

# Market Thoughts



It has been some time since my last update.

While I am never short on words, the current information available leaves one without much direction.

I hope you have enjoyed, as I have, the recent, dramatic stock-market rise that has provided relief to so many investors. Unfortunately,

I am having trouble justifying how it can be sustained. Before I go any further, I want to reiterate that I typically fall on the side of optimism. I think it is entirely possible to find a pony in almost any pile of manure. Right now, however, we are up to our collective neck in manure and still no pony. Unfortunately, the market's rise cannot be sustained. I am not saying this is the end of prosperity, but the returns we experienced in the 1980s and 1990s will probably be only a pleasant memory for some time to come. There will certainly still be opportunities for above-average returns, but those opportunities may require a different approach than in the previous two decades.

Stock-market cycles typically last 15-20 years. If the cycle that ended in 2000 was a bull and the current cycle is a bear, then one might expect it to last until at least 2015—although markets rarely behave according to schedule. Since 1900, there have been three secular (that is, long-term) bear markets, 1906-1921, 1929-1949, and 1966-1982. Fifty-one of the last 109 years were in a secular bear market; 58, in a secular bull market. Although a secular bear

market typically ends at the same nominal level at which it started, it contains a number of rallies. This means positive portfolio returns are possible in a bear market. In bull markets, you leave your profit in the portfolio to earn more; in bear markets, you take profit on a regular basis.

Of course history does not predict the future. What caused previous ups and downs may not affect markets in the future, and it is impossible to know how a market will react to new developments.

Still, a few points are clear.

## **We are in a bear market**

As the investment heat generated by over-leveraging cools, it is reasonable to expect negative returns. Corporate earnings are meeting expectations, but that is because companies have cut nearly every possible expense. Since there is little left to cut, the next round of earnings may be more disappointing. Because markets can change direction in moments, however, I continue to make portfolio recommendations that provide both long and defensive positions.

## **Inflation is a threat**

With the amount of money the Federal Reserve is printing, inflation is likely to be a problem at some point. However, as long as foreign purchases of our debt continue, inflation will remain offshore (see the attached article from Dow Jones Newswire). Should China and others decide to stop purchasing our debt, however, and simultaneously there is little domestic demand for Treasuries, inflation will come home. If the U.S. Treasury can no longer roll over the debt, it will be forced to print the money to pay off foreign debt holders. Should China, say, choose not to take cheaper dollars back home, it could increase its purchases of U.S. goods to avoid erosion of its

purchasing power. But that would flood the monetary system with dollars (read: inflation). Note that high inflation is not confined to good economic times. The U.S. experienced hyper-inflation during the bear market of 1966-1982. So my recommendations for your portfolios have included protections against this threat.

## **America is de-leveraging**

America is de-leveraging at a rapid pace, extracting itself from the huge expansion of debt during the past couple of decades. Next to be hit will be the commercial property market. As this real-estate cycle begins this month, it is questionable how well the banks are positioned. My portfolio recommendations also encompass this issue.

## **Consumer spending has experienced a paradigm shift**

It is hardly a stretch to say the consumer is not in a buying mood. If our economy is truly consumer-driven, it only makes sense to think that the stock market will not show sustainable returns until spending resumes. And durable order reports continue to indicate no resumption of spending.

Again, portfolios can have positive returns in any market. But it may require adjusting your management process—whether that means taking profits, adding defensive positions, or buying and holding. The recent stock-market run-up has provided an opportunity to reposition portfolios and relieve stress. I am continuing my research with the aim of providing you reasonable assumptions and sound recommendations as you consider your strategy in a volatile market.

*For more information, contact Michael Montileone, CFP®, at 412 536 8014 or at [mmontileone@alleghenyfinancial.com](mailto:mmontileone@alleghenyfinancial.com).*

