630 Business Center Drive, Third Floor, King of Prussia, PA 19406 • www.tp-advisory.com
Phone: 610-254-0451 Fax: 484-580-8482 email: thomaspadilla@comcast.net

What's Wrong with the Investment World or Can Captain America Save the Planet

Global Markets and Regions

	1st QTR	2016 YTD
US	1.60%	1.60%
Developed Europe	-4.10%	-4.10%
Asia	-4.40%	-4.40%
Emerging Markets	4.40%	4.40%

US Markets

	1st QTR	2016 YTD
Dow 30	2.80%	2.80%
Large Cap Cos.	2.00%	2.00%
Mid. Cap Cos.	4.30%	4.30%
Small Cap Cos.	2.90%	2.90%
Bonds	2.50%	2.50%

Investors are frustrated with returns. They are frustrated with volatility. Drawdowns have become more pronounced and frequent after a year and a half period of relative calm through the end of 2014. US broad market indices are just returning to levels last seen in mid to late 2014. There is still a ways to go before they reach new highs. Global and non-US indices are still well below those 2014 levels and some are near 2011 levels, which were just recoveries from the 2008 crash. New highs are not yet part of the conversation. Bond returns have been fairly consistent; as in consistently low. Yields are at zero percent for cash and barely over 2% for 30 year US Treasury bonds. Not much interest for committing funds for the rest of your life. And what happens to bond prices if interest rates even hint at returning to "normal"?

The long term average returns on stocks are 7% annually. These returns are truly long term, calculated over 75-100 years of market experience. A lot can happen over that span of time. Anybody remember the market returns during the 1980's? That was a long time ago. The investment world doesn't seem to have that kind of perspective presently.

Public pensions assume those rates of return when calculating contribution and payout requirements over worker careers and retirements that might span 50-60 years. Given the returns seen over the last decade or so and particularly over the last year or so, it's no wonder there is such an uproar about underfunded pensions and general angst among investors not covered by pensions but saving for their own retirements. What gives?

The first place to examine is general economic growth, which is generally expressed as Gross Domestic Product (GDP). For the last several years US GDP growth has barely been 2%. Historically US GDP growth has averaged between 3-4%. The 1980's saw growth rates as high as 6%. Globally, some of our largest trading partners are growing in the sub 1% area. In the case of Japan, the economy is fluctuating between tepid below 1% growth and actually negative numbers. China, the fastest growing large economy, is growing at 6-7%. It had been growing at 10% but has been slowing lately. Emerging and Frontier markets are still growing rapidly. In a global economy, growth matters.

The second place to examine is valuations. The most common metric used is price to earnings ratios (PE). The long term historic range is 10 times earnings at the low end and 25 times at the high end, depending on the method used to calculate earnings. The long term average for US stocks is around 15 to 16 times earnings. We are presently around 17 to 18 times earnings, which is a little on the high side. Earnings of US companies, while not negative, are declining rather than accelerating. We have a mild "earnings recession". In a slow to no growth world, it's hard to justify higher valuations.

The third place to examine is government economic policies. Are they supportive of growth or not? The current face of economic policy since the Great Recession of 2008-2009 has been the world's central bankers. In particular, this has been the US Federal Reserve (The Fed) and the European Central Bank (ECB). They have been trying to restore growth by borrowing and throwing money at the world's economies; Bailouts, Quantitative Easing (QE), Stimulus, Negative Interest Rates. Politically the banks have been vilified as the culprit for the current conditions, but they are the primary instrument used to make things right. Go figure. What the world hasn't had much of is decent fiscal policy addressing taxes, regulations and the looming entitlement crisis. There's that pension thing again. We've been fighting with one hand. The result has been a series of rolling "asset bubbles" that periodically deflate with great volatility.

Through all of the turmoil, Captain America is still standing. Whatever your opinions or world views, we are still the world's largest economy and consequently a major engine of global growth. We are also the world's most fully integrated economy. Over 80% of US economic activity, that GDP thing, occurs within the US. American entrepreneurism and dynamism is alive and well, but struggling. The rest of the world needs for us to be economically vibrant more than the other way around. By most statistical measures, things are still improving. But we can do better. Investment returns are ultimately a reflection of the future. The arc of history is long, often longer than most people's perceptions. If Captain America can find his Mojo again, the future is bright.