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Ripe, or rotten?

During the global financial market's resounding recovery from the great recession of our generation, stock markets have seen remarkable percentage swings...once in a lifetime annual increases that blurred the lines between what is possible and what was historically "normal". Much of that economic and asset-valuation surge was spurred on by the low cost of money coupled with fiscal austerity programs. To draw comparisons today to that atmosphere, that attitude, would be totally uninformed.

Indeed, much of the legwork left to be done now involves the private sector, and acceptance that we can no longer play penny ante, home-run style investing to sustain a secular (generational) economic benefit. Yes, there may be reason to disagree about the prospects for, and future of, the Dow Jones, the S&P, the CAC, the DAX, etc. Good data frequently leads to innumerable interpretations...and that's good. That's what makes markets.

But this discussion involves elements far beyond analysis of X's and O's, charts, graphs, trend lines, fundamentals, or statistics. The direction of capital placement depends upon things somewhat more ethereal, more complicated. **It relates to people's perceptions about chance, and whether the opportunity and playing field is equitable for all participants.** Right now, unfortunately, there is a vast segment of the investing public that has either given up on the market or feels disassociated from the activities and ethical codes manifested by their financial icons.

Look at it this way: anyone tonight who is going to bed hungry, impoverished, jobless, homeless, or otherwise physically and emotionally displaced cares not a whit about the Dow Jones. And, sad to say, it "looks to them" as if the feeling is mutual. That lack of empathy from our financial institutions is at the heart of the market's *"direction dilemma".*

Right now, somewhere in a private basement or well-known research laboratory, someone is working hard to uncover the solution of efficient water filtration, or renewable energy, pandemic diseases, or world hunger. The geographic source of these discoveries matters less than an access to capital and groundswell support required to solve the ethical, political, and social issues of our time. My science, quantitative analysis, is useful in tracking the attention being paid to macro issues by our capital markets, and laying out allocations and theses that reflect society's honorable concerns.

So now we wait...for politics and moral persuasion...to see what factors in 2016 and beyond have the staying power to create significant, sustainable shifts in capital gains opportunity.

Markets

Every market inflection point requires considerable time for trends and wealth transfers to evolve. Instantaneous knee-jerk reactions, in fact, are usually quite un-helpful in building a composite overview that reaches beyond a 24 hour time frame. While the *rate* of improvement in market performance might possibly stall or sputter this year, the conditions for positive momentum are undeniably in place...assuming no major geopolitical events or unforeseen crises occur. **I don't see recovery as V-shaped, nor a quick spike upwards above several "standard deviations". To the contrary we see a solid elongation of progressing patterns, from bottom-left to top-right.**

There are several theories that support the notion that global economies perform better when credit is neither too loose nor too tight....what some call *the Goldilocks Effect*, "just right". During those just-right periods in history, markets have combined with their backdrop to generate an average equity return of about 6% with Gross Domestic Product (GDP) of approximately 3%. Unfortunately, the world's economies currently have been in a highly speculative, and imbalanced, phase of the recovery in which GDP has been static-or-below historical valuations, while (speculative) bidding on depressed financial assets has been exaggerated. I expect that relationship to invert in the next few years.

Going forward, as interest rates continue to rise, so too should GDP expectations, while stock market speculation should migrate back towards longer-term capital gains expectations and performance.

Ultimately, we are searching for earnings acceleration patterns in sectors with improving statistics thus bringing the numerator and denominator in the "P/E" equation back into historically relevant equilibrium.

Although the economy greatly benefitted from a period of low interest rates, a psychological reticence about whether or not there was ubiquitous growth held the economy back. As I once wrote (regarding artificially manipulated interest rates), *"you can lead a horse to water, but you can't make him spend!!"* Investor's pent-up anxiety may have fostered a gambler's mentality in the markets coming out of the recession, but did little to open the capital spigot or quell their concerns about personal financial security. It's incontrovertible that a larger share of the world's net worth is owned by a smaller percentage of persons than ever before, and it's not right nor is it helpful to those on the outside looking in.

