Market Bubbling Amid Mid-Term Election Year Malaise (*SB News-Press*, February 1, 2014)

(Santa Barbara News-Press, February 1, 2014 – Business Section) The recent sell off of U.S. stocks has everyone clamoring for explanations of what is going on now, and what to expect for equity markets in this interesting mid-term election year. Beginning with the start of fourth-quarter 2013, over 20 major stories hit the print, television, and online media calling for a 10-percent correction coming in order to let out some air from the Wall Street valuations bubble. So with the Dow Jones at 14,777 early last October, that projected 10-percent redux would be a 1,400-point drop into the 13,400 range, while the tech-oriented NASDAQ would need a 370-point drop into the land of 3,300 – with the S+P500 giving up 165 points to under 1,500.

But the fourth quarter turned into a buying spree for investors across-the-board – from individuals to mutual funds to large pensions and even hedge funds. In just 3 months' time, the DJIA rose 1,800 points, or 12.2 percent to 16,577. The NASDAQ jumped 500 points, or 13.6 percent – while the S+P climbed to a record 1,848 – up 11.5 percent. This sealed 2013 as one of the best years for U.S. equities in more than a decade, with 12-month gains of 19 percent for the Dow-30, over 32 percent for the NASDAQ, and 23 percent on the S+P500. All the previous naysayers appeared to have misread their negative prognostications.

The first three weeks of January included the disappointing news that December added only 74,000 new jobs (70 percent lower than the near quarter-million expected by most economists). This was followed by negative reports of a significant slowdown in Chinese manufacturing, as everyone wonders whether the world's second-largest economy can continue non-stop 8-percent growth. Mix in continued concerns about the Fed's tapering of its bond-buying (to keep interest rates artificially low), and the markets seemed poised for that expected correction. But stock trading barely responded, with a flat three weeks for the DJIA and S+P, and even a modest 2.5 percent uptick in the NASDAQ. This kept investors and the media questioning what kind of news would be required to initiate the much-anticipated market devaluation.

But in the past week, markets experienced an erratic sell-off, driven primarily by declining economic forecasts for the world's emerging markets in developing countries. Heading into this press deadline, the S+P has shed near 100 points (5 percent), the Dow 700 points (over 4 percent), and the NASDAQ 200 points (almost 5 percent) – all since January 22nd. The thinking seems to be that as the Fed allows interest rates to gradually move higher to true market levels, capital that had been seeking better returns in emerging markets will now stay at home, reducing new investments in these developing economies. A quick review of this week's updated opinions for many economists is that, factoring in this recent short-term drop in stocks, maybe the major correction is not coming, because: 1) the U.S. still has low inflation, 2) short-term money remains very inexpensive, 3) continued (albeit, modest) GDP growth is expected for the rest of the year, and 4) corporations are generally in pretty good financial condition.

Now that President Obama has disclosed his 2014 wish-list in Tuesday's state-of-the-union, the most appropriate descriptor for the economy and the stock market through 'til Tuesday, November 4th is malaise (*Merriam-Webster:* "out of sorts, uneasiness, a condition that harms or weakens a group"). He has executive-ordered: 1) the

Treasury to launch "My R.A." savings accounts that will be backed by the federal government, 2) raising the federal contractor minimum wage to $10.10 per hour, and 3) 'Oh-No-Joe' Biden to "review" federal job training programs. None of these will have any measurable impact on helping grow the U.S. economy. And in keeping with his strong track-record of no plan or sustainable results for job creation, the president will community-organize a group of hand-picked CEOs to discuss how to get the unemployed back to work, giving special attention to hiring workers who have stopped looking for full-time positions (interestingly, those are the folks no longer counted in the denominator of the U.S. unemployment rate).

Given the president's current 40-percent approval rating, and mid-term elections coming up in nine months – when the House is widely expected to remain a Republican majority, it's a virtual guarantee that Obama will literally get nothing done in 2014, before moving into final and complete lame-duck mode with a split Congress for his last two years in office. Perhaps that last sentence should be inserted to the dictionary as the epitome of economic-political malaise. A week ago, Peggy Noonan's WSJ article correctly observed (prior to Obama's speech) that "no one's really listening to the president now". So what do the equity markets have to work with in building sales and earnings forecasts for the remainder of this year, 2015, and 2016? Are there strong enough fundamentals underlying U.S. stocks to avoid a major price correction in this midterm year?

The case could be made that U.S. stocks were overbought during the IVQ-2013, so the recent decline is simply adjusting for investors taking their short-term 90-120 day profits. The major concern is that all likely growth prospects across all industries has already been factored into current equity prices, so with conceivably three years of lame-duck malaise in Washington, there's really no way share prices can go any higher. Remember that uncertainty is what hurts corporate expectations, so the irony could be that Obama's upcoming three years of complete inactivity may actually be the 36 months of basic certainty the markets need to secure solid financial projections.

Company earnings were up on average 11 percent in 2013, but they won't be able to match that this year because there won't be strong enough job creation and GDP growth. And higher interest rates are coming – so bond prices will fall, while all costs of borrowing (personal, business, federal government) will increase, and inflation will then likely resurface. So this mid-term year – and the two that will follow – are poised for continued indifference and no big upside to drive the DJIA to 18,000 – the NASDAQ to 5,000 – and the S+P to 2,000 any time soon.