New Albany
Investment Management

July 19, 2015

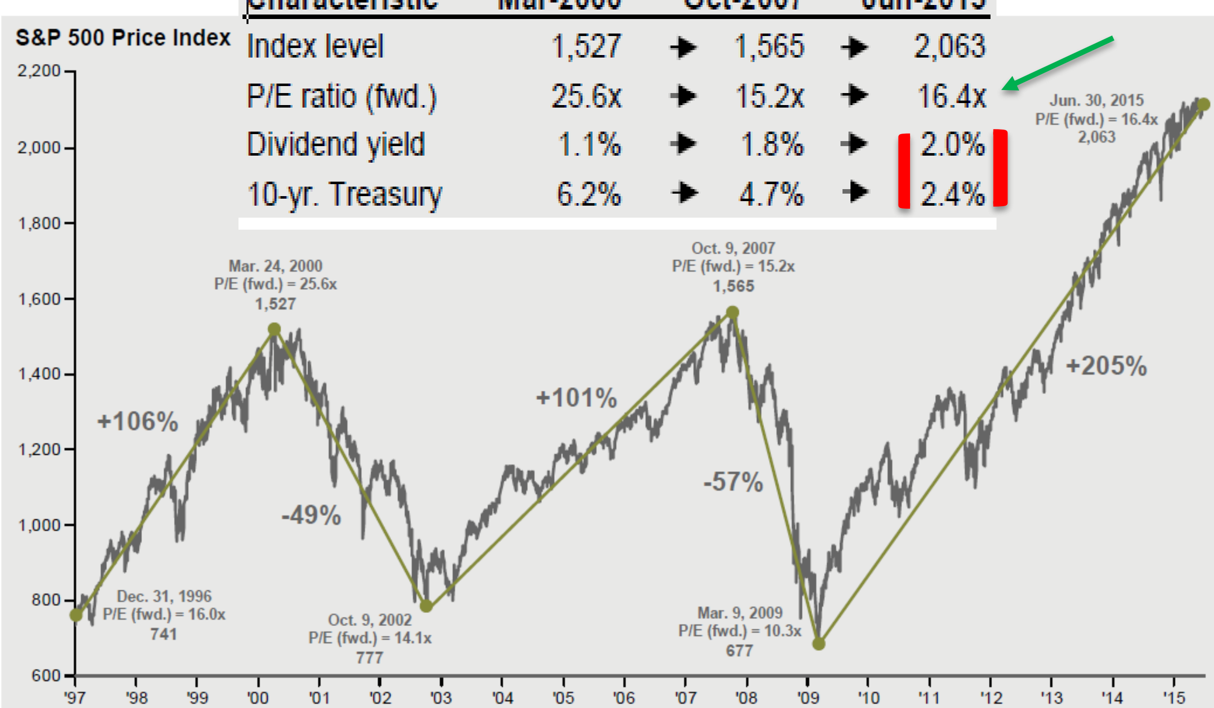
Market Insight: *Inside the Chart Room*

Working on the trading floor at JPMorgan for ten years was nothing short of extraordinary for me. I experienced some amazing market events and had the privilege of learning from brilliant people, both traders and economists alike. As a trader, it was not uncommon to have to make a split second decision on whether to buy or sell millions of dollars of securities based on some economic news release. Economists would camp out on the floor, barking out their interpretation on data and from there it was up the traders to decide how the market was going to react. So correctly understanding economic data was critical to 'staying alive' for another day. In addition to the daily feed of economics, once a week all the traders would gather in an enormous room which had charts from the floor to ceiling, displaying all kinds of information about the economy. The '*Chart Room'* as it was called, was the think tank, where JPMorgan's entire team of economists would pour into us important facts and perspective concerning the global economy. To this day, I attribute much of my knowledge and success in the markets, to my time in the *Chart Room* and the vast teachings from JPMorgan's economists.

Recently I have been able to access JPMorgan's research again and am excited to share each quarter some of the highlights with you. So often pictures tell the story much better than words. Below is the first edition of ***Inside the Chart Room*** which looks at valuation, earnings, and the economy.

