Infomail

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No Confetti, No Crowds

"An investment in knowledge pays the best interest"
Benjamin Franklin

Watching the American's celebrate Thanksgiving, with the traditional Macy's Parade and the associated crowds, it was interesting that three milestones in the U.S. markets were met in the past week with little fanfare.

The Dow-Jones cracked 16,000 for the first time, the S&P 500 breached 1,800 for the first time, and the technology laden Nasdaq crossed 4000 for the first time……since the year 2000.

There was no champagne popping, no balloons, and no confetti.

This has been one of the most unloved, most stealth rallies, I've ever seen in my tenure, and it continues to roll, but is barely a blip on Main Street's radar. Yet for all the articles about a bubble forming, they rarely happen when so many are calling for a top. And while many individuals are trickling back to equities, I would suspect it is mostly through a rotation from bonds, rather than chipping away at the huge cash positions still on the sidelines.

This transition is rarely an overnight phenomenon nor does it mean fundamentals are not critical to keep the rally going. While the bears have been calling for a correction/pullback for 6 months, it has now been 18 months or so since we've had a 10% pullback, which is rare since 2000 as many years have had several of those. I would suspect we will get some kind of pullback in Q1 2014, but again, think they will be short and shallow. I would also suspect we will have increased volatility in general in 2014.

With the bias firmly to the upside, the bears are desperate to derail things sooner than later. Their original argument was that the economy was too weak and sloppy to justify the rally. Now that there are noticeable improvements to the economy, their argument is that the Fed is simply supporting markets and once they begin to taper, all will fall. Personally, I find it hard to believe that after great efforts to keep the economy rolling the past six year, that the Fed will simply toss all those efforts out the door, especially with a Fed under Janet Yellen, who has been Bernanke's right hand woman.

If history serves as a guide, the first Fed-sparked pullback will be short lived and create a buying opportunity, but it might still be a few months away.

Last year (2012) saw the first positive cash flow into equity mutual funds since 2008. The approximately +$200 billion was but a trickle (mostly out of bond funds) of the amount which came out of domestic equity mutual funds for seven consecutive years totaling over $613 billion.

Since the 2008-09 cycle, US bond fund inflows have been as follows:

2009 $310 billion
2010 $246 billion
2011 $125 billion
2012 $304 billion
[Source: Investment Company Institute (ICI)]

But now, the great rotation (which we forecast here over a year ago) from bonds to equities has begun. Just look at the last few weeks:

Week of	Equities	Bonds
Oct 16	$2.8B	-$5.45B
Oct 23	$13.58B	-$2.38B
Oct 30	$7.94B	-$4.30B
Nov 6	$9.07B	-$4.26B
Nov 13	$7.25B	-$7.56B

[Source: ICI]

At some point, there is no question global economies need to pick up from 1-2% GDP growth. Will 2014 be the year "escape velocity" will descend on global economics, and if so, would mean much higher equity prices? This would mean central bankers finally achieve their much sought after goal, and all that cash behind bank walls would finally seep into Main Street.

The sooner the Fed starts tapering, the better. The Street was prepared for it in September, but it never came. That would simply mean the training wheels are coming off as the economy improves.

The fundamentals of the markets are not flashing a major warning signal, even with some at all time highs. Look at these comparisons:

	March 24, 2000	October 9, 2007	November 27, 2013
S&P 500 INDEX	1527	1565	1808
S&P 500 trailing P/E	28.3	17.6	15.5
S&P Dividends Per Share	$17	$28	$34
10 Year US Treasury	6.2%	4.7%	2.85%
Core CPI	2.4%	2.2%	1.8%
Unemployment Rate	4.0%	4.7%	7.3%
S&P rating of US Debt	AAA	AAA	AA

[Source: Bloomberg/Ned Davis Research]

So the arguments for the bullish case:

1) The recent US debt deal bought 3-4 months
2) Yellen will be no different than Bernanke (or Greenspan)
3) 2014 EPS expected to rise 10% giving a historically low P/E of 14X (since 1871 avg. is 15.5X)
4) Global economies are improving
5) Bond rotation to stocks
6) Corporate balance sheets are best they've been in decades
7) With interest rates to remain low, equities only game in town
8) This rally gets almost zero respect

For the bearish argument:

1) US debt ceiling comes up again early 2014
2) US national debt is getting scary (over $17 trillion)
3) QE's effects are diminishing
4) Interest rates are headed higher

5) The US economy is not getting better. It’s stuck in 1.5-2% range, retail sluggish, no job growth.
6) Markets have become addicted to QE and Fed stimulus. As soon as they stop, will hurt.
7) Currently a buy the dip mentality

To be sure, the debate will rage on. In 2014, don’t be surprised if at times the markets react negatively to good news. Yes, markets are cyclical, always have been, always will be. Every day we don’t go down brings us closer to a correction, but it also brings us one day closer to the next all time high as well.

Stay tuned,

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