New Albany Investment Management

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Market Insight: Why Does the Bull Keep Running?

If you followed the expert "consensus" view on what was supposed to happen this year, your portfolio would returns would not look too good. In fact, it would have been left in the dust if you would have followed the consensus view over the last two years. Since the beginning of 2013, the self-proclaimed masters of the universe (hedge fund managers) have gotten it wrong - very wrong.

In January 2013, everybody and their brother was projecting doom and gloom. The "fiscal cliff" was going to kill the U.S. economy. Europe was going to collapse and kill the global economy in the process. And China's growth rate was going to fall on its face. It was a certainty: "Global growth was slowing and stock market gains would be hard to come by." How did the market react? The US market responded with a 30% gain, thank you very much! Not surprising, Hedge funds had a poor year.

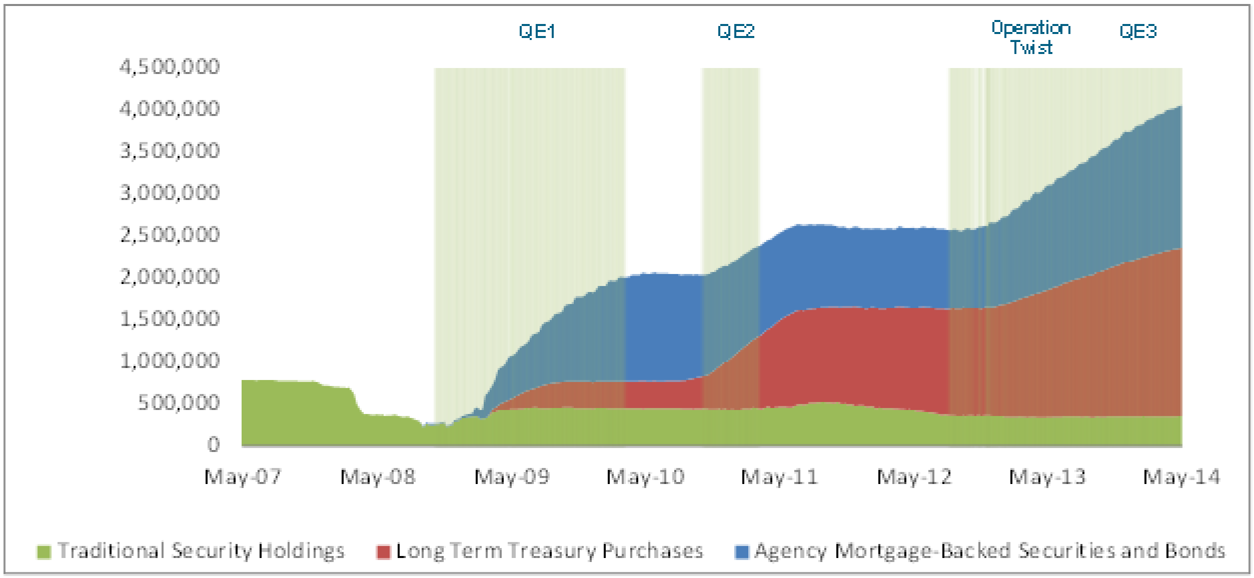
Déjà Vu All Over Again: The situation playing out so far in 2014 is similar, where focusing on a particular event or crisis to predict market outcome has proved unprofitable. To be sure, the market has had a pretty impressive list of issues to overcome. Below is a quick summary of the "crises" that investors have had to confront in the first half of 2014:

- The "Emerging Markets Currency Crisis"
- The Crimea/Ukraine/Russia "Crisis"
- The Polar Vortex-Induced Economic Speed Bump
- The Momentum Meltdown in Biotech, Social Media and Internet Sectors
- The First Defaults in China
- David Tepper (top Hedge Fund manager) warning of correction
- And now...the Iraq "Crisis"

So how has the market reacted? With year now almost half over, the broad market has managed to make new highs. The chart below of the S&P 500 this year, gives a visual on how disruptive (or not) these issues have been.

