Courier Capital Corporation

Market Review & Update

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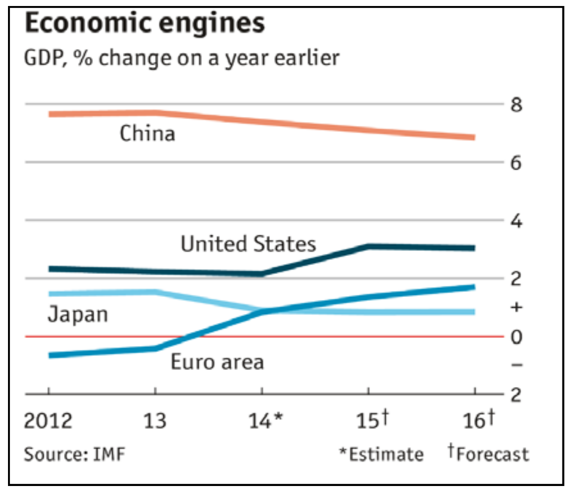
As the sastruga wane…

March strode in like the proverbial lion, a bit less frigid in the temperature column and downright toasty in the markets, with the Dow and S&P cruising to new highs in what is likely to be a decent but more volatile year. More talk about markets later, let's spend some time on the really significant stuff that is at the root of the volatility. Currencies and oil are the primary manifestations of the global effluence caused largely by governmental dystopia. In places like Japan and Europe, governmental policies largely displaced the forces that create growth. In China and the US, governments struggle with ideology versus action, resulting in growth moderating (China) or growth struggling to move higher (US). GDP and inflation will join these metrics to guide the Fed. Fourth quarter GDP came in at a 2.2% level, and it will not be surprising to see the frozen wasteland of the first quarter of this year come in well below that. When processes that can best be lumped under the democracy umbrella become painfully dystopic, what can be done? In ride the central bankers. The Fed, the Bank of Japan and the ECB are not so democratically messy so they can enter the fray with their small yet significant tool set and get to work, surrounding mess notwithstanding. So, what's a central banker to do? Well, they can make riskless savings painful. By driving interest rates to zero, and in some cases beyond (about 25% of currently outstanding sovereign bonds now have a NEGATIVE yield!!) they encourage folks (and companies) to take more risk. The risk taking then begins to drive more risky asset prices higher (houses, stocks, etc) and the higher asset prices create an environment of more confident consumption (aka as growth). The dark side of this exercise is the currency war aspect no central bank will admit to. If you make your currency cheap, you put your exports on sale which should also enhance the prospect of growth. So, whilst the governmental bodies all try to impress their constituents by accomplishing little, the central bankers have been busy, busy, busy. In the hopes of growth to come, they have driven interest rates to the lowest level in the history of this planet (aka making playing it safe too costly…).



Not to be outdone by paper money, oil has been on a similar trajectory. Down 50% in the last year, the change has created uncertainty as the world struggles with whether the change is good or bad. Clearly, for those that consume energy, and most humans and businesses do, there is a massive oil dividend being harvested and it seems to be beginning to show up in spending patterns and the occasional earnings report. It is also negatively impactful on those who make profits on its sale. If the traditional relationships between demand and supply remain in place, lower prices will begat more demand, which will ultimately begat higher prices. And yet, supply is such that it seems unlikely that we will see $100 per barrel any time soon. It should ultimately manifest in a view that less expensive oil is a net positive for the globe.

Domestically, as noted above, the success that has allowed asset prices to rise has not yet yielded a robust economic environment. Remember, as we went through in the Winter issue, the stock markets and GDP can walk surprisingly different paths. We have just heard from our central bank on the vexing issue of whether rates would begin to rise this year and the gravity of the one word "patience". Janet Yellen made it fairly clear that while the word patient would be removed from their statement, the metrics on unemployment and inflation are the very things that central bank patience is made of. As politicians will remind us, the unemployment rate is so very wonderful at the current 5.5%. But the Fed knows better, and so do most people on Main St. While the unemployment rate has declined, we have continued to see a decline in the participation rate (folks who ceased looking for work) and we also know a large portion of the jobs being created are a combination of part-time (30 hrs or less to avoid health care expense millstones) and lower wage. The aforementioned decline in oil prices has had an impact here because many higher wage jobs were attributable to the growth in the domestic energy sector's growth, which has decelerated with the sudden, large decline in the commodity's price. And so, patient the Fed will continue to be for the foreseeable future. The potential for rising rates was yet another source of near term instability. This is simply psychological, as early rises in rates are historically associated with rising growth which is almost universally good for both the economy and asset prices. And what would surprise most is that when rates begin to rise at the Fed's hand, this coincides with a period of p/e expansion. In short, the markets begin to reflect the Fed's vision of a strengthening environment, eventually realize that is good for stocks and become more willing to pay a higher price for what would seem to be a more reliable dollar's worth of earnings.

Back to the markets. As we mentioned above, the broad indices reached new highs by the beginning of March. The Dow breached 18,000, the S&P 500 surpassed 2100 and the NASDAQ is flirting with its previous high set in the year 2000, that memorable era of irrational exuberance. So please note here that earnings have likewise reached new highs. As we have said many times, that number 2000 is about the only similarity with that period. It was the debut of the iPod, and stock valuations in today's light were, frankly, silly. The chart compares a few leading companies and you can easily see that in this environment, valuations are reasonable, especially given a 10 year Treasury yield below 2% versus a then quite devilish 6.66%. Equity markets globally are beginning to respond to QE efforts abroad, similar to ours that recently ceased. I'd like to point out again that despite all the aforementioned catalysts for increased uncertainty and volatility, valuations reflect this skepticism and the S&P 500 currently has a dividend yield of 1.93%. And, in every historical occurrence when the yield of the 10 year Treasury dips below that dividend yield, there has been a 100% occurrence of a positive market return in the forward 12 month period. Other than that Betty Davis might simply suggest a seat belt as a precaution…

2000	P/E	2015	P/E
Microsoft	57	Apple	15
Cisco	127	Google	19
Intel	43	Microsoft	16
Oracle	103	Facebook	39
Sun Microsystems	85	Amazon.com	717
Dell Computer	57	Intel	14
MCI WorldCom	22	Gilead Sciences	11
Chartered Semi	53	Cisco	13
Qualcomm	123	Comcast	17
Yahoo!	418	Amgen	17

And so, our expectations should most certainly include the following. Central bank thaumaturgery, even at this juncture, is still actively proceeding. Valuations for risk based investments that include stocks and housing are most certainly rational. Increases in the latter would most certainly be signaling even more positive change domestically. Global interest rates are ridiculously low, supportive of positive economic improvement, and simultaneously a signal of longer term risk for certain sovereign bonds. As an investor, I think it's very rational to compare 5 year government bonds carrying a negative yield currently to those 3 figure p/e's so common in the dot com bubble. Legendary investor Sir John Templeton had often stated that bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria. Inasmuch as the pessimism is quite palpable, we seem to have a ways to go.

We should also note the passing of the founder of Singapore, Lee Kwan Yew. He demonstrated to the world how a little less democracy, intelligently delivered, could do amazing things. Yes, Singapore, an extremely wealthy nation, with an absurdly low crime rate, and a nationalized health care system that we could learn much from. There are very amusing stories that explain the $10,000 fine for trafficking in chewing gum, the criminal offense of littering and why all elevators could be locked from a single governmental office. Perhaps those stories another day…

Happy Spring! We'll talk to you soon…