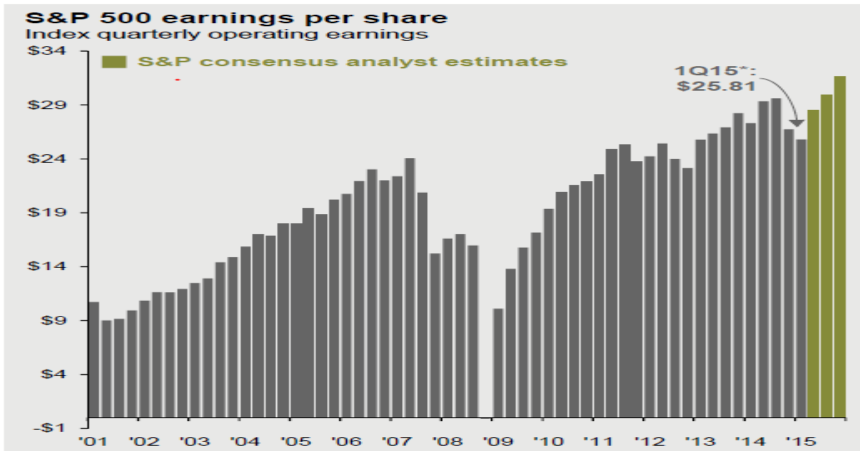
1) S&P Inflection Points and Valuation: The chart below shows the highs/lows in price and valuation levels of the S&P. The current **P/E is 16.4** and considered in the neutral zone for valuation. The current dividend yield on the S&P is 2%; high compared to bonds and it makes stocks look more attractive.

Characteristic	Mar-2000		Oct-2007		Jun-2015
Index level	1,527	→	1,565	→	2,063
P/E ratio (fwd.)	25.6x	→	15.2x	→	16.4x
Dividend yield	1.1%	→	1.8%	→	2.0%
10-yr. Treasury	6.2%	→	4.7%	→	2.4%

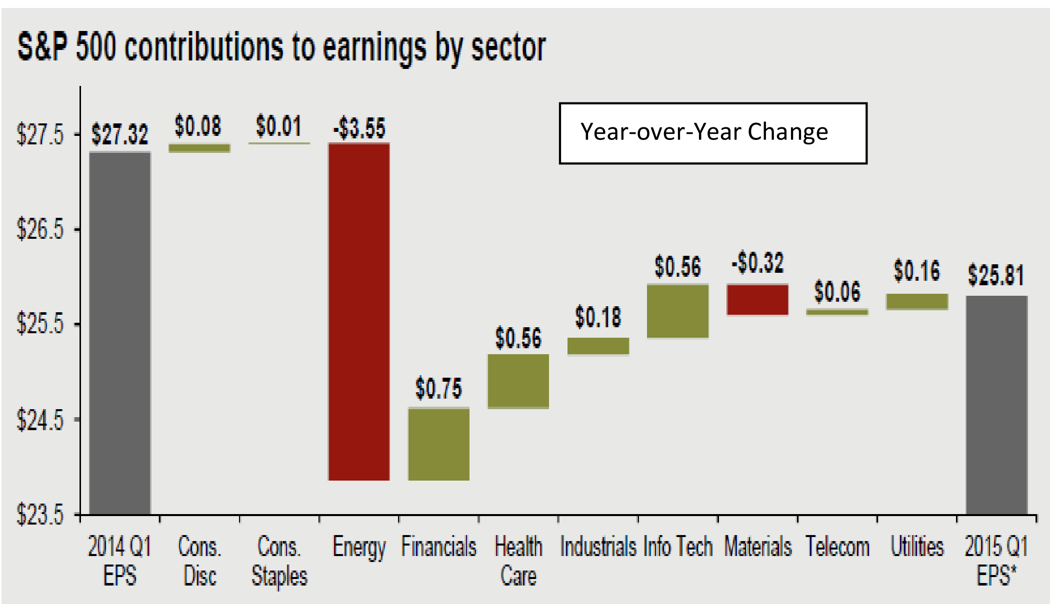


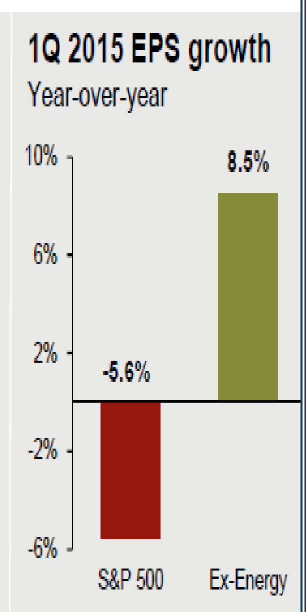
Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.

