June 2010 Market Commentary

When looking at the current state of the economy and the stock market, two common themes consistently emerge. For a bit of variety, rather than using my own words, I thought I would use quotes from people who espouse different viewpoints to quickly summarize different possible paths forward.

According to Nick Thakore, manager of the $4 billion Putnam Voyager Fund, **"The economy is in a lot better shape than most people think.** People have been so burned that they're missing the cyclical recovery and an epic earnings recovery. It looks like 2011 could be an all-time earnings record for the S&P 500." He added, "At the market's bottom, it created the best investment opportunities of my career," he said. While it's a different ballgame now — and some "secular" concerns remain — Mr. Thakore still sees "tremendous opportunities" in the stock market.

The driving forces? "Right now, job growth and capital spending is producing a better outlook than the market believes," he said. "Companies overcut during the downturn and they are starting to hire again, and capital spending is the lost story." With the exception of the financial sector, he said, "American companies are swimming in cash and minting money." Based on his analysis, Mr. Thakore said, "it's hard to be too negative."

An even more influential investor, Barton Biggs, "chief global strategist" for Morgan Stanley and current head of a multi-billion dollar hedge fund believes the market is very undervalued and should see a very quick increase in value.

That's one side of the coin. Obviously, not everyone agrees with this assessment. A shorter summary quickly outlines fears of a very different future. The following quotes from a Hedge Fund Conference on May 26th in New York are from Jonathon Jacobson who founded hedge fund firm Highfields Capital. "As I look at the current investment climate I have to tell you I'm worried." His biggest concern -- U.S. lawmakers who he says are creating a hostile environment for business. "What I worry about are the clowns and the climate in Washington," Jacobson said, adding "there is no leadership on either side of the aisle." Various other investors at the same conference shared concerns about the state of the world economy amid a sharp correction in the stock market that started a month ago.

While you may or may not agree with either assessment above, they represent the primary factors driving the stock market. As people focus more on the US economic and corporate strength, the market goes up. As Washington and European governments make headlines, markets decline.

As would be expected, many economists are monitoring the U.S. recovery closely to see how well the economy can endure the debt troubles that threaten to slow Europe's growth. The above-trend first-quarter U.S. growth suggests a solid base of support. The numbers are slightly shy of hopes, but they show that the U.S. economy is in recovery.

The biggest current risk appears to be Europe. High debt levels and future tax burdens in Europe (and the U.S.) can't be ignored. However, the debt issues in Europe will very likely be resolved in the fairly immediate future.

The US debt is a much larger concern. Yet, this issue is really a secular concern – meaning it's a long term issue that is unlikely to significantly affect the market in the immediate future. Obviously, we will have to deal with the debt, and it will not be pleasant. However, it's too early to accurately factor this issue into current stock market prices. While it's natural and likely right to be concerned about these issues, the immediate and near term picture seems positive enough to most strongly influence near-term stock market values.

While there's no shortage of opinions, one issue appears certain. **Investors are still nervous**. In spite of many very positive economic and corporate profitability indicators and record, or near record, corporate profitability and cash levels, investors have been so shocked by the events of recent years that they're ready to run very quickly.

In reading and talking with Analysts and Economists whom I most respect, their overwhelming belief in which direction the economy will go is the first, and fortunately, more positive direction. Unfortunately, most people also readily admit that this is not a certainty.

I have noticed a very strong trend and correlation among investors, analysts, and even economists. People with longer time horizons appear to be much more optimistic regarding many of the current challenges we face. While this group quickly acknowledges the many challenges this nation and many nations around the world face, there is a strong belief that the US will determine a way to move forward intelligently.

These people are the same ones who didn't panic in the early part of last year. It's not that they were incredibly confident or that they weren't scared by the events of the day. Rather, they looked more objectively at the current events. In their opinion, stock valuations that assumed a US negative growth rate of 5%/year for the next five years were unrealistically pessimistic. By refusing to give in to fear, or by taking advantage of other people's fear, they have done very well over the last year, in spite of the recent market pullback.

Similarly, many of these same people believe that the current political problems are also a low point and will improve over time, possibly much more quickly than appears possible now – possibly not. While these issues appear less clear cut as politics in any country are always very messy, assuming that the US will continue to head in the same direction indefinitely also seems unrealistic. Less certain is what will happen as the current government spending bubble pops.

Regardless, I believe an objective look at the current situation is both unsettling and also encouraging. Corporate profits are way up and are likely to be extremely strong over the next couple years. This, more than anything else, is the primary driver of the stock market. In addition, the frontal assault on US business is not sitting well with much of America. Significant change is likely in the upcoming elections. While this guarantees nothing, a political shift is likely to create a much more favorable economic environment going forward and could lead to a much more extended earnings recovery. To summarize all of the above, the next year looks like it will be a pretty good year, albeit with a fair amount of ups and downs given the many possible areas of instability both domestically and internationally.

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