What if my analysis is wrong? What if the trajectory of the market's reversal is erroneous or doomed to fail? If so, we would note that there is always a "left side" of the parabolic scale for every "right side" bear trend identified. However, I would concede that without the important drivers of *consumer spending* and *consumer confidence* there very well might be market erosion during the next year.

But as time moves us further from the recession there should, in fact, be a gradual shift *away from* doubt and austerity towards an increase of political will and financial commitment to important social, political, and economic objectives. Our mood might be gloomy and apprehensive at present, but every cycle downtrend is always followed by its parabolic upside response.

Even though there are unmet challenges in our world today, accompanied by fits and starts to the recovery, we continue to recommend prudent asset allocation and participation in equities as a part of that strategy. Why? Because of, or in spite of, how valuations might seemingly be in disarray today, the spectrum of data are moving ultimately in the right direction. Curiously, I see a greater gap between stocks that have done well and those that have languished than at any time in several years, presenting opportunity selectively to cull winners from the pack.

Granted, many stocks are not at their "cheapest" right now compared to 7 years ago, but there are population and demographic shifts which make it acceptable to "paying up" for certain categories as they rebalance. Examples that we have previously noted of this shift include **Technology, Renewable Energy, Biosciences, Agriculture (including food and water companies), and Industrials (infrastructure).**

The most important reason to own financial securities is that it makes a statement about your commitment to owning policy and trends that will sustain your community, your region, your earth for decades.

Strategy
We regularly compile and analyze several data indices that we believe are useful to determining security allocation, sector weighting, asset class performance probabilities, and risk. At present, most segments, including trend patterns and sector relative strength are slowly migrating in favor of owning financial assets. Obviously one must stress caution and due diligence, but those indices are *guardedly* moving in the "right" direction.

Two specific factors also weigh heavily within our analysis: oil prices and employment.

(1) While the oil price plunge has largely been attributed to oversupply and overproduction, demand for oil has been strong...but just not strong enough. An emphasis by several countries upon energy independence and conservation has created real problems for the producing nations. As a way for the producers to maintain market share, they have contoured output towards record levels. As ecology and conservation proliferate around the world, as well as new science and technology leading the charge for alternatives, downward pressure on oil prices intensifies.

(2) A slightly larger percentage of the of the world's population is gainfully employed than at any time in the last 15 years. It is true, though, that wages are not increasing fast enough to eradicate poverty for "lower rung" individuals, nor does a significant percentage of that working population feel as if they have a stake in writing their own success story. For many, disaffection and physical or emotional dislocation is an unfortunate fact of life. But these things, we would note, are political and moral influences that cannot easily be measured on a market quantification scale. Nevertheless, they are issues that each of us has an obligation to study and speak up about in our daily lives.

One planet, one chance.

Conclusion
Essentially, the financial markets move only to an objective drumbeat, one that is strictly capital gains oriented. Profit incentives and potential are abundant if we know how to look for them.

The credit crisis reminded us, yet again, of everything we need to know about the ethical, legal, political, and financial challenges of building a level playing field and a rock-steady economy. Whether we heed those lessons is, of course another challenge altogether. A corollary effect of the "crash" was that it made us tired and wary of the constant, yet inevitable, ups and downs in the world's bourses.

I see the coming quarter, the coming year, as a challenge to design a cogent, specific, strategic investment portfolio that pays dividends for several decades hence. Even from a cynical Wall Street-er's perspective, solutions and profit potential outnumber the obstacles.

Suggested Balanced Account Asset Allocation, Q1, 2016

Equities:	**60%**
Fixed Income:	**15%**
Cash:	**25%**

Arlington Econometrics is a quantitative market tool. Utilizing proprietary algorithmic equations, AE offers solutions for market-timing, asset allocation, and macro economic analysis. Using historical time-series measurements, Arlington Econometrics optimizes the analytical process and forecasting coefficients to make economic forecasting more objective.