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Something to Think About

OAKWORTH CAPITAL BANK

COMMON CENTS

Some years ago, I was at the Walt Disney World complex. At the time, Mickey was hard at work selling "remastered animation cels" for what I considered a princely sum, and there seemed to be no shortage of takers. Being a clever mouse, he bandied about the words "rare" and "collectible" like nobody's business, and the hoi polloi gladly forked over their hard earned money for, what, 1/5,000,000th of a direct to video animated picture.

Buy a piece of history! Buy an authenticated piece of Disney's animated classic: "Aladdin XXV: Back Into The Lamp and Thrown Into the Sea." All for the low, low price of $99.95!

I thought then, as I think now, if the words rare and/or collectible are anywhere to be found in the sales pitch or material, walk away from the deal. The reason is simple: if it were truly rare and collectible, the seller probably wouldn't be selling it for less than $100 **and** to someone off the street.

In my personal experience, I have found it is easier to find good deals at garage sales than at estate sales, in general. The merchandise is generally better at an estate sale, so there is a trade-off there. However, the biggest determining factor of whether there is any value to be had at either a garage or estate sale is whether a professional firm is handling them or not. If a company is running the show, things will be more "fairly" marked, and the good stuff won't come cheap, initially.

It is odd: to get the good stuff, you have to come early. To get the good values, you have to show up at closing time. Regardless, the same principle holds true: all transactions are made when the other party values what you have more than you do, and vice versa. In Walt Disney World, Mickey values your money, and he will sell you just about anything in order to get it, but, man, he will make you feel like he is doing you a favor by doing so.

All of this has a point.

When boiled down to basics, the stock market isn't any different than any other transaction, be it at a yard sale or gift shop. You have buyers and sellers. What must the seller do to get the buyer to part with their money? What will the back and forth, the haggling, be? Who will blink first, if at all?

According to various sources, investors have plowed, get this, between $230-275 billion into stock funds and ETFs in 2013 (through October 31). That is the second most all-time, trailing only 2000, which is a somber omen to be sure. However, think about that: close to $300 billion in new money going into 'trackable' funds alone. We aren't counting how much has gone into individual securities, private collective funds, and the like.

So, we really don't have a economically feasible way of determining just how much money has flowed into stocks this year. If someone were to go to the time, trouble, and expense of determining such a thing, the market would be on to something else long, long, long before

Inside this issue:

If you would know the value of money,
go and try to borrow some.

Benjamin Franklin

the final tally.

So, there are no two ways about it: in aggregate, investors found value in stocks in 2013; there were more buyers than sellers, by a wide margin. People were willing to part with their hard earned cash to grab a piece of something seemingly “rare” and “collectible.” As a result, prices have gone up, quite a bit I might add. However, at some point, all those buyers will want to sell their financial equivalents of “remastered animation cels,” but will this happen in 2014?

That is the $64,000 Question. Consider what I wrote for the Montgomery Advertiser for inclusion in this Sunday’s edition:

> **2013 was a much better year than virtually anyone thought it would be. What does your crystal ball hold for 2014?**
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> What can the stock market do for an encore in 2014? The answer is pretty simple: probably not much of anything spectacular. In fact, I anticipate stocks will perform much as they did in 2011. If you can’t remember how that was, well, there is a pretty good reason. Most folks didn’t make much money that year, but they didn’t lose much either.
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> I don’t need a crystal ball or a bunch of tea leaves to tell you there isn’t as much fuel to throw on the markets as there once was. The Fed can’t realistically keep printing $85 billion every month, and corporate America will have a hard time posting double digit earnings growth with economic activity the way it is. Sure, the stars may align, and investors could pull a rabbit out of a hat next year, but I wouldn’t bet on it.
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> No matter how I slice and dice the data, I keep coming up with stock market returns of roughly 7.5% and basically nothing out of bonds. So, the range of returns for balanced portfolios should be anywhere from 3.5-5.0% next year. Maybe some shrewd stock and sector selection will get you another percent or two, but it isn’t going to be like this year in absolute terms.
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> Besides, what looks cheap? That is what a lot of investors want to know.
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> At the end of 2011, the Price/Earnings ratio of the S&P 500, or how much money investors pay for each $1 of profit, was 12.75. At the end of November 2013, investors were paying $16.94, over $4 more. That is a pretty significant move over a 2-year time frame, suggesting US investors have gotten some of their old mojo back. But will they be willing to continue to pay up moving forward?
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> Based on history, the answer is probably not, unless corporate American performs much better than I expect it will. Some Wall Street types have the companies in the S&P 500 growing combined earnings around 10% in 2014. This performance coming after roughly the same type of growth in 2013, and decidedly less than 10% in 2012. In essence, Wall Street believes corporate America can continue to deliver the goods in the face of sub-3% economic growth, if not ramp things up.
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> I have a hard time believing any of this will happen. This isn’t because I am some kind of worry wart or naysayer; it is simply playing the odds.
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> Since the end of 2008, the S&P 500 has returned 122.43% through the end of November 2013. Meanwhile, earnings per share on the index have increased over 80%. Those are awesome numbers considering Gross Domestic Product, the US economy, has grown about 16% since then through the end of September 2013. That is quite a disparity.
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> I understand this is getting nerdy in a hurry, but let me give you one last tidbit. Over the last 50 years,

Something to Think About Cont.

there has been roughly a 3% annual spread between the total rate of return on the S&P 500 and gross economic growth in the United States. It has been over 13% since the financial system collapsed 5 years ago. Wow.

So, in the end, what does my crystal ball say? Come on man; it is a hunk of glass, and doesn't say anything.

In so many ways, expecting 2014 to be as robust as 2013, and even 2012, is analogous to expecting the same unwashed masses to make another pilgrimage to Orlando to buy even more of the exact same "remastered animation cels." This may happen, but it probably won't. The investing public has picked the low hanging fruit. We don't, or won't, want a piece of the Disney animated classic: "Toy Story XVIII: The Death of Woody." However, we might be willing to plop down some cabbage on a new blockbuster or an old classic. Hey, cut up, mat, and frame the original "Steamboat Willy," and you will have plenty of buyers. "The Emperor's New Groove"? Not so much.

In conclusion, man, we have had a heckuva run. There is no reason to think the bottom is going to fall out of the market anytime soon: 1) there is plenty of liquidity in the banking system, plenty already, and; 2) the economic indicators are reasonable, and; 3) believe it or not, the Federal deficit is falling, sharply. In truth, we enter 2014, arguably, on sounder footing than we entered 2013. On the flipside, what can the markets do for an encore? Where can we find value? How can we get investors to dump money into the markets in 2014?

Well, that ain't going to be as easy next year as it has been the last two years. Corporate America will have to deliver on earnings, in a big way. If it does, double digit returns are possible. If not, if they come in as anticipated, you should budget/expect 7.5% on stocks, and be happy with anything greater than that.

Disclosure