Title: Our Mid-Term Election-Year Market Outlook
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Date: May 1, 2014

The Lane Report: May 2014

The stock market was very strong in 2013 with the S&P 500 index finishing at 1,848, up 32%. This was the best annual gain for the index since 1997. All of the ten sectors in the index generated positive returns. After such a strong year, our outlook is more benign yet still positive for the balance of this year.

As of this writing, the S&P 500 is less than 1% above its year-end close while the DJIA is 1.4% below its close. This, however, masks the significant volatility that we've had so far this year compared to all of 2013. The first quarter 2014 saw 13 days with 100+ point gains in the DJIA and 10 days with 100+ point losses.

Despite rising margin debt and more new initial public offerings than any quarter since 2000, fundamental, technical, monetary and sentiment indicators continue to point to further gains for this market. Margin debt as a percent of GDP now exceeds the previous peak of 2007. Once these levels begin to decline, the risk of a bear market will begin to increase. The IPO levels today are not as high as they were during the 1999- 2000 dot com era, nor are the valuations as extreme. Nonetheless, this bears watching closely as extremes in new issuance generally come closer to the end of a bull market than to the beginning.

While U.S. equity market valuations have increased, we believe valuations are still reasonable: The S&P 500 traded at 17 times forward earnings at year-end compared to its 10-year historical average of 16 times. We now are in the second year of the Presidential election cycle, which since World War II has seen the lowest annual stock market returns. And the second and third quarters of the second year have been the poorest of the four year cycle. This seemingly provides an investor an easy strategy: sell now and wait for the smoke to clear. Of course, it is never that easy. There are transaction costs to pay and perhaps capital gains taxes. And then there is the matter of timing. When to sell and when to buy again is never an easy decision. More often than not, market timers get whipsawed, buying back their stocks at higher prices than when they sold. More encouraging is the fact that the fourth quarter of year 2 and the first two quarters of year 3 are the three best quarters of the four year cycle. This would indicate that it is best to ride out any short term volatility in the expectation that better times are just ahead. Also, with the notable exceptions of the bear market years, the average sell-offs during the second and third quarters of year-2 have been mild. Finally, positive second and third quarters are just about equal in frequency to negative quarters, bear market years included. This would further complicate any strategy involving market timing.

So, with the headwinds including margin debt, new stock issuance, and the election cycle, why are we still bullish? Simply stated, there will be no recession in 2014! Since the end of World War II, seven of the ten bear markets have included a recession. The U.S. Leading Economic Index continues to hit new highs and it has been above its eighteen-month moving average since 2010. The peak in the LEI nearly always leads the next recession by at least eight months. There is no weakness evident in the more cyclical sectors of the market: the consumer discretionary, financial, and industrial sectors. Worthy of note is that the quality of earnings of U.S. banks is much higher than in 2008. Since the recession of 2007 - 2008, banks have been forced to maintain higher capital, greater liquidity, and certainly greater regulatory oversight than before. All of this serves to reduce systemic risk. Bank profitability would also improve as the yield curve steepens as they would have more incentive to lend their 0%-cost deposits, a fact not lost on those economists who fault the Federal Reserve for maintaining artificially low short term interest rates.

In our opinion, developed-market stocks should continue to benefit from global growth for the next several years. Although stock prices may be more volatile this year, investors who stay focused on the long term should be well rewarded.

For more information about Marc J. Lane & Company and Marc J. Lane Investment Management, Inc.'s capabilities and services, we invite you to contact Marc Lane, in confidence, at 312/800-372-5000 or mlane@marcjlane.com.

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