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First Quarter 2015 Comments

Something for Nothing

As we stated earlier, we expect 2015 to have an "ok" earnings year. As the first quarter is unfolding, we have S&P 500 company earnings to be 78% positive upside surprises. Unfortunately, many have a tepid outlook for the remainder of the year due to the strength of the U.S. dollar, which makes our exports more expensive. We do have a benefit, which has yet to be realized, and that is cheaper energy. This will eventually be reflected in corporate earnings, especially manufacturing, transportation, materials and utilities. Since oil is traded internationally in U.S. dollars, the domestic benefit is much better than overseas.

The bottom line is that we expect corporate earnings to be up only about 4 – 6% from last year (or around $122 per share). The point I want to make is that, with our valuation method, the market is "fairly valued". It is not that we don't think it will go higher, but just not much. Traditionally, Bull Markets go to (sometimes extreme) overvaluations before they correct. But if we only expect an 8 – 10% year, and we get up 4% in early March, we may be in a trading range for the remaining part of the year.

When I wrote back in Mid-November that the market was going to go up and not down, it was based almost purely on valuations. The market was around 16,100 and now it is at 18,100. That is over a 12% increase in about four months. Too much too fast.

The problem is what to do? As we stated in our previous letter, we are looking more toward large caps than small caps. We are now leaning even more in that style – large, dividend paying stocks and funds. Cash is not an alternative (well, for short periods it is), and bonds will be lucky to have much of a gain over the next twelve months. So we are maintaining our asset allocations, but just "pulling in the reins" a little. We are not in an overvalued state yet, just fairly valued.

It may get a little bumpy, but it will be okay. Keep the faith!

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