Courier Capital Corporation

Market Review & Update

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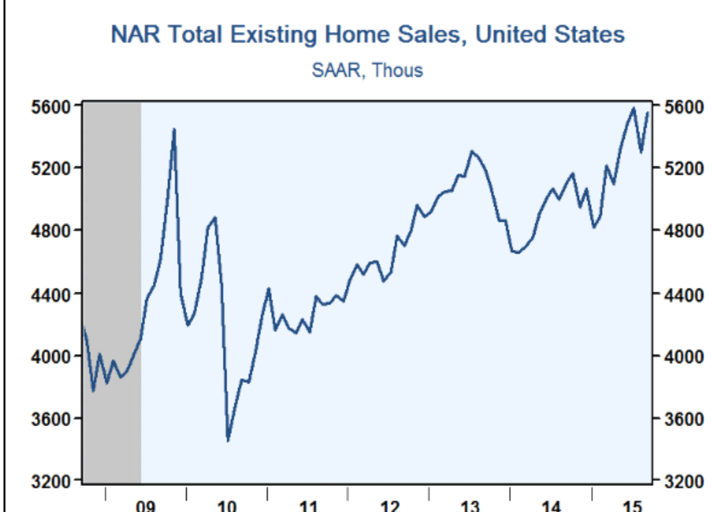
If you crack open the right fortune cookie you'll see the famous Chinese proverb "May you live in interesting times"… Interesting times have been China's most impactful export during the August/September period. With little fundamental data coming down the pipe, the fear and greed that move the markets relied on the hyperbolics surrounding the fears of the impact of a China economic slowdown. Several points are important here. The first is that China's slowdown to a 6-7% growth rate is by design and a consumer led economy is a more rational way forward than internal investment that was essentially building the equivalent of two large US cities per month. Google "empty Chinese French villages" and you'll get an entertaining example. The second is that China, while huge, is not a big contributor to US GDP, less than 2% at this writing, and hence the oft cited term "trade imbalance"…. And, like the drop in the price of oil, it's not all bad as a decline in the yuan to the dollar means cheaper imports for the US. Additionally, we'd be remiss if we left the Fed out of the "interesting times" saga. Their public vacillation added to the uncertainty during this vacuum of fundamentals.

We're now in the midst of earnings season, so the fundamentals that the markets rely on to temper hyperbolics are arriving. What do they tell us and what are the underlying catalysts? Let's peek.

Beneath the earnings we find several reliable sources of strength in the underlying economy. Obviously, the entirety of 2015 will not grade out well due the stalled economy in Q1. Recall from previous pieces that we dealt with a crushing port strike on the west coast, a sharp rise in the dollar due to the currency war as the Euro Zone drove interest rates to all-time lows in a QE stimulus effort, a sharp drop in oil prices as market forces punished the substantial new production growth, and let's not forget the frigid weather that paralyzed business over a third of the nation (oil and the dollar will shave a few bucks off S&P earnings). But thereafter so many things began to thaw. Q2 saw a rebound in GDP growth that exceeded 3%. Component trends will provide some needed reassurance. Consumer spending rose as the savings from lower gas prices began to trickle into other purchases. Auto sales rose to levels above 17 million units and, most significant, housing continues a rising trajectory.

