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June 4, 2013 Dow Industrial Average: 15,177

Record Highs are Making Me Queasy…

It has been a while since I penned my market outlook / perspective, and given the fact that the market has moved up so substantially this year- I think it is time for another market commentary.

Let's start with a quick history reminder: 2012 was a rollercoaster of a market. The first half of the year, the market had moved up roughly 12%, and then the second half of the year was consumed with the politics of the election, budget concerns, and then the sequester paranoia. The second half of the year was flat overall, although it fell 1000 points in one month, and then slowly built it back over the next 6 months.

For 2013, we have not seen a rollercoaster- we have essentially seen a "Price Is Right" game play out in front of our eyes:

(I miss Bob Barker)…if you listen closely, you can even hear the song that they play when the contestant is forced to play the game for money (YO-Diddd-E-Oh….).

During the first five months of 2013, the market has done nothing but go up. Even with negative news, the market just pushes higher. Now the market is up roughly 15.35% through 5/31/13. **And my question is: when will the "Mountain Climber" fall off the cliff?**

Now, I tend to be a "Glass-Half Full Person", but I think given some of the following information that I will lay out for you, I think it makes sense to step out of some of the more aggressive investments (maybe only for the summer / maybe only for a month) and then wait for the market to pull-back. Let's start with the good news:

<u>Positives for the market (Glass Half Full perspective):</u>

- Technology: From the iPad, to 3D printing, to "The Cloud"—technology is allowing U.S. companies to become more profitable while having less sales. Companies are able to squeeze more profits out of the same amount of sales than they did in 2012. We saw this play out during the recent earnings season—many companies missed sales expectations, but increased their earnings for the period.

- Exploration of Oil and Natural Gas: The U.S. economy is starting to feel the advantages of having cheap, abundant energy. From the Bakken Shale oil field in the Dakotas, to the Marcellus Shale field in the North-East, to the Eagle Ford Shale in Texas—corporate America may soon find itself paying less and less for energy to transport it's products which will then translate into more profits (and energy independence).

  According to the International Energy Agency, by 2020 the U.S. is anticipated to become the world's biggest oil producer. By 2025 North America will be a net energy exporter.*

- Housing Recovery: With residential real estate coming back on line, consumer based companies (Home Depot, Lowes, Wal-Mart, Target, etc) should do well. Additionally, many of the unemployed skilled laborers may be able to find more steady work which will then translate into more dollars being spent in the economy (for instance: auto sales have significantly improved over recent years). Finally, as home values start to go back up- the net worth of American citizens will also rebound—unfortunately, home equity loans may come back into favor which is potentially a negative.

<u>Negatives for the market (Reasons to be Short-Term Negative on the Stock Market):</u>

- Right now, the market is solely focused on when the Federal Reserve will start raising rates. Yesterday (June 2nd), an economic number (the ISM number) was released which showed economic contraction—the miss was fairly significantly- and the stock market went up. Meaning that if the economy was starting to slow, maybe the Federal Reserve would not raise interest rates. So, "bad numbers = good numbers". **That is a bad recipe**.

- With the significant economic challenges around the world, in addition, to the U.S. challenges- shouldn't the market be lowering the growth trajectory of the market? Consider the following:
  - The Eurozone has declined for six quarters in a row. Unemployment in the Eurozone is 12.2%. Unemployment amongst young people is staggering.
  - Economic growth in India has been the slowest it has been in an entire decade.
  - Japan is trying to inflate it's economy, which initially saw a sharp increase in their stock market, but now it is reversing and their stock market is down roughly 18% within the last 10 days.

- In regards to the Quantitative Easing being employed by the Federal Reserve, the U.S. economy has shown very little reason to keep it going (in my opinion)—interest rates are at all time lows, mortgage rates have reached all time lows—yet, the economy is ONLY growing at 2.5% growth rate--well below the typical recovery rates.

  So, the effectiveness of the Fed's $85 billion bond buying per month really has to be asked—is the risk of inflation and the bloating of the financial markets worth the cost of the subsidy?

- Margin debt on the New York Stock Exchange is now at an all-time high. Which translates to many market speculators are trying to leverage their way to higher returns (Margin Investors borrow against their existing investments to buy more investments). I think that is one reason why the market has not seen a correction in 5 months, because traders are driving up the market.

  The potential problem is that as the market corrects itself, the same traders that ran up the market to highs, will now attempt to make returns as the market falls. This tends to exacerbate any downturn (it turns into a snowball effect pushing the market even lower).

Where do we go from here? My recommendation for investors is to be patient with the market. You don't want to chase the market.

If you are looking to invest some new dollars into the market- be patient and let the market come down. As the market "draws-down" to certain levels- put a percentage of the funds to work. Similar to the following (utilizing the Dow Industrial Average):

When the Dow hits 14,750	put in 25%
When the Dow hits 14,500	put in 25%
When the Dow hits 14,250	put in 25%
When the Dow hits 14,000	put in 25%

Long-term, I think the market (and the economy) will continue to move higher, but I hate the feeling of chasing the market.

So, I am asking investors (and myself) to be patient and do not overpay for growth potential—with so much uncertainty in the market and global economies, the risk outweighs the reward--**presently**.

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