



U.S. Market Update

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Why we are staying invested?

For equity investors with the typical long investment horizon, I would advise against trying to time the market by selling stock positions:

1. The economy may not be growing rapidly (~2% pa), but it is expanding. A recession is not on the horizon;
2. Corporate sales and profits are not booming, but they are in an upward trend (~2% - 5% pa);
3. Inflation is very low (~1.0%) and there is no pressure on the Fed, other than political pressure in some quarters, to tighten monetary policy; interest rates are expected to stay low for a considerable period of time;
4. Equity valuations are still low considering the low level of inflation and fair valuation is some 20% higher by our measure;
5. Equities are also still under-owned due to deep and lasting fear in the markets that came from the Bear Markets of 2000 and 2008. Healing comes with a struggle, but after 10 years of a cumulative negative return (through 2009), it appears that equities have since begun a secular Bull Market and we expect flows to shift back into equities over a period of many years;
6. The government “shutdown,” although some 85% of Federal workers are still working, is not expected to have any material impact on the economy. The “shutdown” may drag on in a battle of political wills, but this may be good if it ends in budget reforms that reduce future deficits;
7. The “debt ceiling” will almost certainly be increased before a theoretical “default” is even possible. The debt ceiling is used as a weapon in the political battles, but no one ever wants to see it actually used. An agreement is highly likely we think. Also, keep in mind that interest costs for all the Federal debt is only about 1.5% of GDP. The U.S. is easily capable of paying its cost of debt. Also, by law, the U.S. is required to pay the debt, although some members of the Democratic Party dispute this as part of the political battles.

In summary, it does not appear likely that there will be any real or significant damage due to the current political theater going on. Once an agreement is reached, which could be in only days, or perhaps weeks, the market is expected to resume its upward trajectory. In fact, the S&P 500 is up 1.7% today due to rumors of talks between Obama and the Republicans. The market wants to go higher.

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