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OBSERVATIONS ON THE MARKET

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I do believe in Santa Claus, otherwise known as ‘the Fed’. The Fed gave us a present for the holidays that was everything we wanted. A little less bond buying, a promise of low interest rates for a few years to come, and a firm stance that policy is still accommodative. It is hard to imagine that it could have been a better ending to the Bernanke Fed. To complete the gift, we have a newly appointed Fed chairwoman who will continue our current policy with no deviations from our easy money policy. One uncertainty removed. There are four more reasons to believe that there really is a Santa Claus.

We finally have a budget. No, it doesn’t change the course of our debt problem by much, but it is a miracle that congress was finally able to accomplish something without any major drama attached. A subdued political environment is something that the markets welcome with higher prices. Investors love a little less uncertainty, even though the investing public has proved recently that political infighting has become accepted as just part of our daily life.

The prospects of low interest rates for several more years help to justify higher valuations, just like lower interest rates allow you to buy a bigger house. The forward P/E for the past 10 years has been 14 according to Factset. We start 2014 with an estimated P/E of 15.1, not cheap, but not in nosebleed territory either. The market started 2013 with a valuation of 12.7 based on estimates for the coming year, which proved to be attainable. With a few tailwinds, 2014 is beginning with the hope that maybe things are getting a little better.

Corporations are in their own quantitative easing cycle. During the third quarter of 2013 companies paid out dividends and bought back stock in the amount of $207 billion. We are nearing the previous high set in 2007. It would be more encouraging to see companies investing more in plant, equipment, and especially staffing, however, stock buybacks do have a short-term positive impact on prices. It is a little concerning that companies continue to buy more as prices climb higher, but at least prices are not as expensive as they were in 2007, not yet anyway.

Finally, gas prices have fallen below $3 a gallon. There is no single item that can help the economy more than lower gasoline prices. It is better than a tax cut. We begin 2014 with our country moving towards becoming an energy exporter. This helps consumer confidence, lowers our global political risk, and has the potential of transforming our manufacturing economy. If you could ask for only one thing from Santa, abundant energy would have to be at the top of the list.

So we start 2014 on a high note with some wind at our back. This is otherwise known as the sweet spot. There are no guarantees how long it will last, enjoy it while it’s here. How many predicted this kind of a year for stocks at the beginning of 2013? We all wake up tomorrow and start over. Or, as they say, what have you done for me lately? The year was good for stocks, but it was not good for all investments. Next month is January and the traditional time to speculate as to the coming year. Will next year be as festive?