INVESTING IT

Perception vs. reality: The economy and the market

I'm a global macro junkie, and admittedly, am sometimes referred to as a real geek. I awake every morning with much anticipation about what happened overnight in other economies. I scurry to my iPad to read various newspapers, view my Twitter feed, and start to disseminate all of this information in a way that helps set a foundation for what to expect in U.S. markets.

INSIDER'S VIEW

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Having a global macro approach to investing is incredibly helpful when it comes to anticipating and mitigating risk. Most of what we've seen and heard, particularly for the past five years, has not been hopeful when it comes to global economics. We had the worst worldwide financial crisis since the Great Depression. Maybe this isn't news to you, but let's fast-forward to what's happening today. Even now, when we look at the statistics, financial growth is still extremely low and unemployment is high — not just in the U.S., but globally.

It has been five years since the crisis, with extreme recovery measures implemented by central bankers around the world. No one could have imagined the economy would take this long to heal, and with continuing low GDP growth, it won't take much to upset this fledgling recovery.

Here's the burning question: If the economy has taken so long to recover and has done so at a slow pace, then why had the stock market gone up 160 percent (as of mid-July) since hitting bottom on March 9, 2009?

In my many years of navigating the financial industry, this is the No. 1 issue the average investor misses. As I said earlier, paying attention to economics is great for managing risk. But the problem is that geeking out over economic trends is not so great for taking advantage of investing opportunities. You have to dig deeper into what is making an investment thrive, or even buck an economic trend. Average investors respond to the media and the evening news. Average investors hear about unemployment and that the economy is struggling, and say, "Sounds bad, I'm not going to invest in this negative environment."

Just look at the swirling economic headlines from this past year. Many Americans worried about what waves the presidential election would generate, and let's not forget about the fiscal cliff drama. We started the year with tax increases and the sequestration — all perceived to be bad for the economy. But, yet, as of mid-July, the stock market was up more than 19 percent so far this year. How is this possible?

The answer is simple, yet possibly too simple, as it represents one of the largest realities investors overlook: The economy is *not* the market.

I know, I said I'm a global macro junkie and economic projections are an important part of managing risk, but when it comes to identifying investment opportunity, the most essential part of the process is to better understand "valuation" and the direction of corporate earnings. What is something worth, and what will it be worth in the future? Investors should take time to evaluate a corporation's movements rather than only economy movements and psychology.

Even in the worst economic times, leading corporations will do what they must to preserve and protect their bottom line and create a new strategy for growth and profitability. This is the main reason why a good stock may initially take a hit when economic disruption occurs, but then starts to reaccelerate in price as a result of smart adjustments. For the smartest business leaders, recession can be the mother of innovation, and position a corporation to be even stronger coming out of economic crisis.

The Argus (Independent Equity Research) Market Digest report from July 5 quantifies this relationship between annual growth in U.S. GDP and corporate profits quite well: "In the four years of the bull market to date (2009 through 2012), U.S. GDP growth averaged just 1.48 percent; but S&P 500 earnings from continuing operations averaged 15.3 percent growth; and the ratio of earnings to GDP was a whopping 10.4 times."

These statistics suggest an opportunity for a layered strategy. Investors have the opportunity to leverage global macro research to manage risk based on understanding large economic, industry and physiological shifts, while layering in a deeper understanding of earnings, valuation and corporations' plans to ride these global tides.

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