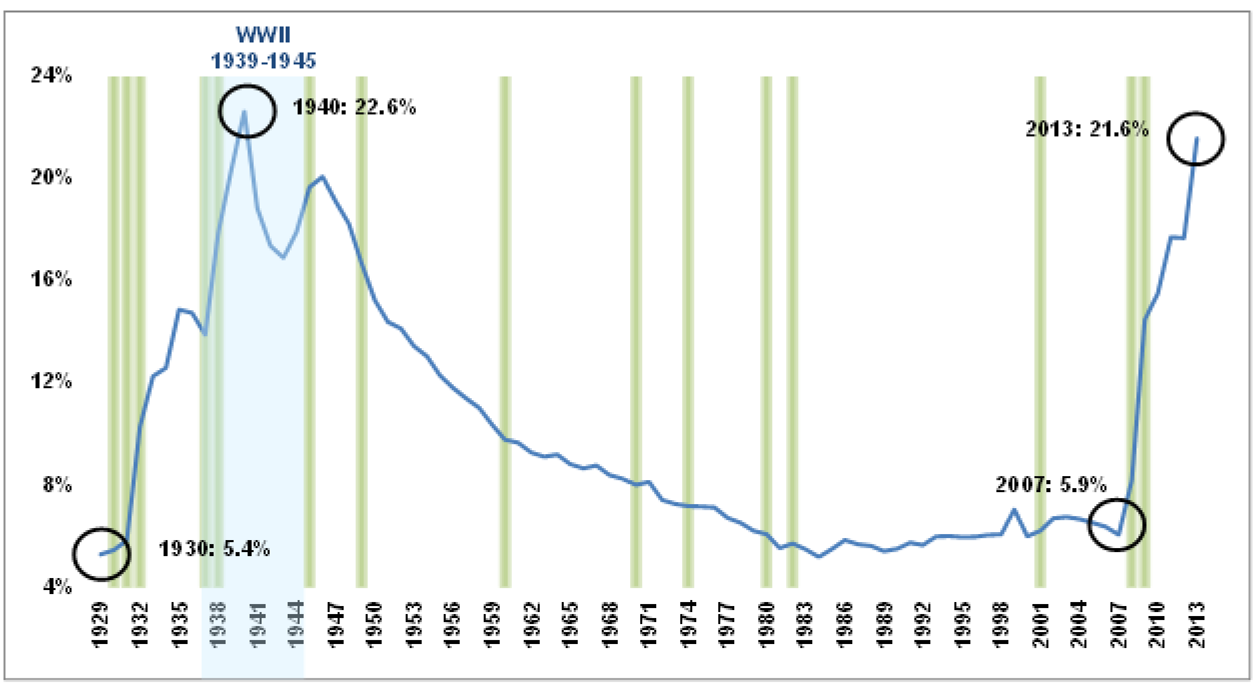
Why does the Bull Keep Running? A few pictures can best explain this behavior:

Created Cheap Money: The first chart shows the actions the Federal Reserve has taken to prop up both the economy and the markets since the financial meltdown in 2008. They have **"created" or printed over $4 trillion** to purchase various US Government bonds which has driven long term interest rates to all-time lows and in doing so , has propped up all financial assets.



Source: Federal Reserve Bank of Cleveland and the Schwab Center for Financial Research.

The Big Stick: The last time the Fed's reserves were this high relative to GDP was in the 1940s, when the Fed bought bonds to help finance the debt from WWII. It took over two decades to bring the size of the balance sheet back to pre-war levels. Clearly the Fed carries a big stick!



Co-dependent Market: The next chart shows the positive effect of the huge bond buying programs (Quantitative Easing/ QE) on the S&P 500 since March 2009. The market has risen over 190%. **Notice how all the colored segments of the chart are rising during periods of Fed stimulus** and the **Gray segments are falling during periods of no action from the Fed.**

Change of Course Ahead or Change Perspective? With Federal Reserve ending their stimulus this year, the experts are warning of significant pullback. Institutional investors are obediently following suit and positioning more defensively yet the market is still grinding higher. Is there something else driving these markets?

Global policies effect Global markets Globally. Admittedly, over the past five years, the Fed has been the main engine for growth both domestically and abroad but now the 'stimulus baton' has been transferred. The European Central Bank has embarked on both quantitative easing and negative interest rates for banks. At the same time, Japan's central bank has an ultra-easy monetary policy, and you can be sure China is actively managing its economic growth. Thus even though the Fed is pulling back, the flow of liquidity and cheap money around the globe will continue to support asset prices. How much and for how long? Stay tuned.

Investment Strategy: Portfolios are fully invested with broad diversification across asset classes.

Please don't hesitate to contact me with any questions or concerns.

Kind Regards,

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