing fruit, it would only make sense that we are now experiencing a reversal in the cycle pattern, evolving finally from *low to high*, from *economic crisis to economic recovery*.

Clearly, a change like the one being forecast affects many segments of the economy in different ways, at different times. Not all asset classes (bonds, stocks, cash, tangibles, e.g.) move with synchronicity. Sometimes one category is going up while another might be in decline. Our clients know, for example, that we manage portfolios as earnings-driven asset allocators, diversifying amongst both sectors and specific equities. In the realm of probability sciences, everything is measured on a *parabolic scale*....left side, right side, up, down. Somewhere on this paradigm one can locate any financial security. The key to our proprietary quantitative database is that we succeed better than most at measuring the magnitude(height) and amplitude(duration) of existing and prospective trends, and to use that data to help shape a portfolio allocation which best narrates to each client's risk/reward tolerances. *In fact, I believe that asset allocation plays a greater role in the probability of portfolio capital gains than does any individual security within that portfolio.*

Given the framework of that discipline, we see positive long term implications for technology, alternative and renewable energy, biotech and biopharmaceuticals, infrastructure, and consumer non-cyclical equities, particularly agriculture and water-related companies. Each of these investment segments is likely to build earnings momentum, price performance and relative strength, according to our metrics, for the next decade and beyond.

With the recession recovery already in its sixth year, we would urge short-term caution, however. There are simply too many exogenous news-driven phenomena that could derail the market's traction for us to view this moment, this seminal juncture as the "right time" to go all in. That having been said, knowing that a rate increase is in the offing, we view this cyclical "tectonic" monetary change as an overall positive for the economy and the stock market.

Big blue marble

Beyond the scope of the financial markets, however, there are other things to consider when making our macro assessments. As the economy "improves", we have to bear in mind that not everyone feels the positive social or financial impact of those gradual transformations. Part of Wall Street's problem is that it is frequented by a smaller and smaller percentage of the population than in the previous two generations. With the middle class shrinking, the stock markets are perceived as a plaything for the already-wealthy, rather than the vehicle for achieving aspirations to creating wealth. As the negative rhetoric and financial displacements exacerbate here and abroad, so too does the perception by many that they are becoming, if not already, disenfranchised from the political, financial, and social fabric.

The markets could use a hero...someone or something that inspires confidence about sustainable themes for the long-term; that which decouples our emotions from day-to-day concerns about oil prices, politics, terrorism, monetary policy, commodities deflation, our children's welfare, our portfolio net worth.....and which focuses, in their stead, upon an overarching unifying social calling.

Unfortunately, "*Hermes*" is not a category in our financial database, nor easy to dial up on demand.

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