



## **Gump Pong November 14, 2011**

In the past three months, the behavior of the stock market has been a lot like Forrest Gump [practicing ping pong](#) - blazingly fast and completely mesmerizing. After zoning out for a while, I had to ask myself, did that really just happen?

I've experienced many ups and downs in the stock market over the last twenty-five years, but rarely have I ever seen so many high speed, directional changes compressed into such a narrow period of time. By my count, the S&P 500 experienced four round trip volleys of ten percent or more since early August, before moving to higher ground in late October – all on lighter than normal volumes.

Economic and political uncertainties in Europe are certainly playing a role in the volatility, but to be frank, concerns about Greece have now been with us for more than eighteen months, suggesting that other factors may be at work.

The low trading volumes during such extreme moves may suggest a lack of conviction by the majority of longer term participants in the equity markets, many of whom may be sitting on the sidelines as mesmerized by the new world order of risk on, risk off trading as I have been. The proliferation of exchange traded funds and their day to day influence on the markets has no doubt had an overwhelming influence on macro oriented moves by the stock market, leading correlations among individual stocks and asset classes to historical highs.

In the age old battle for relevance between top down economics data and bottoms up earnings reports, earnings finally appear to have won the most recent skirmish. Over the summer months, the macroeconomic data pointed to an imminent recession even though most corporate management teams remained largely upbeat, and in my experience, were more perplexed by the disconnect between what they were seeing in their businesses and what they were reading in the papers than I've ever seen before. Insider buying trends reached historical highs this past summer, reflecting the notable disconnect.

In this sense, we knew that this earnings season was setting itself up to be an important and potentially outsized catalyst for the stock market, and on that front, it did not disappoint. Driven by continued earnings strength and guidance commentary, the S&P 500 finally powered beyond its summer resistance levels and is now bumping up against prior 2011 level support areas of 1250-1300. Recent macroeconomic releases also appear more encouraging, with many leading economic indicators turning positive.

While the stock market's recent breakout has been positive, we would caution that the move has once again occurred on light trading volumes, suggesting that investors shouldn't get carried away with or begin to believe that a new investing era is upon us. In spite of the market volatility, our long term views remain unchanged. "Slower growth for as far as the eyes can see," remains an appropriate mantra, we believe, in guiding our overall investment strategy.

Of the factors that will restrain growth, the European headwinds remain intense, with Germany – once the strongman of Europe - now on the brink of recession. At home, progress by the Super committee charged with finding \$1.2 trillion dollars in deficit savings this month isn't all that encouraging, making us look a lot more like Europe than we might care to admit. The domestic housing market remains mired in a depression and while it may be small in size relative to the overall economy, there is no doubt that its influence is far greater given its impact on labor mobility and credit.

Of the factors promoting growth, many American corporations are stronger than they've ever been, reporting solid earnings gains and healthy business outlooks. Most foreign central banks are in easing mode and China appears to be turning the corner on its inflation problem. Leading economic indicators have begun to improve, suggesting that cyclical factors could provide a near term boost to the economy and stock market. With net hedge fund exposure to equities near historic lows last seen in March 2009 – in hindsight, a great time to buy - the firepower exists for a sustained up move when any semblance of market conviction returns.

In the short term, the stock market may get a boost from the cyclical benefits of an improvement in leading economic indicators and sentiment, but sustained outperformance in a period of slow growth will likely remain heavily dependent on innovation as the cycle most relevant to long term value creation.

While the picture isn't pretty, it isn't nearly as ugly as it feels at times. If you find yourself discouraged, just zone out to a good game of [Gump Pong](#) and everything will be okay.

Kindest Regards,

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