

Financially Speaking

With Trisha Arndt, CFP®

Another Rollercoaster Ride on Wall Street

I don't know about the rest of you but the older I get the less I like the "big" rides at amusement parks. Where once I was happy to wait in line for the chance to feel my stomach drop as I plummeted straight toward the ground and whooshed back up, flipping upside down along the way, I'm now pretty content to ride in the little convertible cars with my four year old.

Frankly I think a lot of investors are feeling the same way about the stock market.

Where once the excitement and allure of the possibility of striking it rich with that one timely trade (remember the internet bubble and day trading frenzy anyone?) seemed to outweigh the fear of losses, investors are now panicking at the first sign of declines.

This certainly has been an attention-grabbing several weeks for the global stock markets, punctuated by extreme volatility in both directions. In the week following Standard and Poor's downgrade of United States government debt, we saw the stock market (as measured by the S&P 500 Index) swing several hundred points each day, alternating between losing several percent and gaining back several percent. For a few days calmer heads seemed to be prevailing and the extreme swings took a break but investors are reacting with "sell first and ask questions later" to any bad news so I'm afraid the ride isn't over yet.

So what is causing all of this volatility? It's fairly clearly not the corporations the stocks represent. Second quarter corporate earnings announcements are almost complete and were once again even better than expected. A full 72% of companies have beaten expectations and provided generally positive profit guidance for the full year. Corporate balance sheets on average look extremely good and interest rates are low - and according to the Federal Reserve they are going to stay low for at least two more years. By many measures of valuation stocks at current prices are selling for far less than what historical guidance would imply they should be.

If the companies that stocks represent ownership in are generally doing well than why would stock prices be falling? One word – fear.

This correction was brought on by a lack of confidence. There is a general lack of confidence in our political leaders (both in the US and many European nations), a lack of confidence in a continuation of growth in the global economy and frankly a fear hangover on the part of many investors following the severe market sell off during the Great Recession. The painful memories of the havoc the Great Recession played on investment portfolios is so fresh in people's memories that the mere mention of the word "recession" sends shudders down the backs of investors.

I'm not going to sugar coat the situation, nor do I have my head in the sand. The global economy is not growing as quickly as we would like to see it and a recession, while not a foregone conclusion, is a very real possibility. BUT - this is NOT 2008 all over again. In fact things are extremely different in many ways. We are not on the brink of collapsing a bubble of excess like we were then – there is no bubble to burst. If you want to use the roller coaster analogy as an example, in 2008 we were sitting on the top of the American Eagle and today we've maybe climbed up the kiddie coaster at Hometown Days. Recessions are actually fairly common and have historically occurred ever few years. The Great Recession was an anomaly – and hopefully a one time event.

So where do I see stock prices going from here? I'm frankly not sure over the short term. While corporate fundamentals would lead me to believe that stocks are significantly undervalued and could be due for a nice bump in prices, the uncertainties in Washington, Europe and with the global economy in general could trigger an additional decline. One near term concern that I have is actually the fear factor itself. Extreme fear of a possible recession amongst investors can actually become a self fulfilling prophecy. If people panic, pull money out of long term investments and stop their normal spending they can trigger the very recession that they fear by their own actions.

Over the longer term though I continue to have strong convictions about good quality stocks, especially given the positive position that many corporations are in today and the prospects for significant revenue growth as the emerging markets continue to expand (remember that many US companies today derive more than 50% of their revenue from outside the US - our economy doesn't have to grow for their profits to rise). A large number of corporations today are paying annualized dividends of over 2-3% per year. In an environment when savings accounts are often yielding less than 0.5% those dividends should look even more attractive than normal.

As we continue to work through this volatile time I would encourage you to keep sight of your long term goals and view your investments through the perspective of your personal time horizon. For those with enough time, price declines can provide a buying opportunity.

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