

"Cup of Joe"

Over the past two years, our "Cup of Joe" market updates have been on the tepid side of optimistic. Slow growth, an oil collapse, a China slowdown, high-yield fears, the Brexit, etc. have dominated headlines as we watched the markets move sideways. We are finally back to new highs. This gives us the opportunity to recap what we have learned, and emphasize the reasons for optimism.

When the market is flat, it can be frustrating on many levels. But, when you look back and really analyze what events were taking place, things have gone surprisingly well. We have weathered a historic collapse in the price of oil. This event cost our country 200,000 jobs, hurt the high-yield bond market and crushed about 12% of all of the stocks (EXXON, etc.) in the S&P 500. Not only that, it resulted in the oil exporting countries (Saudi Arabia, Brazil, Venezuela) to liquidate massive amounts of stock in their countries sovereign wealth accounts to fund their budgets (remember, they are dependent on the oil revenue to feed their people). In addition, this mass selloff was exacerbated by hedge funds and short sellers trying to make a quick buck and artificially forcing the markets even lower. You can see these pullbacks and their abrupt snapbacks in any chart of the S&P 500 for the first six weeks of this year. Adding insult to injury, slow GDP growth and lower productivity numbers created a perfect storm of negative news. And don't forget about the Brexit (where the voters in Great Britain decided to leave the European Union) creating a massive amount of uncertainty surrounding the future of the EU and its member countries. Oh, and just to throw one more little tidbit into the equation - we are 8 years removed from the worst economic collapse since the Great Depression. A study by Reinhart and Rogoff revealed that middle-class incomes do NOT rebound from a major banking crisis for 8 years. That's good news and seems to be accurate, considering we are now experiencing wage growth in 2016, 8 years from the date of the financial crisis. This would also explain the lack of consumer spending we have experienced until recently.

All of that happened in a span of 2 years…pretty wild! And that brings us to today. So, why aren't we focusing on all of those past events? Because we are fundamentally in good shape! Let's take a closer look at the data points:

- 4.9% unemployment
- The Bank of England launched a new stimulus package to keep Britain out of recession
- Oil has rebounded from its lows of $26/barrel, buoying the high-yield market and staving off mass energy defaults

- Tons of money on the sidelines that needs to find a home
- A dovish Federal Reserve Bank keeping accommodative monetary policy in place for the foreseeable future (interest rates lower for longer)
- Energy sector earnings are improving, which will help the S&P's valuation
- Consumer spending is up (finally people feel better about their financial situation)
- Mortgage rates are historically low, providing support to the housing market
- China auto sales are up the most in 17 months (Chinese are spending again)
- Markets rebounded from the Brexit in 2 days
- Huge jobs number beat, last week adding $255k jobs
- If oil stays around $40-50/barrel for the foreseeable future, this is an ongoing stimulus package for the American consumer, now in the trillions of dollars
- Americans are busy paying off their debt
- The bull market did not start in 2008! It started in 2013 when the market gained back what it had lost (therefore, the bull market is really only 3 years old and counting)
- Valuations based off of trailing earnings numbers seem high (taking into account the energy collapse). With energy projected to recover into 2017 (forward earnings projections) and interest rates incredibly low, valuations seem very reasonable.
- If you believe in the FED MODEL, markets usually don't sell off when there is a huge market premium, i.e. 10-year treasury bond currently pays 1.6% vs the historical stock market return average of around 4% and the S&P dividend yield over 2% (that's a 6% average total return). With tons of money on the sidelines, equities still look very attractive in relation to interest rates.
- Rebound from the earnings recession is in the cards (companies are starting to post healthy earnings numbers)
- Money invested in the international markets not only provide diversification for our clients' portfolios, but provides over a 30% discount to the U.S. market valuations

Here at CHIA, we have even more reason for optimism -- APPLE! If you examine Apple stock, you would discover that the stock price is very cyclical. The stock does well when new product cycles are announced and does poorly when they are in between new phone cycles. To make matters worse, traders know this and they exacerbate the sell-off. Apple is about to enter into what is perceived to be a huge upgrade cycle, with new phone technology about to be released in the iPhone 7, and further out, the iPhone 8. Warren Buffet seems to agree as well as he has loaded up on Apple shares once again, bringing his tally to 15 million shares. Apple is also extremely cheap relative to the market as a whole. Apple trades at 12x earnings, whereas the S&P 500 trades over 20x. It also pays a 2.12% dividend and has over 200 billion in cash reserves. One final point to make on Apple: most of our clients think short-term and have seen Apple decline over 10% in their portfolios. What most don't realize is that we are way above where Apple was originally purchased. The recent sell-off was just giving back some of the profits. Remember, stocks do not and cannot move higher and higher without a pullback. If it did, that would cause a bubble in the stock's price.

To recap, the market looks to be regaining steam and putting much of the negative noise on the back burner. As oil slowly starts to creep back towards $50/barrel and we find out who will be the next President of the United States, the market should gain more confidence and trudge higher. In the short term, we realize that markets do not move in straight lines and pullbacks are normal. To be a long-term investor, one must be comfortable riding through the soft patches or market declines and accept the volatility because, in reality, this is how the stock markets move. The media likes to sensationalize the speed bumps discussed earlier, but with strong fundamentals on the horizon, a dovish FED and interest rates still historically low, we feel optimistic heading into 2017.

As always, we thank all of our clients for your business, your referrals, and your patience through tough economic times as we look forward to a prosperous future. Have a great rest of your summer and feel

free to check out some of the interesting articles we have listed.

-Joe, Ryan, and the Chapel Hill Investment Team

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