



March 1, 2013

## Market Insight: Scaling the Wall of Worry

by Barbara Huff, CEO New Albany Investment

How quickly the market mood can change. Several weeks ago the waters were calm and global equities were gliding higher each day. But recent headwinds have emerged and volatility has returned as significant policy issues from around the globe have created a wall of worry for investors to scale. Key items include: uncertainty over the impact of the sequestration; discord amongst Fed members on how long to continue QE; renewed concerns over the European debt crises in light of Italian elections; and China's concern with property inflation. Can the market overcome these factors and continue on its path to new highs?

**The pattern is familiar.** The past three years the market has rallied strongly in the first two months, stalled around March-April, sold off in the early summer and rallied into the fall.

Pattern Repeating?



Source: FactSet, Standard & Poor's. As of Feb. 25, 2013.

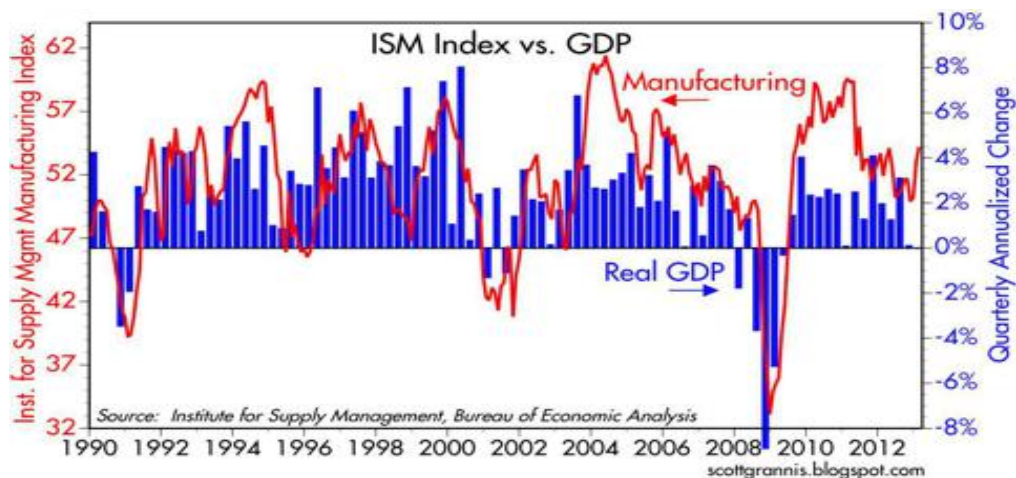
Each time there was a sell off, there were key policy issues on the world stage: US debt ceiling and debt rating cut; Europe's credit crisis; China's slow down; or the Tsunami in Japan. At the time, these issues seemed critical to sustaining economic life and therefore stock prices. Today, once again, there are many significant issues that are giving the market reason to stall. But this time there are also some new and solid tailwinds to offset potential weakness.

### Key Positive Factors:

- The housing market is a major positive contributor to economic growth. Housing inventory is lean, prices are rising, and new home sales have jumped 15% this year. The improvement in the housing market not only gives a lift to the wealth effect but also creates jobs. Employment in construction and all the services supporting the housing market is growing again.
- Merger & Acquisitions activity is at the highest point since 2005, indicating increasing business confidence. This in turn will lead to other capital investment and hiring.
- Global central banks are nearly universally in synch, keeping monetary policy extremely easy. The latest action has come from the Bank of Japan, who is finally engaged directly in fighting against deflation through currency devaluation.
- Interest rates around the globe remain exceptionally low, encouraging money to find return in riskier assets like real estate, stocks, and commodities.
- Manufacturing is continuing to expand, as balance sheets are very healthy. Businesses are bringing jobs back to the US.

Manufacturing is a good indicator of future growth. In the chart below we see manufacturing activity (red line) picking up, indicating future strength for the economy and a positive for GDP (blue bars).

### Manufacturing & GDP



### **Not too Hot, Not too Cold**

Despite all the negative headlines, the economy keeps chugging along with modest growth, providing a sweet spot for investors. It is strong enough to avoid a recession, allowing earnings to grow albeit slowly, but not too strong such that the Fed takes away the stimulus. As the market and policy makers around the globe digest the recent events, the wall of worry will slowly crumble and money will once again flow into equities, providing support to stock prices.

**Investment Strategy:** Portfolios are positioned at the higher end of risk bands. Risk is managed through broad diversification across multiple asset classes. Main drivers of return this year are expected to be more from stocks than bonds. Exposure to Small and Mid cap US stocks, and specific stock sectors such as Health Care, Global Infrastructure and Global Real Estate, has been increased. Investment grade bond exposure has been reduced.