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MARKET COMMENTARY

Over the last six months, stock markets around the globe have been on a tear. Growing confidence in Europe's ability to address its problems combined with steady improvements in the U.S. economy has encouraged investors to jump back into markets. Since the beginning of last October, the S&P 500 is up just short of 30 percent, emerging markets are up nearly 25 percent and even foreign developed markets are up just shy of 20 percent (through March 26). Since the beginning of the year, the upward march has been steady with all three markets up over 12 percent.

Given the incredibly low valuations 6 months ago, the recent rise hasn't been a surprise. We've been highlighting the opportunity since last October. Good news from multiple sources, or at least lack of bad news, removed the heavy blanket of pessimism while providing enough hope for ongoing future improvements to entice people back into investments.

A seemingly more permanent solution to Greece's problems kicked off much of the enthusiasm. While I believe it's still likely that Greece will eventually default, potential damage seems to be minimized enough to ease fears of major harm. Other struggling nations such as Portugal also appear to be progressing. As a result, Europe's potential to inflict major global economic destruction appears to have lessened considerably.

Progress outside of troubled developed nations is also picking up. In a survey of over 250 economists in mid-March, growth for developed economies was projected to increase due to various ultra-loose monetary policies from major central banks. This year's growth forecasts for the Euro Zone, Britain and Japan were all revised up.

In the U.S., improvements continue as well. Retail sales climbed the most in 5 months in February following increases in January that were better than expected. Retail sales for the year are projected to grow by 6%. The primary driver appears to be increasing consumer confidence linked to solid recent job growth. Unseasonably mild weather across most of the U.S. also contributed to gains.

Sales of cars and trucks are exploding as consumers make up for years of delayed purchases. The recent strength of U.S. car companies combined with the struggles of Japanese car manufacturers means that sales increases are benefitting the U.S. more than during past booms. Sales for the year are projected to surpass last year's numbers by more than a million.

After a tortured 5 years, the U.S. housing market is also showing signs of recovery. In 38 states, prices are above early-2011 lows, and 30 states have enjoyed two quarters in a row of growth. Inventories of unsold homes continue to drop. Economists also predict homebuilders will break ground on 700,000 homes this year, which is up about 15 percent from 2011.

People are noticing the trend. According to a February Bloomberg survey, sixty percent of respondents viewed the housing market positively with 70 percent of them expecting property values to improve over the next two years. In the same survey, about 63 percent of respondents said they considered real estate a good investment, up from 52 percent last year.

Unemployment should continue to improve. Productivity gains since the end of the recession are slowing. In order to continue to grow, companies are increasingly needing to invest capital and hire people, both of which should continue to boost the economy. While unemployment may remain stubbornly high as individuals who dropped out of the job market start looking again, consumer sentiment should continue to improve with lower unemployment levels.

GDP growth is likely to continue even if the pace remains around an anemic 2 percent level. Corporate profits will likely remain strong at least as long as the Federal Reserve maintains rates at such low levels. Even with China's and Brazil's recent growth hiccups, emerging markets remain fairly strong, and even Europe is looking a bit less like a basket case.

For all this generally good news, as economic growth continues and confidence grows, **I'm becoming less bullish on the stock market.** It's not that I don't appreciate the more stable economy and the many factors contributing to it. Rather, I'm looking ahead to where we'll be over the next several years and beyond.

During the last quarter of 2011, I repeatedly emphasized the upside possibility of stocks and nearly any asset that offered some level of risk because nearly all stocks and risk based assets seemed to be on sale. Today, after a nearly 30 percent increase since last October, U.S. stock prices appear to be pretty close to fair value by many measures.

While I don't believe the market is expensive, and the market will probably continue up in the short-term barring major disruptions, long-term growth projections are probably about average. Given the relatively slow growth projected for the U.S. economy combined with the recent massive increase in bureaucracy and regulation, it can be easily argued that future growth rates will fall short of past trends. Current prices also present more risk of a downside correction resulting from bad news or even a slowing of good news. I'm not bearish, I just don't believe stocks represent the incredible opportunity they did months ago.

Investments other than U.S. stocks could offer more potential. Emerging markets enjoyed GDP growth much higher than developed economies last year, yet their stock markets were pummeled in 2011 losing about 20 percent as investors fled to safety. Today, prices have recovered some of the losses, but haven't increased as much as U.S. stocks, leaving most valuation well below U.S. levels. Developed markets probably also offer more attractive valuations, although ongoing economic weaknesses could justify lower prices.

Various assets including real estate, private equity, direct debt investments, and possibly even commodities may offer better return potential in the short and long term as prices align with expectations. Still, positive trends from many sources will likely continue to push U.S. stock prices higher, even if the upside has been trimmed, and I believe most risk based assets continue to offer opportunity.

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