2) Earnings: Quarterly Earnings have fallen the last two quarters due to severe weakness in the energy sector. Without energy, EPS has grown 8.5% year-over-year.

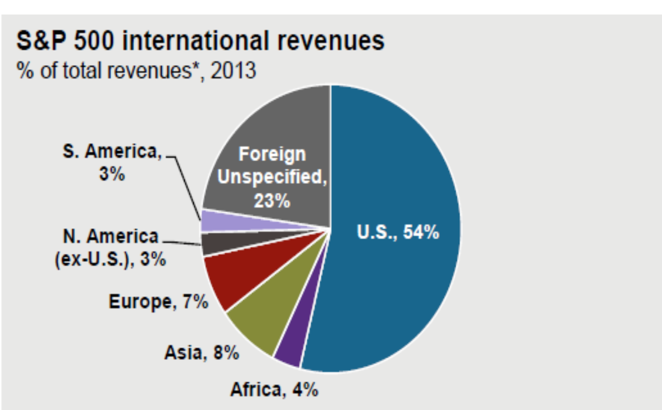


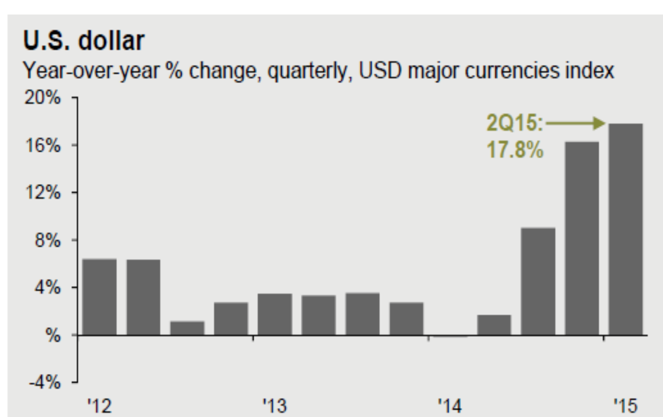
Source: BEA, Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.





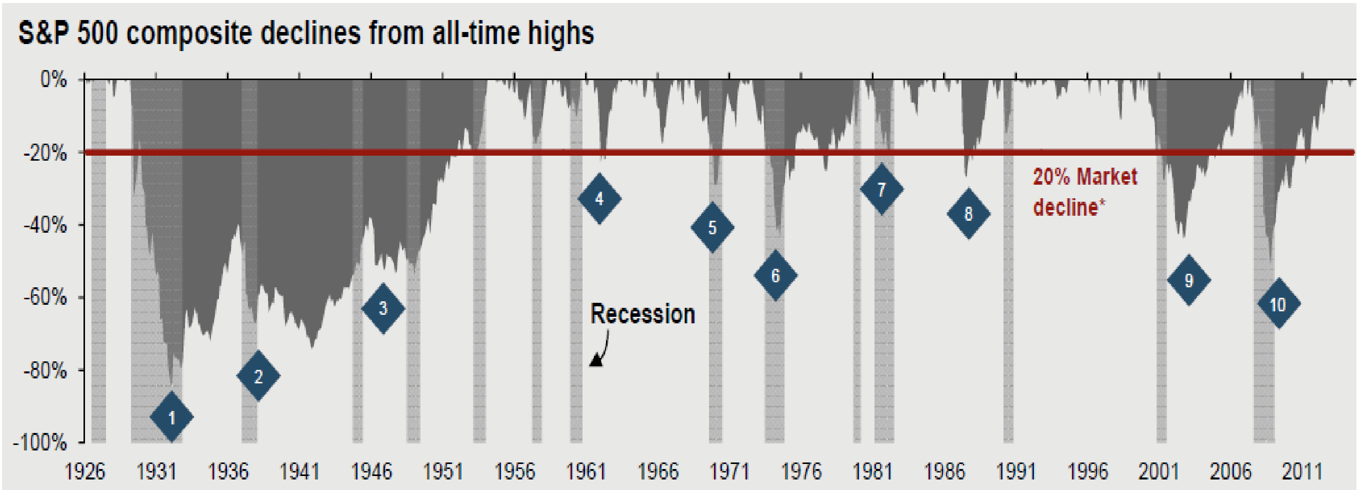
3) Truly a Global Market: Nearly 46% of revenue for S&P 500 companies comes from outside the US. Strengthening dollar has been a drag on international sales.





