CONWAY• JARVIS LLC
Investment Outlook

Volume 24 Issue 1 September 4, 2014

Say Hello to the Bad News Bull Market

As summer comes to a close, we reflect back on the past several years in the stock market and realize that there hasn't been much to complain, or write about. During that time, stocks have advanced relentlessly, scaling a wall of worry that would make Chicken Little proud. Investors willing to take risk have been rewarded while many others remain on the sidelines, fearful of the "terrible recovery", geopolitical events, and the impending economic doom certain to follow the Fed's monetary acrobatics. With so many participants focused on reasons for the market to go down, we remain modestly bullish. It's been our experience that we rarely see a bear market, much less a crash, when so many are critical of the economy and the market's advance. That doesn't mean the market won't deliver a correction along the way to higher levels. *Putting aside the gloom and doom in the headlines, we'll identify what we view as tangible risks to this bull market in the longer term.*

Putting This Recovery in Perspective

Rarely has there been an economic recovery so maligned as this one. We're reminded daily of its lack of robustness by politico-economists criticizing either the Fed for what it is doing or blaming the White House and Congress for failing to act. There's plenty of bad news out there for critics to seize upon as a reason for the economy to falter and for stocks to decline: The Fed's budget-busting monetary policy, a gridlocked Washington going on strike, a nearly bankrupt EU, the Japan Tsunami, the Arab Spring bringing chaos to Egypt, Libya, and Syria, Russia reclaiming the Ukraine, and ISIS invading Iraq. It's not a pretty picture.

If that isn't enough to put you off buying stocks, you'll find market "experts" using all of the above to sell you gold, their latest book, or a bomb shelter in anticipation of the crash of a lifetime. Didn't we just have one of those? Just as the perma-bulls failed to read the tea leaves in 2007, the sky-is-falling crowd has misread the past several years. We think they're failing to realize that, when tail events such as 2008 occur, the aftermath is likely to be equally anomalous. That means the crash of a lifetime *isn't* likely to be followed by your run-of-the-mill recovery.

We're skeptical of many experts' opinions, especially those who compare the current post-crash environment to those following recessions of the past thirty years. We suggest going back to the 1930's for valid comparisons to the current recovery. Some professionals warn of today's eerily similar chart pattern to that of 1930-1937. Whatever they're selling, we're not buying. We acknowledge the similarity but refute the conclusion because central bankers today have employed a radically different strategy from that used in the 30's. Extraordinary conditions called for an extraordinary response and that's what Ben Bernanke and Janet Yellen have provided in the way of unprecedented stimulus to the global financial system. Observers are divided along ideological lines with regard to the prudence of that approach. We side with the Fed and those that view monetary CPR as a necessary first step in saving the economy regardless of the cost.

Because of what *hasn't* been happening in Washington with regard to fiscal policy, the Fed has shouldered the entire burden of resuscitating the private sector economy. With Congress and the White House planted on the sidelines slinging rhetoric at each other across the field of play, we don't see that changing before the next general election. We think that actually bodes well for stocks. *Washington can't improve the recovery while gridlocked but the good news is it can't derail it either*.

Where's the Correction?

It's been almost three years since we've seen a pullback of more than 10% in stocks and many investors are wondering if the market has disconnected from the economy. There's an ideological divide between those who believe the Fed has perverted the operation of the markets and those who think the Fed has called all the right plays. *We count ourselves among the latter and believe the stock market does reflect where the economy is headed. It also reflects the lack of attractive returns from cash, bonds, and high-priced real estate.* However this doesn't mean we're comfortable with the unabated advance of stock prices. We're on the lookout for the catalyst that will trigger a correction or worse.

In our recent letter to clients we stated our preference for seeing a pullback in stocks sooner rather than later. The theory being that we have less downside from here at "fair-value" rather than from the over-valued levels we might see if the market "melts up". Regardless of where you stand on valuations, all can agree that stock market bubbles are fun while they last but painful when they pop. That's why we prefer to see a long slow slog to higher stock valuations, punctuated by the occasional consolidation of gains. For now, absent any significant escalation of the Ukraine conflict in the near-term, we expect the stock market to move modestly higher into 2015 with perhaps a brief pullback along the way.

What are the catalysts likely to bring about a correction or worse? **The last few years of market behavior would suggest two things as likely causes: A geo-political event that negatively impacts the Global Growth Story or rapidly rising interest rates, whichever comes first.** In our next installment we'll examine how, where, and when those causes might arise and what conditions will determine the difference between a short-lived pullback and the next bear market.

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