Market Update: 2/3/2014
Written by: Doug Ciocca

When I reached out last week with a market update, I wrapped by referencing the *Super Bowl Indicator of the Stock Market*. You may recall: if the team representing the NFC wins the Lombardy Trophy, there is an 80% chance that the stock market will record a positive year of performance[1]. And last night, the collective sigh of investor relief could have propelled the confetti skyward that victoriously showered the Seahawks.

Even the stock market futures (derivatives contracts that provide directional data on traditional equity indices outside of normal market hours) were nicely positive before I dozed off.[2]

But the market woke up in a much different mood. Asian markets were weak – the Japanese Nikkei 225 Index actually breached a 10% drop from its near-term peak, crossing into what is known as "correction" territory – and markets in countries such as Australia and India could muster no strength.

The catalyst for the persistent pressure remained the "emerging markets": their weak currencies, haphazard monetary policies and precarious growth outlooks.

There are economic expansion concerns in these developing countries known for their rich natural resources, inexpensive labor forces and aspirant living standards.

And all of these concerns drive off of reduced demand – demand ***for*** their raw materials and employee bases and demand ***by*** their populace.

The demand ambiguity is a function of many cross-currents, but most notably: theories of a more vibrant developed world, able to profitably meet production quotas, thereby offering investors attractive return potential with prospectively less risk. (Emerging markets are perceived to possess greater risk due to their relative youngness on the global economic scene, and theoretically compensate by offering higher returns).

The developed countries are the big boys – for instance Japan, Germany, UK, and the biggest boy, the US. And when the biggest boy reported 2 weak data points after the open of its stock market, angst elevated that the aforementioned theory may not hold water. Subsequently, investors did not want to hold stocks.

The data points of note: a gauge of US manufacturing activity expanded at its weakest pace in eight months (also well below consensus estimates of its level) and total vehicle sales were less than had been expected.

So, with the Dow Jones Industrial Average off 7.26%[2] and the S&P 500 down 5.76%[2] to start the year, there is constant chatter about the prospects of the US market being headed for a correction of its own?

That question is answerable only with the benefit of hindsight, but Newtonian principles of motion tend to dominate emotion in the midst of market meanderings.

However, consider that almost 5 years later, there is no known reason why the market found its bottom on March 9, 2009. The same holds for the pivot points in 2002, 2011 and even last year's nadir after a 5.76% (coincidence…..yes, probably) drop in May and June.

The point is that the recent spate of volatility will most likely end without any necessarily identifiable point of attribution. But it will end.

Arguably its end will arrive inversely proportional to the length that the consensus presumes it will extend.

As you may have read, going into 2014, it was a fairly common amongst the investment glitterati (yes, they exist) to predict a financial market follow-thru from 2013 - strong stock markets, wobbly bond markets and weakness in commodities.[3]

I don't think we should expect retractions because stocks are down, bonds are up and gold is at 3 month highs to start the year, but I do think that it underscores the following: being in the prediction business is difficult.

We prefer to take a different path. We prefer to employ measureable quantitative metrics to identify value. As stocks tend to price off of earnings and interest rates, we search for companies that have sustainable cash flow generation and consistent returns on capital (it's a lot easier when capital, as a proxy for interest rates, is cheaper!)

When we make loans, in the form of bond buying, we want to get paid a reasonable level above our expected rate of inflation, on an after-tax equivalent basis and we certainly want to get paid back – heightening out intensity on credit analysis.

We've been looking for bargains as this year has progressed and are confident any of the mutual fund managers whose funds we incorporate into your allocation are doing the same.

It is hard to believe that we are already in the second month of 2014, especially since I still find myself wishing people a Happy New Year, but as fast as it has gone, it is going to be a long year.

Patience may be more pertinent this year than last. Reinforcement of the balance of portfolios and the bias of expected returns within certain classes of assets is not driven by the calendar, but by the objectives of our clients in collaboration with our team, respectively.

We'll keep in close touch as the market gyrates – and that is not a prediction. That is a promise.

Have a great night, dc

[1]http://www.investopedia.com/terms/s/superbowlindicator.asp
[2]Source: Bloomberg Market Data
[3]http://online.barrons.com/article/SB50001424053111904246304579304173748744570.html

IMPORTANT DISCLOSURES

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