Eideard Group
GUARDIANS OF PROSPERITY

Market Commentary *Autumn 2013*

Despite what were some potentially troubling - even treacherous - concerns for long term investors over the summer, by the end of September and well into October, financial markets again rallied to build on earlier year gains. Following a short mid-summer breather, US equities renewed their run to new all-time highs. So too, bond markets reversed their dismal mid-year losses with a very strong rally, allowing the most stalwart of bondholders to recoup lost value on the year.

In our view these rallies were the product of “relief” from what might have occurred but, thankfully, didn’t. First, came the hype and angst over Fed bond tapering - more on that in a moment. Then, of course, we witnessed what appeared to be an inevitable intervention in Syria only to find a last minute escape hatch. And finally, there remained the overarching problem of the $17 trillion US public debt, the fixes thereto and the backdrop of folly and brinksmanship surrounding it. Worst of all, this time around, the US was running very short on time before its “technical default” and the myriad of negative consequences that would arise from it. But once again, escape we did! We suspect that if Harry Houdini were still alive, this was the summer he may have stolen some material for his own act.

OK, so back to monetary policy. In hindsight, what was the point? We are referring to the Fed speak which began in late May when Ben Bernanke unveiled his intention to begin bond tapering over a near, but indefinite, timeline only to recant the intention by mid-September. We suspected then that the Federal Open Market Committee (FOMC) was too premature in calling the action and, in so doing, unnecessarily alarming the markets. In our view, economic growth was still too meager to absorb any form of tightening - perceived or otherwise. Looking back on the summer, we figure that most bond traders would say there wasn’t much of one! We knew they were temporarily preoccupied with executing massive liquidity trades to accommodate the billions in redemptions from all variety of interest sensitive investments including mutual bond funds as most investors were being spooked by the notion of rising rates.

On the positive side of things, what we are left with is the “right decision for now”, particularly as new economic data streams in to corroborate what is shaping up as a softening in overall economic activity, corporate profitability, housing statistics and employment figures. On the flip side, we are left with a central bank that has miscued in decision-making and fumbled in its communications thus giving the markets good reason to question the timing of its eventual QE exit strategy. In the meantime, though, we wonder if our collective memory is so short as to have already forgotten what the budget impasse and default sequestration imposed in 2011 is now costing us in terms of economic growth at a time when public spending has so crowded out private investment.

So, where do things stand today and where are we headed? It is accurate to say that while we remain optimistic over continued global and US economic growth and that we do have a definite bias toward stocks, we think the return to normalized US GDP growth and interest rates will take longer than the consensus view which puts it somewhere beyond mid 2014 at the earliest. Today, we know that while the S&P reporting season is in full swing with 69% of the companies posting earnings surprises, margins continue to narrow. This notwithstanding, the stock market, now valued at 16X earnings, will likely continue to gain ground on uninterrupted easy money. In our view this bias was re-affirmed with Janet Yellen's appointment to head the Federal Reserve. At the same time we, less enthusiastically, recognize that the latest manufacturing data, nonfarm payrolls and consumer sentiment have again slipped below expectations. More alarmingly, we know that while unemployment recently dropped to 7.2%, the reality is that the labor participation rate remains just north of 63%. We also know that while Obamacare is the law of the land and, in the ideal a noble goal, it is suffering from significant growing pains and a public cost yet to be determined both in dollars and employment impact. And finally, we know that Congress has once again deferred on its core budgetary decisions until mid-December.

With all of the above stirring the pot, we remain guardedly cautious about the very near term and continue to focus on ensuring that our clients are reasonably allocated for the long run but also sufficiently liquid to weather any near term market events.

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