What Might Go Right?

After the worst quarter in four years, the major market indices are all in the red for the year. The S&P 500, Dow Jones Industrial Average and NASADAQ Composite are down respectively by -6.74%, -8.63% and -2.45% through the end of the third quarter.

To be sure, there has been plenty for investors to worry about. Does the slowdown in China signal an imminent global recession? When will the Federal Reserve raise interest rates? Will Congress avert another government shutdown? How will the conflict in Syria be resolved? How will the sharp decline in commodity prices impact emerging markets? Have profit margins peaked? Can multinational companies survive such a strong dollar? Can the U.S. remain a pillar of strength in an otherwise unstable world?

While the answers to these questions remain largely unknown, the stock market did not wait for answers as the recent decline reflects collective investor fear and uncertainty. Markets always move on emotion. Pessimism and fear drive prices lower, while optimism and hope push stocks higher.

Especially during periods when emotions and uncertainty are high, it is critical to focus on one's long term life goals and objectives. Staying the course and buying high-quality companies as others panic has produced superior returns over time and proved to be the best way to preserve and build one's wealth in the stock market.

Pessimism recently rose to such extreme levels in such a short period of time that it would not take much of any good news to move markets higher. Through the lenses of more rose-colored glasses, let's imagine just what might go right.

- China engineers an economic "soft landing" and the baton is successfully handed off from an export-led economy to a more consumer-driven one.
- The Federal Reserve's recent inaction is validated by recent global weakness and the Fed remains on hold through the end of the year.
- Shutdown is averted and the U.S. government remains open for business.
- The U.S. and Russia work together to contain the Syrian conflict.
- Commodity prices stabilize in tandem with China. Emerging markets follow suit.
- Squeezed by higher labor costs and the potential for higher interest rates, corporations put their enormous cash balances to work and a new merger and acquisition boom is born.
- With Fed action prolonged and China stable, the dollar's surge is abated and year over year comparisons become favorable for multinationals.
- The next President works with Congress to bring about entitlement and tax reform.
- Given the slow growth environment, corporations focus on buybacks and dividend increases to reward shareholders. Obtaining an approximate 3% and growing dividend yield continues to trump an approximate 2% ten-year Treasury bond.
- Worldwide demand for safety and U.S Treasuries remains strong and keeps a lid on interest rates, even as the Federal Reserve gradually hikes rates over the coming months and years.

- Wal-Mart's recent surprise announcement and reduction in its intermediate earnings outlook marks a sea change in labor costs. Rising wages coincide with an uptick in inflation, ending the prevailing threat of deflation. Bernanke, Yellen and the Fed are proved victorious in the war against deflation.
- Rising wages give the middle class consumer a boost and U.S. GDP surprises to the upside.

We would not be surprised if any number of these rose-colored possibilities became reality. In the meantime, favorable economic trends here in the U.S. cannot be ignored. Unemployment is low. Consumer confidence is high. The service based economy is very strong even as manufacturing struggles. Auto sales are at all-time highs. Real estate remains strong. Corporate balance sheets are awash in cash. Bank loans are growing and banks are in the best condition in many years. Consumers have deleveraged and have the capacity to continue driving GDP growth. Yes, the super-tanker U.S. economy is the world's strongest and will remain a pillar of strength.

Even with the recent rebound off the market lows, the S&P 500 trades at just over 15x 2016 earnings estimates. While stocks overall are reasonably priced, there are many companies battered especially hard that represent significant value and the market may be poised to favor value over growth. In such a low interest rate environment where value prevails, our focus on wide moat businesses that offer the rare trifecta of consistent earnings growth, rising dividends and favorable valuations will serve our clients especially well.