“On the subject of excesses”

By Tommy Williams, CFP®

The great mystery of stock markets reared its head last week. With no clear driver, the Dow Jones Industrial Average gained more than 3 percent, while the Nasdaq Composite and Standard & Poor’s (S&P) 500 Index moved higher by about 2.5 percent. It was a puzzler. Ben Levisohn of Barron’s explained:


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“Given those gains, we’d expect a heaping helping of good news, but not much was forthcoming. Earnings reports from [two large multinational companies] left investors wanting. And economic data were either bad or terrible in the United States – industrial production declined in January, the first drop in eight months, while December’s retail sales fell the most for any month since 2009. But who needs good news when the United States and China are reportedly making progress on trade talks? Yes, the details remain a little fuzzy, but at least the tone is more constructive.”

It probably wasn’t just optimism about China that pushed markets higher. Consumer Sentiment, which gauges Americans expectations for the economy, was up more than 4 percent month-to-month. One driver of consumer optimism was relief the government shutdown had ended. Another driver is a change in inflation expectations, which are at the lowest level seen in half a century. Americans think inflation will remain low and they anticipate wages will rise. The Federal Reserve’s newly accommodative attitude hasn’t hurt, either.

Obviously, investor sentiment was leaning optimistically last week as well. Willie Delwiche of See It Market reported the Investor Intelligence survey of financial advisors showed 49 percent bullish and 21 percent bearish. The AAII Investor Sentiment Survey reported bulls (40 percent) edged bears (37 percent) by a neck. Those indicators were balanced by the Daily Trading Sentiment Composite from Ned Davis Research which suggested optimism was too high.

When markets rise, as they have during the past few weeks, it may be tempting to take a more aggressive stance and tilt your portfolio toward U.S. stocks. That is probably, in terms of intelligent investment strategy, no different than panicking this past December when everything was falling through the floor. Not a reason to change the fundamentals of your investment plan.

As we reflect on market volatility and find ourselves rapidly approaching the tenth year of this economic growth cycle (it began in June of 2009) we can't help but muse over the frequency of economic downturns. Nine of the last recessions began under a Republican president going back 66 years to 1953. The only recession that began under a Democratic president in the White House was a 6-month recession that began in January 1980 during Jimmy Carter's last year as President.

That is not to say we are headed into a recession. Growth cycles do not die of old age, they die of excesses (sub-prime mortgages, dotcoms, savings and loans, etc.). However, historical trends are handy for lively cocktail conversation. As of this moment, do you see anything excessive?

Though the impact on the U.S. is yet to be seen, one thing that is excessive is the amount of oil in Venezuela. Surprisingly, Venezuela has the largest estimated oil reserves in the world (301 billion barrels). That's nearly 8 times the estimated reserves in the United States (39 billion) according to the World Atlas. It remains to be seen what global impact their Presidential and humanitarian crisis will have on our oil sensitive markets. One living in this part of the country could only hope for higher prices for both oil and natural gas.

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