February 2014

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Stocks Slumped in January: What's Next?

After a great 2013, investors have struggled out of the gate in 2014. It is hard to pin point the stock market sell-off early this year. So far reports show total earnings for the 219 companies that have reported are already up 9.6% year over year with 70.8% of companies exceeding their earnings estimates. Sentiment got so elevated from 2013, that it didn't take much to drop stocks.

I predicted in my last newsletter that volatility might pick up this year; I just didn't know we'd see it so soon. We saw two down months in 2013 which tended to be quite tame. I would expect to see a little more continued volatility in 2014.

Some analysts explain this most recent sell-off by looking at investors rebalancing their portfolios. Some mention the emerging market worries with China's manufacturing slowdown, currency instability, and others worry about the Federal Reserve tapering. Whatever the cause, it seems like a "shoot first and ask questions later" mentality in January.

Over the last several years, while the economy has continued to grow little by little, we have witnessed several opportunities to fret - the BP oil spill, Greece, Italy, Cypress, the Middle East crisis, budget debt ceilings, the Government partial shutdown, sequestration, and Fed tapering just to mention a few.

Overall, it seems like the driving fundamentals have not changed. The following factors instill optimism:

- Tons of global liquidity
- Home prices have given consumers a little cushion
- Oil prices are lower
- Incomes are increasing, unemployment rates have gotten somewhat better
- Government spending as a percentage of GDP is 21% today versus 25% in 2009
- Interest rates are low
- Inflation is benign
- Stock dividends are increasing along with stock buy backs
- Innovation, productivity, and the medical sciences continue to surprise
- The renaissance in manufacturing and energy should provide a boost

The markets could sell-off a little bit more early this year, but I am not in that panic selling camp. Rarely does that make sense. You may hear some bearish forecasts, but I do not think anything fundamentally has changed.

It is true; the core problem for global investors is that stock valuations have risen a lot over the last few years and, historically, no longer seem cheap. We are roughly at the "fair value" historical median. We are due for a stock market correction sometime this year.

So what do investors do?

Keep a long-term focus. Remember, bull markets do not exclude the possibility of corrections from time to time. In fact, the large stock market correction in 1987 was mixed into a great long-term investment cycle. Bull markets never go up in a straight line, so we should always be positioned to ride out market turbulence.

Buy on the dips, diversify, rebalance, and invest in non-correlated assets. That is what we are trying to do in our clients' portfolios. The Fed's commitment to spurring faster economic growth has not altered. Patience is always an investor's best friend.