viewpoint

MARSHALL & SULLIVAN

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90's Rewind

Historically after recessions, the economy and stock market have usually had a rebound that is rather dynamic. After the "great recession", which officially ended in June of 2009, we did not experience a dynamic rebound. There are many reasons for this; high consumer debt, high government debt, the financial meltdown, the housing market blow up and overseas issues to name a few.

This month, we are focusing on the current U.S. economy and whether or not it is likely to sustain sufficient growth to fuel the equity market to even higher levels over the next few years. Normally, this task would include a look at corporate earnings in relation to stock prices. However, we were intrigued by a series of financial charts provided by Liz Ann Sonders, Schwab's Chief Market Strategist, at a recent luncheon and thought we would share our observations.

During the meeting, Ms. Sonders presented an excellent chart highlighting several of her favorite leading economic indicators: new orders, unemployment claims, and credit rating index, among others. All of her indicators showed to be either improving or stable with the exception of two - *interest rate spreads* (the difference between the interest rates charged by commercial banks on private sector loans and the interest rates paid by commercial banks for deposits) and *building permits*. These outliers seem reasonable to us given the economic struggles the market has had to endure since the 2008 financial and real estate crisis. More importantly, the majority of leading indicators appear to us to be pointing in the right direction for continued growth in the economy.

Gross Domestic Product (GDP), a way to measure the growth of the economy, is also growing at a modest clip. The growth is primarily due to increased personal spending over the past few years. More recently, we are beginning to see incremental spending increases at both the state and local government level. This should further contribute to GDP advancement. The only drag to GDP currently is the Federal Government.

With economic indicators pointing in the right direction and the economy growing slowly, the real question on our minds is whether or not stocks will continue their upward march.

We believe the current market is very similar to the 1990's which was typified by rolling rallies and corrections throughout the range of investment asset classes and sectors. When a company or asset class gets ahead of its earnings, we will see it pull back until earnings catch up and then resume their upward trend.

We have already seen it this year with some sectors showing impressive resilience. In the domestic equity market, small companies which significantly out-performed large companies last year are down 10% this quarter and slightly down for the year. Biotechnology stocks which dropped nearly 18% earlier this year have already recovered and are now up for the year.

This is not to say that we will not see a correction in the overall market in the foreseeable future. This could happen at any time. We do believe we are in the middle of broader bull market where stocks will generally rise over time. As we see pull backs in individual stocks and asset classes that meet our criteria, we will take advantage of the opportunity and add positions. When a company or asset class becomes over valued we will be likely to trim positions to lower our exposure.

Just like the 90's, we think this is a time where patience will pay off.

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