

Thought for the Week: Monday, March 7th, 2011

Can an Injured Bull still Run?

Despite recent events in the Middle East, U.S stock indices took everything in their stride and continued to move upwards. On Jan 31st, the S&P 500 closed at 1,286; by the close on March 4th it had risen to 1,321.

The chart below shows the S&P 500 from early 2007 to last week – **clearly a “V” shaped chart.**



Now that we have celebrated the second birthday of the Bull market recovery, it's a good time to try and gauge **how far we have come and what might happen next**. Understanding the strength of the recovery is a useful metaphor. How strongly and quickly the market recovers from bad news gives us **an excellent insight into market sentiment and what may happen next**.

Although fundamentals tend to dictate the long-term movement of the stock market, **sentiment is a major factor in the short term**.

The Pamplona Effect

As the members of our investment team who have been to Pamplona to see the Running of the Bulls might put it: **The Bull is two years old and still appears to be running strong, despite periodic injuries** caused by bad news. How long can it keep charging and what type of injury might halt it?

In our opinion, the Middle East is an impediment to upwards momentum; however, El Toro still looks like it wants to keep charging.

Last week, restorative shots in the arm from manufacturing and employment data quickly dispelled any worries about the bull's current health. It can be stopped for a day or two but these “market matadors” can only inflict flesh wounds which **just seem to make the Bull angry and make it charge back for a day**.



Let's do a Health Check: we continually review the level to which the following factors are currently priced into markets:

Reasons the Bull still has a ways to Run

- Thus far, the recovery has been jobless and based on productivity. Employment is showing signs of strength which may help markets.
- Companies and economic data continue to improve. Although the overall market looks fairly priced, there are attractive sectors trading at discounts.
- Merger & Acquisition Activity is increasing which should be a boon to stocks
- Larger Companies and Developed Countries are now performing well.

Reasons the Bull Run may be coming to an End

- Government stimulus may have contributed to the elevated level of stocks. The end of Q.E. 2 in June is well within the sights of the market.
- U.S. spending cuts and the slowing of emerging market growth will have an effect on economic growth and markets in the near future.
- Oil and Food prices are potential headwinds
- Corporate Profit Margins appear to be peaking

Summary

- At this time, the crowd is cheering the Bull on; their **enthusiasm is moving prices higher**.
- There is definitely **more room for price appreciation** but don't expect this to be vigorous or untroubled. Stocks are still a good place to invest but a longer term approach should be more rewarding than the 'easy' returns of recent years.
- Recent volatility is a sign that **opposing forces are fairly well balanced**.
- Much of the positive news is already priced in and **the market will need more supporting data to maintain its current momentum**.
- The next move will depend on the direction of the next batch of economic data. **Economic growth prospects are the primary driver** of the market. Investors will try and assess the effect every piece of data will have on the U.S. and Global prospects for growth.

Our portfolios remain **positioned for a more mature Bull; a market that may move a little slower and not charge as vigorously**. A market which may not be able to shake off injury and disease as quickly as it did in its youth. But not an animal reaching the end of its life.