

June 30, 2010

Stocks Retreat

After four straight quarters of stock market gains, the market sold off during the second quarter as economic data showing troubling signals from housing and jobs fueled fears that the economic recovery may be in jeopardy. An unexpected drop in consumer confidence also spooked the markets. Economic recoveries rarely happen in a straight line and slowdowns in growth during recoveries are not unusual. Whether this is a bump in the road to recovery or the end of the recovery itself remains to be seen.

Most of the disappointing economic news we have seen recently appears to show an economy struggling to sustain growth rather than one headed for a recession. While jobs growth has been weak, the economy is still adding jobs. The private sector is expected to add about 100,000 new jobs monthly going forward. Year over year growth in the automotive industry has shown strong growth, although it remains far below peak numbers. While these numbers need to show improvement, they do provide some positive news.

Ultimately, economic numbers only matter to investors because they impact the ability of corporations to produce profits. Consensus analyst earnings forecasts show 2010 S&P 500 earnings growing at 34% over depressed 2009 levels. Analysts are expecting 40-50% annual growth in the second quarter of 2010. From a valuation standpoint, the stock market is currently trading at 13 times this year's earnings outlook and 11 times 2011 forecasts. With these numbers, the market is currently trading at a 40% discount to its five year average P/E ratio. The one thing we do know is that stocks are either very cheap or earnings are way over stated. A good argument can be made by both sides, but as is normally the case, time will tell and we suspect that reality will fall between both extremes. The good news is that stocks are not over valued by most any measure, which provides downside protection.

There is no denying that there is a lot of emotion in the investment world today. Investors are understandably leery of the market after the collapse of two years ago. When emotion is injected into stock investing, whether it is exuberance or fear, volatility and unrealistic valuations inevitably follow. In both good markets and bad markets, investors often forget investing fundamentals and let emotion lead them to bad decisions. We recognize that investing can be very frustrating at times, but we also know that, over time, stock and bond investing are very good ways to reach financial goals. We are always available to discuss your portfolio, so please feel free to contact us to schedule a meeting.

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