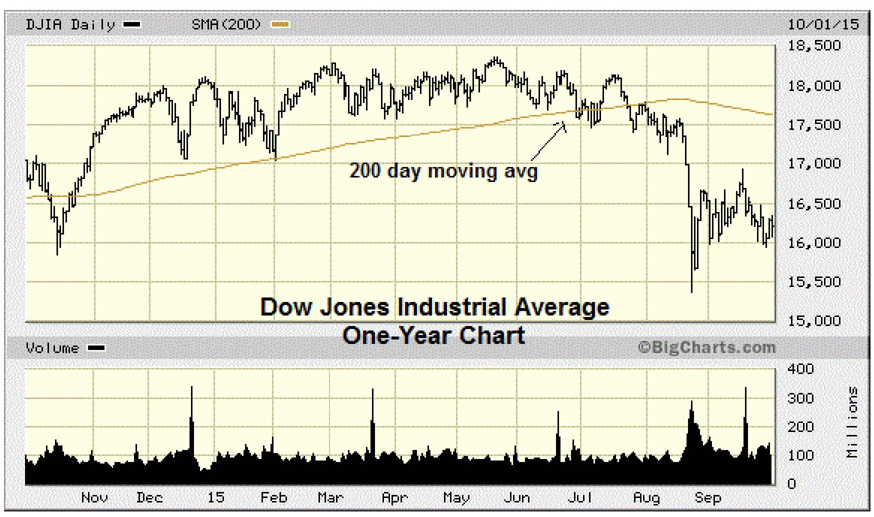
American Heritage Financial

October Update October 1, 2015

Fear Factor

Like the short-lived TV show whose name was better than its content, the market was all about fear-inducing headlines in September—with an unfavorable impact on stock prices. After the devastating 6% decline in August, the market was attempting to build on a late August/early September rebound and was 7% above its low of August 25 when, on September 17, the Federal Reserve made its long anticipated pronouncement on interest rates and the economy. Fallout from the Fed's decision to hold interest rates near zero resulted in stocks resuming their downward slide, to end September with another monthly drop; this time –2.6% for the S&P 500. As a result, the third quarter logged a total decline of about 7%, the worst performance since the 3rd quarter of 2011 when the index dropped 12.1%. Since stocks were basically flat in the first six months of the year, broad market indices are down about 7% year-to-date for 2015.



Economists' expectations going into the Fed announcement were near evenly split but, whatever the decision, there was hope for some clarity on interest rate policy going forward. The Fed's reason for holding interest rates near zero was "global uncertainties," which, they felt, overrode the improving job market and steady economy in the U.S. That decision unsettled investors because it suggests that the central bank lacks confidence in the many signs of U.S. economic strength. Even worse, constantly conflicting messages from various Fed members has elevated uncertainty. Some Fed members are calling for immediate interest rate increases and others are vocally supporting the dovish majority. It is beginning to resemble a cafeteria food fight; the lack of clarity and leadership is showing, and a critical component of our economic policy is losing credibility.

Yes, there are issues beyond the Federal Reserve that are depressing stock prices and investor attitudes. China continues to be the most important fundamental challenge for the global economy and, thus, our market. It was China's surprise currency devaluation that set the current correction in motion. The devaluation was a drastic measure in response to potentially drastic economic conditions. For an economy that had steamed ahead with amazingly well-managed and consistent growth for 25 years, the decelerating trend—estimates have now slipped to about 4% growth in China—are unsettling. Remember, China grew at 15% or better for years as it became the world's second largest economy. China's development created new opportunities for global corporations, put a commodity super-cycle in motion and checked inflationary pressures while supplying the world with lower cost products. Now, the slowdown is one of the primary reasons for the bear market in commodities and it is devastating small "developing" economies that once feed China's many appetites. Thus far, our economy has not been greatly affected, but a full meltdown of the Chinese economy would have a global impact which no country would escape.

The Chinese slowdown, the Fed's vacillation on monetary policy, devastating declines in commodity prices and fragile economic conditions throughout the world (outside the U.S.) are all interrelated. Of course, the VW emissions scandal, saber-rattling by a presidential candidate about health industry pricing and renewed concerns about leadership in Washington have not helped. It is easy to see how all these concerns provide investors a reason to sell now and ask questions later; especially when one considers that stock prices, as of mid-year, were better than three times higher than their low of March 2009 and had not experienced a significant correction for over six years.

The various risks can't be ignored but neither can the steadily strengthening U.S. economy and the reasonable condition of the stock market. Growth continues strong; 2nd quarter growth was revised up again in late September to 3.9% and major areas of demand in the economy appear healthy. Housing is strong, auto sales are approaching 17 million units, the employment numbers are some of the best since 2007 and consumer spending is solid. Manufacturing is one weak spot in the economy; reflecting global weakness and weak commodity industries—especially oil.

The stock market has bent but not broken. Valuations are now "good" with the S&P trading at just 15.0 forward earnings estimates and sporting an average dividend yield of 2.27%. The technical outlook is not so positive; market indices are currently trading well below their 200 day moving averages although indices seem to be in a normal bottoming process. A couple of technical statistics that are easier to relate to: 236 of the S&P 500 stocks, or 47%, are 20% or more below their 52 week high and an astounding 85% (or 424) are more than 10% off their highs. Clearly, downside momentum is in control and a positive catalyst that could turn the market higher is not currently obvious. On the other hand, long term investors should be considering the strong fundamental condition of the market and our economy, and, even more important, the attractive price and outlook for many great companies, and use this period to build a strong portfolio which will benefit from future gains.

Ted Ingraham

EGI Financial, Inc.
American Heritage Securities, Inc.

Questions or comments?
Email us at: ahs@egifinancial.com or call 330-535-0881. Visit us at www.EGIFinancial.com