Figure 1

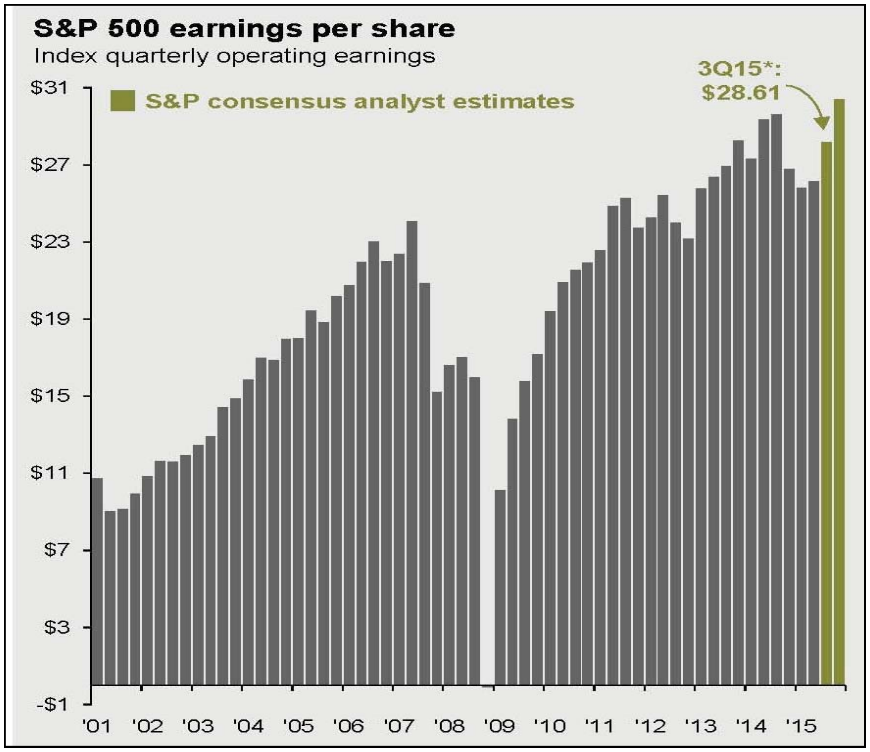


Source: National Association of Realtors /Haver Analytics

Let's remember that expansions do not die of old age. They die when economies recede. With housing, autos and retail sales enjoying positive momentum predicting a recession might be a losing proposition, especially when we consider that China's impact is likely much less than was feared. The aforementioned forces, combined with the remaining fuel, in the form of corporate and household cash, to provide future growth, and plenty of people who would like to be employed more lucratively (as evidenced by the Fed's U6 unemployment number of over 10%), give us more reason to be positive than negative. With all the activity GDP would normally be higher, some experts targeting 4-5% growth, but we have seen a stall in the past few years in the level of productivity. That can be caused by two things, hiring in areas that don't add to production (compliance, hr, etc) and more unskilled hirings. The latter can be blamed on both the environment and the pool of labor available. Clearly, any rise in energy prices would add positively as many high wage jobs were in that sector, likewise any decline in the dollar would provide a boost to the manufacturing sector.

These trends are implying that the domestic economy is becoming stronger rather than weaker. S&P earnings are estimated to head toward $130 in 2016, all other things being equal that should place the index on a path exceeding previous highs. Citi's respected strategist Tobias Levkovich constructs a Panic/Euphoria model with numerous statistical inputs, having recently touched the panic level, that model now indicates a 96% probability of positive market returns 12 months forward. In his camp is Wharton economist Jeremy Siegel who suggests the Dow could reach 20,000 in that timeframe and could hit 18,000 by year end. So far, we have seen a near 10% rise in the S&P alongside a greater than1500 point move up for the Dow Industrials from the lows of August. A major catalyst to this is the aforementioned earnings releases, at this writing approximately 70% of companies are exceeding expectations. Expect that to continue into 2016.

Figure 2



We do expect volatility to be an annoying companion as this expansion trudges forward. We will encounter a lot of periods like this August/September when the data stream thins out and people start thinking about the unknown. And the world has quite a list of unknowns to ponder at this juncture. That is a primary reason that this quite impressive rise in the markets since '09 has been termed "unloved". So much talk about bad news had pushed the literal achievements in the markets to the back burner. But, quietly and slowly the earnings progression over this six year period has been steady. That word "slowly" is quite important, especially at this juncture. When you grow GDP at numbers that struggle to rise above 3% you use up fuel in a very measured way. The positive hidden in that slowness, as we have often mentioned, is that there remains plenty of fuel in the tank to keep us on a positive, yet gradual, trajectory for some time. If we were to speed up, it would seem to be because of an external stimulus, like the much requested repatriation tax relief to act as a catalyst, that fuel would be used up more quickly. Till then, we will likely see this gradual pattern repeat.

So, while the domestic economy remains on a gradual, yet improving, trajectory, coupled with what seems to be an entirely manageable transition to a more realistic consumer led economy in China, and the beginnings of success in Europe (at our expense of course) as a result of their efforts to stimulate via aggressive QE, "better" seems to be the reality of these interesting times, rather than worse.

It's been a pretty autumn so far, and the recent weekend's snow is a gentle reminder of what's to come.

We'll talk to you soon…

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