

### **Market Insight: How Long Can the Bulls Command the Market?**

It has been an amazing run in the stock market this year despite concerns over tepid economic growth, slowing earnings growth, Fed tapering threats, a government shut down scare, and ugly fiscal budget debates. Several clients have asked me why does the market keep rising? I too have been surprised at the magnitude of rise in stocks prices. Is the market borrowing from future gains? Do the concerns listed above really matter?

One could make a strong case our whole economy and government has indeed borrowed from the future and eventually will pay a huge price. I cannot disagree. But for now, both monetary and fiscal policy is very much in control, creating a perceived stable investment environment where wealth is expected to grow. It is against this backdrop, individual and corporate investors are seeking opportunities to prosper. So for now, it does appear the Bulls have the upper hand, but for how long?

Of course it is impossible to predict the future, but recognizing key market drivers will offer at least a framework for making investment decisions. As we look over the next six months, there are both bullish and bearish influences, with the former more likely at play through the end of the 4<sup>th</sup> quarter, while the later piping up in the 1<sup>st</sup> quarter of 2014.

#### **Bullish Influences in 4<sup>th</sup> Quarter:**

-“Don’t Fight the Fed” The Fed backed off its initiative to begin tapering this Fall and now most economist believe tapering is off the table until at least March of 2014, after the new Fed Chairman is in place. This means the markets will have at least five more months of very supportive monetary policy. This is very good news for the stock market

-Interest Rates Remain Ultra Low: Cash parked in a savings account at 0.2% insures a negative return against a 1.9% inflation rate. Savers need to both preserve capital (which means keeping pace with inflation) and grow wealth for retirement. Thus, ultra low rates drive investors to look for other opportunities. As long as rates stay ultra low, prices for stocks and real estate will be well supported.

-Dividend Growth Outpacing Earnings Growth: Dividend growth has been more than 3x earnings growth over the past 12 months. This is one of the strongest indicators of confidence in corporate America. Dividends represent real cash paid out. If companies were worried about the future, they would hoard cash to face whatever crisis is coming next. They have been doing the exact opposite – increasing their dividends by nearly 18%. Companies are much more bullish about the future than the headlines seem to indicate.

### **Bullish Influences in 4<sup>th</sup> Quarter cont.:**

*-Rising Home & Stock Prices:* One of the most powerful stimulants to the economy is the creation of wealth. It influences both the consumer- in terms of confidence and spending, and businesses -in terms of hiring and capital investment. As stock and home prices rises, so too will GDP.

*-Gas Prices Below \$3.00?* According to an energy analyst, consumers could get a big boost to their wallets before the end of the year because the EPA is about to make some long-overdue adjustments to the federal ethanol mandate that's been acting as a stealth tax on American drivers for years. The result could push the national average price for a gallon of gas lower, possibly below \$3 by the end of the year. If realized, this could be a big tailwind going to into the holiday shopping season.

### **Bearish Influences in 1<sup>st</sup> Quarter 2014**

*-Fiscal Fall Out on GDP:* In the 11th hour, the bill was passed to extend the Treasury's borrowing authority through February 7, 2014 and avert the first ever default in U.S. history. The bill also funded the government through January 15, 2014, thus ending the 16-day long partial shutdown. Estimates of the economic impact of the fiscal impasse vary from 0.3% to 0.6% reduction in Q4 real GDP growth at an annual rate. Despite its immediate positive impact, the bill provides only a temporary solution to the crisis. The new deadlines set the stage for another political showdown early next year. This crisis mode of fiscal policy making has a negative impact on both business and consumer sentiment, which could result in lower investment and consumer spending, thus ultimately reducing economic growth

*-Obamacare (ACA) Implementation Raises Uncertainty* for both the consumer and businesses. No one really knows what the impact on the economy will be because it is still not clear how many people will actually use it and what it will cost. This could be a major headwind.

*-Stock Valuation:* With earnings growth only 4.5% verses stock price appreciation of +15% to +25%, the P/E of many sectors is moving into the 'high' valuation zone. High P/E's alone will not stop prices from rising further; but when interest rates start to rise, it will become huge negative factor to valuation and likely cause prices to fall. We saw a preview of this potential downdraft earlier this year (May-June) when the Fed indicated they were going to withdraw their bonds buying program.

**Investment Strategy:** Investing is not about riding the trends, but is about recognizing the true risks and return opportunities, and then strategically positioning portfolios according to sound fundamentals that over time prevail despite the current bullish or bearish influences. It should be indeed an interesting six months ahead! Please keep calling with any questions or concerns.

I hope you enjoy the last bit of beautiful Fall color!



Kind Regards,  
Barbara

*Barbara HS Huff*

CEO & President

New Albany Investment Management

614-216-6139 ~ [www.newalbanyinvestment.com](http://www.newalbanyinvestment.com)