

Valparaiso magazine

Our Voice

[Closing Thoughts]



Investments Should Be Guided By Reason, Not Fear

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Trends in stock market trades often reflect fear and greed, and recent market developments clearly indicate unease and anxiety as driving factors in investment decision-making:

- Bank stocks have cratered on fears of insolvency and government takeovers.
- Transportation and other cyclical stocks have slumped due to fears that an unprecedented decline in global industrial activity is likely to worsen.
- Consumer-product stocks have suffered, impaired by fears that overseas economies no longer represent avenues for growth.

Beyond sector-specific fears, investors worry that government bailouts are making things worse, that the nation's process for dealing with failed companies is ineffective. Unless companies like General Motors and Citigroup can fail and be reorganized, some argue, the natural process of economic recovery will be thwarted. Both U.S. and Foreign investors are worried that the U.S. government leaders are making things up as they go along, putting out fires without getting to the root cause of the economy's problems.

And U.S. consumers, hurt by huge declines in home prices and share prices, are pessimistic. In February, the Conference Board Consumer Confidence Index reached its lowest level since its 1976 inception, with consumers citing a rapidly deteriorating job market. Consumer spending has slumped, with cut-backs in everything from luxury items to basic household goods.

In short, the economic news is pretty bleak these days.

It is important to make a distinction, however, between the economy and the stock market. There's no question that economic times are tough. But that doesn't necessarily mean that stocks have to continue their downward slide. Indeed, the economic and corporate news does not need to be good for stocks to advance; the trends need to be less severe than what is reflected in stock prices. And it appears that a good portion of today's bad news is already reflected in stock prices. Indeed, the Dow Jones Industrial Average has already fallen roughly 50 percent from its October 2007 peak, returning to levels not seen since 1997. Shares of the median profitable company in the S&P 500 Index trade at roughly 10 times trailing earnings, versus the norm of 18 since 1990. And sentiment surveys and mutual-fund outflows indicate investors are quite pessimistic.

However, the stock market's recent price action does not suggest that all the bad news has been discounted. The fact that the Dow Jones Industrial and Transportation Averages could not avoid breakdowns below the November 20 lows suggests underlying values are still deteriorating. And that could mean lower stock prices in the short term.

Valparaiso has not been immune to the economy's struggles. True, in the February national jobs report, only two sectors showed increases: government jobs, and the health-care and education sector. And that's good news for Valpo given its exposure to education and health-care sectors. Still, there are plenty of Valpo households getting squeezed by a weak stock market, declining home values, and employment uncertainties.