## Market Commentary: August 2014

The Dow Jones Industrial Average[1] has closed above 17,000 several times recently, a historical record and milestone. Consequently, the question at the forefront of many investors' minds has understandably been raised: Has the market now become dangerously high and therefore destined for a crash? Alarming news headlines add to the concern: "Jim Cramer: It's a Mistake to Buy Stocks Now"; "The Indicator That Proves the Bull Market is Ending"; and "We're in the Third Biggest Stock Bubble in US History".

Obviously, no one knows what the stock market might do over the short run. On the other hand, just because the stock market is hitting all-time highs, it does not necessarily follow that stocks are dangerously overvalued at the same time.

It's important to note the distinction between "price" and "value". In this regard, there are several possibilities that can be true when a stock (or an index) is trading at an all-time high. For example, if the company's earnings have grown faster than its price, the company can actually be undervalued or fairly valued at the same time. Conversely, if earnings growth has not kept up with price, then it is quite possible the company is truly overvalued. The point is, a high price alone does not necessarily indicate high valuation.

It's only a job half done if we measure price without also measuring its relationship relative to earnings. Unfortunately, most investors focus only on price, because stock prices are what is reported so often, and even continuously, in the popular media. For those investors who also follow earnings and the price-to-earnings ratio (P/E), there are several figures that can complicate understanding the whole picture: 1) trailing 12-months' earnings; 2) smoothed 10-year average earnings; and, 3) estimated future earnings.

Regardless of which earnings number an investor prefers, it is important to remember that valuation is only *one* factor in evaluating where we are in a market cycle. Based on today's level of earnings and prices, the market appears to be fairly valued or slightly overvalued.

### Other Factors

Even if some observers believe the market is overvalued today, history has shown markets can remain overvalued for extended periods of time. Therefore, we should also look to other evidence to make some sense of today's situation.

Jim Stack of Investech Research maintains a set of "bear market warning signs" to help judge where we are in a market cycle. These signs include valuation, but also encompass Monetary, Economic, Sentiment, Cyclical, and Technical. We won't attempt an explanation of each of these signs here, but we will tell you that not one of these market analysis areas is flashing "red" today. Investech research shows that, based on history, we will not move into a bear market when none of these signs are in warning mode, which gives us confidence that we don't have to be concerned about a bear market in the near future.

### Concerns

We do have a few: First, the Federal Reserve has kept interest rates very low for over five years, as they have also continued their bond-buying program. As they taper off the buying, no one knows for sure how it will affect the markets -- we are in uncharted territory. Second, we are beginning to see some frothiness in sentiment and some complacency in the markets, as many investors expect the bull market to continue indefinitely. Finally, while some of the technical factors are very positive, others are showing some cyclical weakness.

**The Short Term**

So, having said all of this, what is our short-term expectation? The market is fairly to slightly overvalued, which is not a concern, given that none of the imminent-bear-market indicators are showing a danger signal. Client portfolios are currently invested where they need to be according to each person's individual performance goals and future planning needs. These portfolios are monitored regularly and changes are made as needed according to market insight and/or changes in an individual client's personal circumstances.

**The Long Term**

As always, it is important to remember that we invest for the long term, and we invest based on your goals and objectives. While it may be fun and interesting to speculate on the direction of the stock market, our allocation for each client is based on needs and objectives. Our overriding goal is to help you achieve *your* goals.

Thank you for your continued support and confidence. Please do not hesitate to contact us with your questions and concerns. And remember, we want you to call us with your "Here's what I'm thinking about doing" questions, not your "Guess what I just did" comments!



[1] *The Dow Jones Industrial Average (DJIA) is an index of 30 stocks traded in the US that represent a cross section of industries.*

## Dates for your Calendar:

Kevin and Gwen will be out of the office August 5th through August 8th, attending the annual Cambridge Investment Research compliance conference in Chicago. Susan will be available to answer any questions or help with customer service-related issues, and Kevin will be checking in regularly for phone calls and email.

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