Q3 2011 Commentary

Equities experienced continued weakness in the third quarter of 2011, especially in September, with market averages finishing broadly lower. The troubles have been building since late July and August, when fears about European debt and global growth took the Dow down over 15% in three weeks. To add to that scenario, domestically, Washington's inability to properly address the debt ceiling issue was hugely disappointing and took away any investor confidence that was left. The Dow, S&P and NASDAQ posted (12%), (14%) and (13%) losses for the quarter, the worst since Q4 2008.

There was doubt as to the healthiness of the global recovery. In September, following news that the Chinese economy might be cooling off, the Dow dropped 3.5 percent in two days, capping its biggest two-day drop since the height of the financial crisis in 2008. But it wasn't just stocks markets that were showing the stress. Commodities plummeted after months of holding steady. The selloff in all asset classes resulted in a flight to the safety of U.S. Treasuries, spooked by fears of another recession and a Greek debt default.

Domestically, economic news tended to support that outlook. Jobless claims rose in August, contributing to the persistently high unemployment rate. Home prices ticked up in July, but remain lower than last year. In addition, retailers posted flat sales results for August. In an attempt to keep interest rates low, the Fed announced a plan to shift its holdings of treasury securities from shorter to longer term maturities.

I don't see a double dip recession happening. Unlike the crisis in 2008, liquidity is not the problem. The markets are awash in cash. The banking system is much healthier than in 2008, and companies are in good shape financially. The problem is that there is just too much debt at the government level, as highlighted when S&P downgraded the U.S. debt. The problems in the U.S. can be resolved. The U.S. is not Europe, and Europe needs to fix their debt burden problems.

Stock valuations are still attractive. There are some great buying opportunities in the market today. In retrospect, I have been a little too optimistic in expecting the economy to rebound this year. I did not forecast the $25 dollar a barrel drop in oil prices and a 23% decline in copper prices in the third quarter alone, which hurt our performance. However, I still believe strongly in the companies that are in our portfolios and think they are poised to outperform.

I have attended a few investor conferences in recent weeks, and I've heard a disconnect between management commentary and broader macro concerns, with a majority of companies continuing to see good demand and little business impact from negative economic headlines. A few companies even highlighted their beliefs that political rhetoric and the media may be over-amplifying the macro deterioration.

In a time where everyone says they are "bearish", the market's weakness already reflects that negative sentiment. If the bears have already sold, their next move would be to buy. If the bears sell more, they become vulnerable to any further positive news, and it increases the potential of a countertrend rally. With that in mind, I remain upbeat on stocks' prospects for the next several months, and that the economy will sidestep the European debt contagion and fears of falling into a recession.

All eyes will be on the upcoming third quarter earnings reports and their outlooks for profits and the economy. I remain cautiously optimistic!

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