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7th Inning Stretch!

First, a follow up mention to our previous comments on the Brexit market move. The World's stock markets lost a total value of approximately $6.5 Trillion over two days (and hence recovered some). The total annual GDP of Great Britain is less than $3 Trillion. It does 4% of the World's GDP… but world markets lost 7%... Can you say "overreaction"?

Many of us in the financial service industry like to use sports analogies, especially baseball. So, when recently asked where we are in the current economic cycle, I used baseball terminology and stated that we were probably in the 7th inning. I then remembered that I have left some games in the 7th inning – should I be thinking of leaving this "game", and to start reducing my equity positions? Hmmm. Well, the conclusion is not yet. There is still plenty of time (probably 2 years) and we don't want to miss the action.

Going into mid-year, we are pretty much where I thought we would be… up 3-4%. I must admit that after the January shock (Holy Toledo Milo!), it was a little "disconcerting". So, what to expect in the second half of 2016? More of the same or slightly better! Here is what we see. First, corporate earnings should be up around 5% this year, so equity prices should correspondingly be up 5%. But as the recent increase in employment slowly filter through the economy, this should provide a little wind at our back. Next, the dollar stabilizing and slightly weakening should add at least 1% to the U. S. market. Third, energy stabilization should provide another 1%. That is 7%, and if you add 1.5% for dividends, you get 8.5%. But historically speaking, at this stage of the cycle, one would expect P/E multiple expansion. It's fairly common to see a 1% rise in P/E ratios at this time. It should also be noted that equity money had a large outflow last year (and early this year), and bonds had a large inflow. This door swings both ways, almost annually. Once interest rates look like they finally will rise (we could see two more rate increases this year by the Fed), money will leave bonds and head back to equities. Hence, an additional 6% increase in equities is not out of the question.

Last year we had three major surprises. China weakening, oil falling, and the dollar rising. When it is all said and done, we had a flat year. We WILL have another shock. It just happens. But when 12-31 rolls around, don't be surprised if we are up 5-8% from current levels.

One final thought. When we start to reduce our equities, I am suggesting a hybrid or balanced investment, not necessarily going to cash. Start thinking about a 30-40-30 portfolio, where 40 is the balanced. Nuff said, and Happy Birthday America!

If you would like to discuss the market and/or your account(s), please call me at 713.428.2050, x2 or via email to josborn@houcap.com.

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