Source: Compustat, Federal Reserve, S&P 500 individual company 10K filings, S&P Index Alert, Standard & Poor's, J.P. Morgan Asset Management.

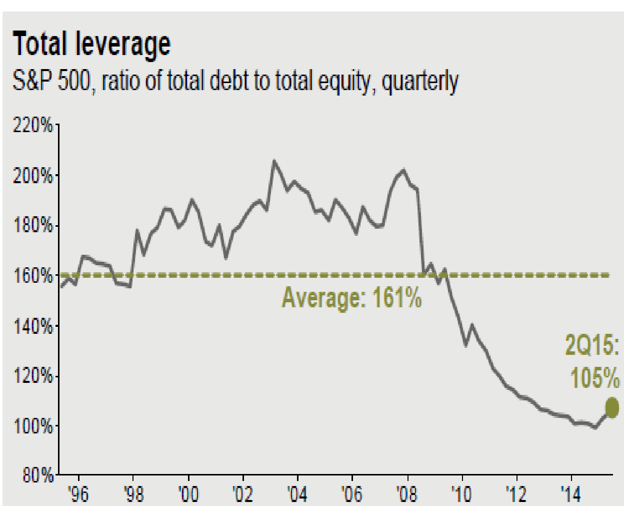
4) Causes of Past Bear Markets: In every case except one (1937) the cause was due to an asset price bubble/burst (Stocks, Housing,), excess leverage, Inflation, or a sudden exogenous event (Oil Embargo, Missile crisis). Today, Businesses' and Consumers' balance sheets are healthy and inflation is quite low. The only bubble is the Government Debt. And as long as the US dollar remains the world's reserve currency, this bubble is contained.

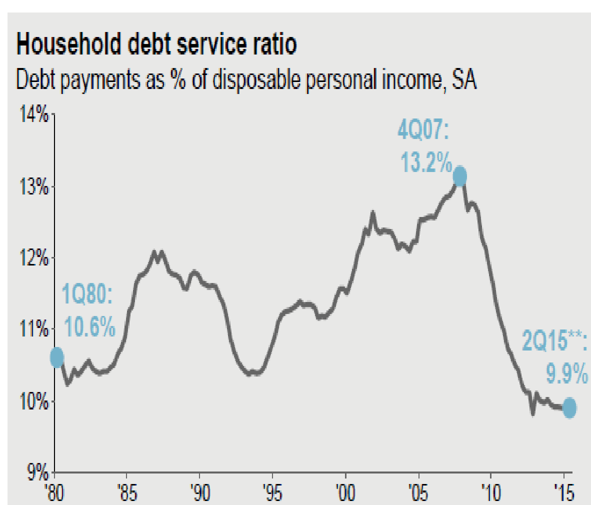


Characteristics of past bear markets

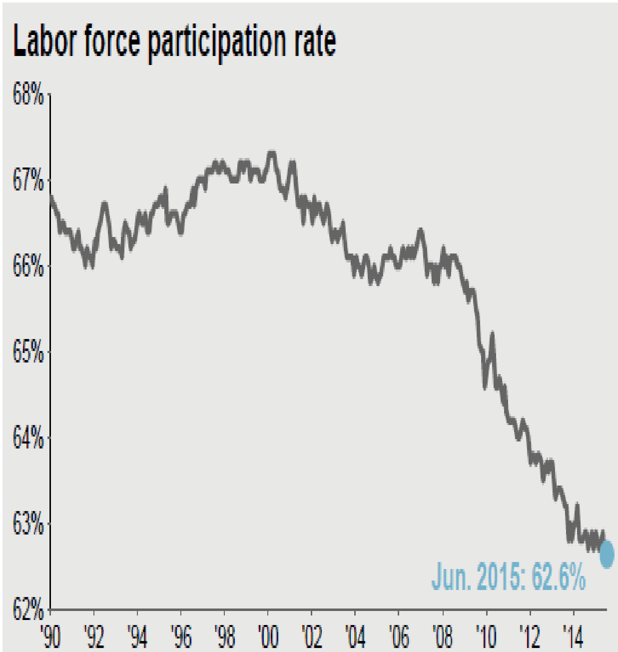
◆	Market Corrections	Cycle Peak	Bull Market Duration (Months)	Decline from All-time High	Recession	Commodity Spike	Aggressive Fed Tightening	Extreme Valuations	Commentary
1	Crash of 1929	Aug 1929	37	-84%	◆			◆	Excessive leverage, irrational exuberance
2	1937 Fed Tightening	Feb 1937	22	-74%	◆		◆		Premature monetary tightening
3	Post WWII Crash	May 1946	48	-54%	◆			◆	Post-war demobilization, recession fears
4	Flash Crash of 1962	Dec 1961	14	-22%				◆	Flash crash, Cuban Missile Crisis
5	Tech Crash of 1970	Dec 1968	73	-29%	◆	◆	◆		Economic overheating, civil unrest
6	Stagflation	Dec 1972	29	-43%	◆	◆			OPEC oil embargo
7	Volcker Tightening	Nov 1980	31	-19%	◆	◆	◆		Extremely high rates to rein in inflation
8	1987 Crash	Aug 1987	59	-27%					Program trading, overheated market
9	Tech Bubble	Aug 2000	118	-42%	◆			◆	Extreme valuations, mostly in tech stocks
10	Global Financial Crisis	Oct 2007	55	-51%	◆	◆	◆		Leverage, housing, Lehman collapse

