Friday, August 07, 2009

Climbing the "Wall of Worry"

The best news of the week comes today as the Labor Department says that job losses are slowing. Payrolls fell by 247,000 workers, after a 443,000 loss in June. The jobless rate dropped to 9.4% from 9.5% last month. It is the clearest sign yet that the worst recession since the Great Depression is coming to an end if it has not already ended. Stocks jumped on the news taking the S&P 500 to a new high since the March 9th low. The index is now up more than 50% since that watershed day when Citigroup CEO Vikram Pandit told employees in an internal memo that the bank was having its best quarter since 2007 as well as comments from regulators suggesting that they might reinstate rules to limit short selling. Nearly $4 trillion in value has been returned to investors during this timeframe.

Markets gained further energy in July on the success 'cash for clunkers' program had in stoking auto sales, rising retail sales, improving housing starts, and slowing housing price deterioration, and surprisingly good corporate earnings. There is also the strong suggestion that the market has been rising on the possibility that President Obama's drop in popularity due to increasingly unpopular healthcare reform will bring future congressional gridlock, stalling or toning down both that legislation and other large spending initiatives.

House Speaker Nancy Pelosi's made a rather visceral attack this week on the health insurance companies calling them villains and saying "they have not made America healthier. They have made health care more costly and it is important for us to have this legislation that puts the leverage back in the hands of the patients."

Economist Dr. Ed Yardeni responded with some very interesting facts to dispute Ms. Pelosi's claims and those of others pushing for speedy passage. His remarks are presented in their entirety:

> "Really? Let's consider the facts. Life expectancy rose to 77.7 years during 2006, up from 74.8 twenty years ago. Medicare, which is operated by the federal government, is spending $11,064 per senior citizen over the past 12 months through June, up 87% since 2000. During 2007, Medicare spending accounted for 22% of total national health care spending, varying by type of service: 41% of home health care, 28% of hospital services, 20% of physician services, and 21% of prescription drug spending. According to the Kaiser Family Foundation, Medicare spending per beneficiary varies, with the top 10% most costly beneficiaries in Medicare accounting for nearly two-thirds (63%) of total Medicare spending in 2005. Average Medicare spending for the 4% of beneficiaries who died during 2005 was nearly four times greater than for other beneficiaries ($23,047 vs. $6,351). Could it be that Medicare is contributing to the rising costs of health care?
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> Ms. Pelosi also claimed that the insurance companies "have been the ones with the exorbitant profits and immoral decision making in terms of coming between patients and their doctors." Really? Joe and I monitor the profit margins of most of the major S&P 500 industries using forward earnings. S&P 500 Managed Health Care includes six companies (AET, CI, CVH, HUM, UNH, and WLP). Their trailing four-quarter composite operating profit margin was at a six-year low of only 4.3% during Q1, well below the 7.3% of the S&P 500 Industrials Composite. On average, it has been 2.9 percentage points below the S&P 500 Industrial Composite's profit margin since mid-1996!"

Dr. Yardeni continued by saying "the good news is that Congress is on vacation and that our legislators left without voting on any health care bills. Hopefully, they will find that the majority of their constituents are opposed to NancyCare. If they vote it down in September when they return to DC, stock prices should continue to rise. Gridlock is bullish."

Before they left for their summer break, the senate managed to tack on an additional two billion dollars for the 'cash for clunkers' program and the President signed the bill today. As a result of the program so far sales of North American made light vehicles jumped to an 8.3 million annual unit rate in July for a more than 15% rise from June. But the program is not an unqualified success as sales for Toyota, Mazda, Nissan, and Honda are slightly ahead of GM and Chrysler (those imported cars do not qualify for the program).

Corporate profits for S&P 500 companies are falling for a record eighth straight quarter, yet results are surpassing projections by an average of 10% this quarter. Per-share earnings have beaten estimates at 75% of the 446 companies of the S&P 500 that released second-quarter results since June 17, according to data compiled by Bloomberg.

Stocks are rising in the Dow and the S&P 500 indices, but they are rising even faster abroad. Year to date, the S&P 500 is in 31st place globally. The index remains heavily weighted to the US, European, and Japanese economies which are lagging in their recovery relative to some faster growing emerging economies.

While we believe the economic recovery is indeed underway and that the recession is likely already over, it is apparent that the market has been anticipating recovery since March. There has been little irrationality among investors as the market climbs the "wall of worry." In other words it has risen persistently these past four months amidst both good and disappointing news. In essence, the bad news keeps the speculators at bay. Prices are thought to rise more rationally.

But as many investors have waited for more concrete news of recovery, they may now fear that they are going to miss the rally if they don't jump in. Numerous strategists are predicting that the market may rise an additional 10-20% this year adding fuel to their interest. But recent momentum may be a bit ahead of the supporting data, so we caution against panic buying.

Our best advice to our clients and friends is to avoid entirely the temptation to react to the market's gyrations, up or down, allowing your emotions drive your investment decisions. By taking a disciplined approach to market uncertainty and volatility as they impact your specific plan for savings and distribution, you afford yourself the opportunity to make modest adjustments along the way to stay on track, rather than major adjustments when the capital markets misbehave. We believe our Wealthcare approach is the best in the industry for helping our clients *reduce risk and live confidently™*. Please give us a call if you wish to learn more.

Have a good weekend.