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• One Man's Opinions – Fall 2011

ONE MAN'S OPINIONS – October 1st, 2011

The stock market and the U.S. economy certainly led us on a merry chase these last three months. The Standard and Poor's 500 index is down 9.64% for the year as of last Friday. Certainly this is not what I was expecting, as common stocks are a resounding buy at these prices, and corporate profits are quite strong, up 10% over last year. In the final analysis over the long term, stock prices are driven by corporate earnings. Stocks are now, as a group, at historically reasonable prices. What is driving them down is fear!

Let me start with some facts. There will NOT be a “double dip” recession. This is for the simple reason that the last recession, 2008-2009, ended in June of 2009! We are over two years into this admittedly very weak recovery. A recession, if it comes, will be a new one, not an extension of the last one. Second, arguing against another recession, there are very few excesses or bubbles in our economy, such as the real estate bubble that burst in 2007, and the high tech stock craze of the late 1990s, which ended in disaster in 2001. Lastly, while Europe's economic troubles are more severe than our own, as a group the Euro countries have sufficient financial resources to handle the Greek deficit problem, and probably those of Ireland, Portugal, Italy and Spain as well. The European central banks have pledged their resources to head off a financial meltdown. In recent days this fear has ameliorated.

Last year at this time, the press was full of concerns about the Congress, health care, Greece, municipal bond defaults, and a double dip recession. Stocks had declined 16% and recovered to show a 12% increase for the year. This year we are down 20% (from the high). The news is full of fears about Greece, a double-dip recession (impossible, see above), lack of national leadership, debt reduction plans, and the downgrade of USA debt. All of this does not amount to a crisis, except to frighten the public and incite panic. It is relevant for traders and the CNBC audience, but NOT for long term investors, which describes nearly all my readers.

So far we have made it through the municipal bond default scare of 2010 with almost no damage, the Congress and the administration are now all talking about (if not doing much about) lowering the national budget deficit. Cuts in entitlements are at least being talked about, even by the president and some of his allies. Interest rates hardly budged when S&P lowered its debt rating on the United States, and long term bonds keep rising in price, of all things. How much lower can interest rates go? They are already negative in the short term, up to two years, when taxes are considered. How many times must we listen to the “sky is falling” and other negative main stream media financial news?

The facts are we are in a sluggish growth mode, interest rates are at historically low stimulative levels, and we are not making a dent in the unemployment rate. There is obviously a lack of public confidence in our political leadership in Washington D.C. Both the current administration and Congress have not demonstrated significant leadership in facing current economic challenges. The administration, especially, seems bent on further strangling private business with more and more regulation and higher taxes. While not a surprise, given the historic mindset of the left, especially the current leadership of the Democrat party, they appear to have a deep reluctance to give up long held ideas which have clearly not worked. At least this is the perception of private business owners, who generate the vast majority of new jobs. To a great extent they being ignored as well as irritated by our current administration.

We are just thirteen months away from the 2012 Federal elections. Assuming things do not change dramatically, and I fail to see any way this can happen, we will have a new president in sixteen months. More than likely the current Senate will change hands also. Next summer, when this begins to appear to be the likely case, the markets will reflect this as a perceived positive change. For good or bad, a Republican congress and president is where we seem to be going. I was not at all happy with our last Republican presidency so far as financial discipline and deficit management is concerned. However, it would be very unlikely for any new administration to not learn from their failures and mistakes, as well as those of our current leaders. Better days surely are ahead.

American firms have the largest cash positions in their history. This should allow them to weather almost any storm. This is in contrast to the dark days of 2008-09 when they were cash starved, and bankers closed their credit lines. At that time they could not expand, and often resorted to laying off employees to survive. Not so today.

And let us not forget inflation, which is good for stocks as earnings adjust fairly quickly to rising prices. Producer and consumer prices have risen sharply this year. The Producer Price Index (PPI) is up 11%, meanwhile the Consumer Price Index (CPI), is up 4%. Further price increases seem inevitable to this observer.

Most investors never seem learn, but the best policy is to ignore the chatter and buy strong stocks paying competitive dividends, ones that are historically cheap and should gain as sentiment improves, which should be less than a year away in a worst case. There is no shortage of blue chip stocks selling at fire sale prices, with strong balance sheets and good outlooks given the impetus from the monetary policy of the Federal Reserve. Only rarely in my 49 year career in the investment business have I seen bargains such as these.

We continue to have room for a number of new clients, both for investment management and personal financial planning. Call 317-571-1112 or email tom@tommcallister.com to discuss your personal situation.

Have an enjoyable fall.

Tom McAllister, CFPtm

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