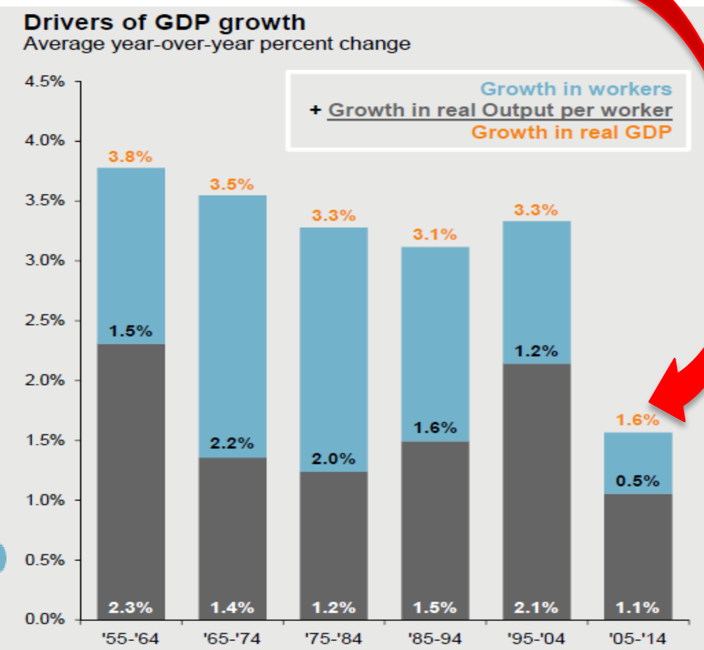
Source: FactSet, NBER, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.





5) Workforce: Labor force growth, participation, and productivity have declined which has negatively impacted GDP. This explains why economic growth remains below the historical average.





Summary: The investing environment is fairly balanced here in the US. Valuation is neutral to positive, balance sheets are healthy, and economic growth is modest. There are no significant bubbles right now so the risk of a recession is low. With growth and inflation below the Fed's target, their action to raise rates will be slow and modest. Even with slightly higher rates, the relative level is still very low, and thus investors will continue to seek alternative assets over bonds for return. This redirected demand will continue to act as tailwind for stocks. Market returns should be positive but short of the levels seen over the last several years.

Market Performance/Portfolio Strategy: For the first time in many years, there is a wide variance in returns across all asset sectors. <u>What is working</u>: 'Growth Stock' sectors (newer companies with innovative products) in US and Europe, and 'Foreign' assets denominated in US dollars. On the Bond side, 'Floating Rate Notes' and 'High Yield Bonds' are performing solidly. <u>What is dragging or declining</u>: 'Value Stock' sectors (mature, dividend paying companies) and 'Fixed Rate Investment Grade Bonds" in the US and Emerging Markets. Of course this can all change on a dime which is why each portfolio strategy is broadly diversified. However, areas of concentration are in growth sectors for stocks and floating rate and High Yield for bonds.

As always, please contact me with any questions or concerns.

Kind Regards,
Barbara

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