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MARKET COMMENTARY

Global stock markets have certainly struggled this August. As we wrote during our mid-Month update, however, we think recent price drops are overdone. The belief that economic weakness inevitably will throw us back into a crippling recession seem overblown.

Recent high volatility trading days appear to be more driven by computer trading that largely ignores fundamental issues such as corporate earnings and Europe's sovereign debt challenges. Trades execute automatically based on various patterns. Most trading programs utilize technical analysis and completely ignore intrinsic value. As Marc Pado, U.S. technical market strategist at Cantor Fitzgerald & Co. stated, "Clearly this is not stock picking (but) indiscriminate buying and selling."

High volatility can present great buying opportunities if it drives prices down for reasons other than underlying values. Billionaire investor Wilbur Ross said he's buying assets as the losses in global markets are being driven by fear rather than economic reality. "Has the world really gotten 10, 12, 15 percent worse in the last 48 hours? I don't think so," Ross, who leads WL Ross & Co., said in an interview with Bloomberg Television. "Buying stocks at today's prices over a couple of years' time period will prove to be a uniquely rewarding experience."

He had a lot of company. Sixty-six insiders at 50 companies bought shares between Aug. 3 and Aug. 9, the most since the five days ended March 9, 2009, when the benchmark index for U.S. equities reached a 12- year low, according to data compiled by Bloomberg.

Slow expansion of the economy kicked off the trading frenzy. The struggling U.S. economy grew even more slowly than previously thought in the second quarter of 2011 generating only a 1.0 percent annualized growth level after first quarter's anemic 0.4 percent level.

Yet, while confidence indicators have plummeted lately, the most timely hard economic numbers don't suggest that the economy is nearing a recession. Economists and analysts' annualized growth projections for the second half of the year mostly center around 2.0%. The numbers aren't exciting, but they're hardly catastrophic.

Various data support the more optimistic, if restrained, outlook. Industrial output climbed in July by the most this year, according to figures from the Federal Reserve. Durable goods orders jumped 4 percent, the Commerce Department said on Wednesday. Demand for autos and airplanes surged erasing June's 1.3 percent drop. The rise was double economists' expectations.

Consumer spending rose at its fastest pace in five months in July. Spending remains stable in spite of the Thomson Reuters/University of Michigan's preliminary August reading showing that U.S. consumer sentiment had fallen to its lowest point since May 1980. Consumers may be depressed, but they're spending more, not less.

Even if a recession materialized, we don't believe it would impact companies as much as many fear. Corporate profitability still provides the primary market driver. Corporate America has remained conservative and hasn't assumed significant domestic growth. Companies are sitting on record levels of cash and maintaining their bottom-line focus. Profits at companies ranging from Home Depot Inc. to Macy's Inc. are beating analysts' estimates as sales increase. Cisco Systems Inc. shares soared last week as demand for its networking equipment improved, hinting at a pickup in business investment. Even if profits stop rising, they're unlikely to nosedive. Analyst calls and company announcements provide no indication that companies are cutting back abruptly in their hiring or spending.

Claims for jobless benefits dropped to the lowest level since early April. New jobs levels continue at weak levels, but trends suggesting a return to 2008 and 2009 aren't evident.

Housing appears to be finally bottoming. Mortgage delinquencies 90 days or more past due are at the lowest level since early 2009. As encouraging, the backlog of homes that banks may foreclose doesn't appear to be large. The pig is moving through the python. Again, not great news, but not bad either. **There's even some positive news in the construction industry.** Privately financed construction such as apartment buildings, factories, power plants, and medical clinics is generating jobs. Industry employment recently hit a 15-month high. Employment still lags way behind pre-recession levels, but the industry is becoming a jobs contributor versus the detractor it's been.

Gas prices appeared poised to fall and may drop below $3 per gallon by the end of the year. Gas had topped $4 a gallon earlier this year and prices now average around $3.65. Any relief will be welcome and will probably lift consumer spirits a bit.

We believe these mostly positive factors validate our belief that the U.S will not fall back into recession. Yet, there's little cause for unguarded enthusiasm. The economy's not that bad, but it's not that good either. Washington's on-going policy confusion and regulatory quagmire likely ensure muted growth for the foreseeable future.

We believe the larger and more serious near-term concern remains Europe's long running sovereign debt saga. A full-blown problem will likely be avoided, but the possibility that Europe will fail to address on-going issues adds a credible threat to global markets. Monday's merger of two big banks in Greece drove markets sharply higher as risk was perceived to decline..

Potential Federal Reserve actions also provide some backdrop to stocks, or at least make future appreciation more likely because of inflation. The Fed will probably print more money and buy more Treasuries. Ultimately, this should drive prices for commodity stocks up along with stocks in general.

In this environment, the bond market is expected to become increasingly dangerous. Interest rates may not rise for a while, but recent investor stampedes back into treasuries have forced yields down to phenomenally low levels that are unlikely to be sustained. Even moderate interest rate increases could cause bond investors substantial pain. Various bond experts are loudly warning of danger in treasury bond market.

In the longer term, nearly all concerns – and opportunities – center on Washington. It's unlikely we'll see substantial economic improvement within the next 18 months given extraordinarily high levels of policy uncertainty and regulatory burden. Most likely, we'll muddle along until after the fallout of next year's elections provides a clearer indication of Washington's future and its impact on the private sector. Until then, we expect the economy to slowly muddle forward just as it has for the past several years. More to the point, we believe the recent market dive provides a buying opportunity rather than a warning that a repeat of 2008-2009 is coming. We wish you a great Labor Day.

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