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OBSERVATIONS ON THE MARKET

By Greg Denewiler, CFA

In this weekend's Wall Street Journal Sunday edition, the lead story implies that since the market has climbed 149% from its March 9th, 2009 bottom – there is a growing sense among Wall Street pros that it's time to slow down. The article goes on to suggest this may not be an attractive time to invest because the market's P/E ratio is about the same as when stocks peaked in October of 2007. Are we really at the same inflection point as 2007? Comparisons are always risky, and yes, the market is up a lot. So if price is your only matrix, you probably should be worried. There are also a few reasons not to be as worried as they suggest.

Yes, the market has surprised everyone, but so have earnings. Since the market low, S&P 500 earnings are up 170%, a number that puts the market's advance in a little different perspective. Is 2014 comparable to 2007? Several economic factors are in much better shape than 2007. The most important one being the housing market is not at the frothy levels of 2007. The banking system is also much less leveraged to the mortgage market, and banks have raised more capital making them more stable. Corporate balance sheets continue to hold more cash, and they have cut their financing costs by refinancing debt in this low interest rate environment. Even federal and state deficits have improved. This does not mean that the stock market cannot decline, but we are not in the same space that we were in during 2007. The biggest current challenge is most likely that the economy continues to lack much momentum, and the global central banks have yet to exit their stimulus.

This week's Barron's provides another interesting observation. In the Market Week section, the headline reads: "Russian Roulette – Moscow's meddling makes its stock market uninvestable". This is music to a value investors ears. Should anyone invest in a Russian equity right now? No one knows for sure. However, when some of the largest Russian energy companies trade at 3 times earnings, it is probably time to start looking at them. The reserves they own aren't going anywhere. The down side is well known, trade restrictions will limit customers, and Russia has a bad habit of wiping out minority shareholders. If it wasn't for Russia's past record of seizing assets, it would be a bet the farm moment. It would seem that the Russian oligarchs do not want to give up their wealth, nor their ability to spend it in Europe or America, so Russia's land grab will be limited. There is an interesting way to get exposure in Russia without taking significant risk, but then there is always the issue of who wants to support a criminal? As a Rothschild famously said, "Buy when there is blood in the streets."

In regards to the market valuation, here is an interest perspective: 'Moreover, there's no reason to think that the valuations of those eras – distorted by world wars (1914-1918, 1939-1945, 1950-1953), gross economic mismanagement (1929-1938), and painfully high inflation and interest rates (1970-1982)-were somehow more "appropriate" than current valuations. The valuations in those eras were "appropriate" to the circumstances of those eras; we live in different circumstances.' The issue is always; buy more, hold, or sell. On a macro scale, circumstances probably warrant a hold. However, there is always something to buy when you focus on value, not price. You just have to look harder now.