

Has the Market Reached the Current Limits on Optimism?

April 5th, 2012 by Steven Albrecht

Much of 2009, 2010 and 2011 were spent with most financial analysts trying to convince investors that the market was on the verge of a double dip recession. I didn't subscribe to this conclusion as almost every economic statistic was indicating that we were coming to the end of the decline and once on the bottom, the economy would improve. I was a buyer while much of the world was hiding for cover. It was a bit lonely out there waiting for the recovery to begin. As it turns out, most of 2009 and both 2010 and 2011 treated investments well with gains throughout the world.

After the Great Recession did its wonderful work on just about every investors' confidence, the market ended up hitting a low in Feb 2009 and the recovery started ever so slowly. The decline was not unusual because fear and disappointment drove investors to sell until values were well below fair value and even reached a level well below a 20% discount. (green line in chart)

At this point, there was a high probability that stock prices would return to fair value (white line) in the future. As panic stricken investors were selling, another investor was buying, because they could see a higher chance of opportunity than fear of further decline.



After three years of good increases in the market, I am beginning to wonder if the expectations for opportunity are becoming overly optimistic. Prices have reached a level that represents an overvalued position. (red line) Earnings are not supporting some of the elevated prices in the marketplace and since about March 13th the market has had great difficulty moving ahead.

I wonder if recent projections for continued expansion can materialize. How much of the current search for opportunity is based on hope and how much on fundamental analysis?

Earnings reports will be important for the quarter to tell us if corporations have enough strength to deliver on the expectations that are clearly reflected in current prices. We will see. If you are

the cautious type, you might consider securing some of the gains you have made over the last 3 years and stabilizing the values.

Later this week we will explore how individual sectors are responding. Are they matching the market or is it actually a better, stronger or less likely growth opportunity for the future?