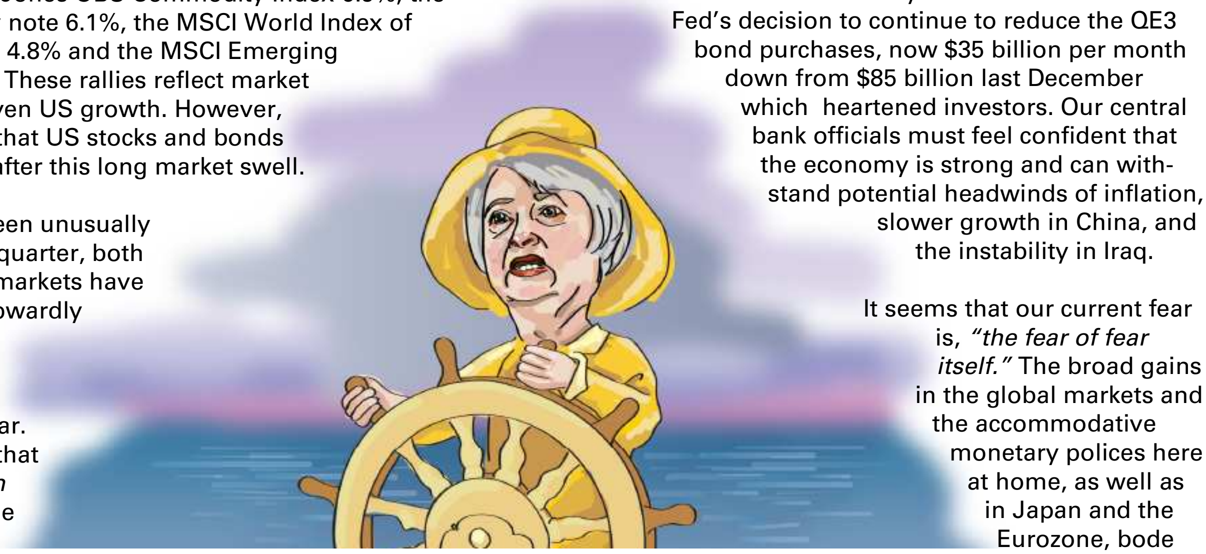
Smooth Sailing?

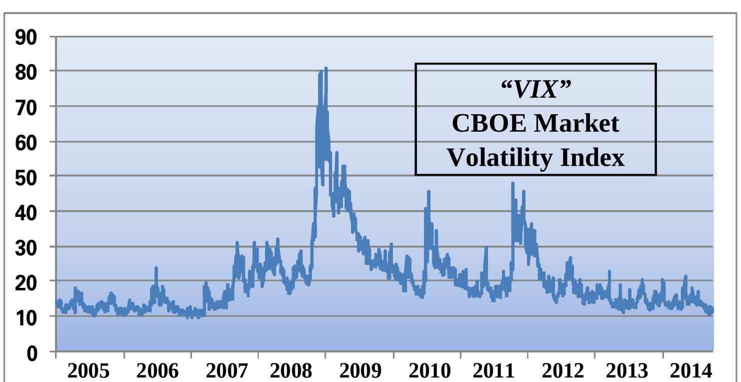
The recent gains in the capital markets imply it's nothing but smooth sailing ahead. However, nervous investors fear strong undertows and worry about rough seas on the horizon. Are they being too cautious? Should they go with the flow or has the market foolishly risen with high tide just waiting to recede with the outgoing ebb tide?

According to last weekend's Wall Street Journal, the stars aligned from stocks to bonds to commodities propelling broad gains in world financial markets. Six closely tracked gauges of global health all grew in unison during the last six months for the first time since '93. For the year, the S&P 500 is up 7.1%, the Dow Jones UBS Commodity Index 6.9%, the 10-year US Treasury note 6.1%, the MSCI World Index of developed countries 4.8% and the MSCI Emerging Markets Index 4.8%. These rallies reflect market resilience amid uneven US growth. However, some investors fret that US stocks and bonds have become pricy after this long market swell.

The markets have been unusually calm. Over the past quarter, both the stock and bond markets have been tranquil and upwardly cooperative, but many investors may not be as calm as the markets appear. Investors are afraid that this may be *the calm before the storm*. The CBOE Market Volatility Index *"VIX"* is the acknowledged gauge of investor anxiety which was formulated in 1992 by Vanderbilt University Professor Robert Whaley. He developed *"VIX"* for the Chicago Board Options Exchange to measure the implied volatility of the S&P 500 index options—commonly called the *fear index* or *fear gauge*.



The *"VIX"* has measured these recent abnormally placid seas, but it also documented the extreme anxiety during the Great Recession. As the *"VIX"* Volatility Index below reveals, after the tsunami in 2008 and the rough surf in 2010-11, the waves have subsided and the markets have calmed.



Some attribute this tranquility partly to Fed Chief Janet Yellen's steady hand in steering our economy. After her June 18th press conference, investors took comfort in the Fed's upbeat global economic outlook. Pointing out that the Fed's projection for 2014 GDP growth was lowered to 2.1%, she calmed their fears saying the 1st quarter's unexpected contraction would not result in a drag on future growth. She reiterated the Fed's commitment to keep interest rates low well after unemployment and inflation are within the Fed's targets.

Her words were like a balmy ocean breeze to pundits and fund managers alike, driving the S&P 500 to a new record and quelling investor fears as verified by the *"VIX"* falling to its lowest level in seven years. She reinforced the Fed's decision to continue to reduce the QE3 bond purchases, now $35 billion per month down from $85 billion last December which heartened investors. Our central bank officials must feel confident that the economy is strong and can withstand potential headwinds of inflation, slower growth in China, and the instability in Iraq.

It seems that our current fear is, *"the fear of fear itself."* The broad gains in the global markets and the accommodative monetary polices here at home, as well as in Japan and the Eurozone, bode well for global growth. Undeniably, growth has not only been sluggish, but also bumpy. A self-sustaining, robust world economy won't come easy nor soon, but it feels that we're on the right course.

The economic good news/bad news cycle, which permeates our lives through ever-increasing media channels, heightens our anxiety. Our economy is growing, albeit slowly and in fits and starts. But many believe this *"not too hot, not too cold"* Goldilocks pattern may foster a longer lasting recovery than those in the past.

Investors have rode this historic bull market into its sixth year, yet are concerned about stock valuations that are somewhat above their long-term average. However, this year's unprecedented rally in world markets has buoyed investor optimism. We've been treading water for some time, but with Fed Chair Yellen at the helm and most foreign central banks manning the sails, let's all hope for stronger winds at our backs to drive the world economy forward to sustainable growth.

June 30, 2014

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