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## Wealth advisers offer market insights

Denver Business Journal - by [Renee McGaw](#)

The stock market enjoyed a robust first quarter, but challenges remain. Denver Business Journal finance reporter Renee McGaw asked local investment professionals for their opinions on the markets, the economy and Washington.

**The stock market has enjoyed a remarkable recovery since March 2009, yet the underlying economy hasn't improved all that much. What's driving stock prices, and is it sustainable?**

**John Cormey | Senior vice president, portfolio manager | Wagner Investment:** The initial phase of the market recovery was a relief rally that the U.S. banking system was not going to fail. The trigger was the unusual announcement by Citibank of positive two-month earnings. The recovery since then has been typical. The first phase is P/E-driven in anticipation of better earnings, followed by the earnings-driven phase. In order to continue, earnings need to continue to improve, which will require improving sales and an improving economy. I believe that will occur, but the "easy" money has been made.

**Fred Taylor | Principal | Northstar Investment Advisors LLC:** Aside from the horrific unemployment number in this country, the economic news has been steadily improving every month since March 2009. You can look at GDP, consumer spending and even the Case-Shiller home price index to support the thesis that the economy is on the mend.

**Jennifer Pierce | Senior portfolio manager | The Private Client Reserve at U.S. Bank:** Since March 2009, investors have ridden improving expectations for the U.S. and global economic recoveries. We believe the economic recovery will likely prove sustainable, but stock market prices may be volatile and further price acceleration is not likely.

**Gregory Anderson | Founder and CEO | GRAnderson Wealth Management:** Many of the stock market's multinational companies are deriving revenues from abroad. Additionally, the stock market often moves in advance of an economic development, so recent activity might indicate a subsiding or recovery from the recession. In any case, as the world economy improves, all boats will rise with the tide.

**Trevor Emery | Managing director | Wealth Strategy Partners LLC:** The market has simply repaired itself from the depths of the recession. Our viewpoint is that the recession is over. Also remember, it was one year after the recession started that the data actually confirmed it. As pessimism becomes optimism, we will advise clients to begin trimming equity allocations.

**Todd Owen | Regional investment manager/Colorado | Wells Fargo:** The 77 percent recovery in U.S.

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large-cap stocks, put in historical perspective, compares to the average bull-market return following a bear market of 178 percent, so the current recovery could be considered in the early innings. The average 12-month return following a bear-market low is 53 percent and the best return has been 139 percent. The current recovery is slightly above average. The sustainability of the recovery would come from the pent-up demand in areas where we are seeing signs of recovery.

**Brooks Rarden | Senior portfolio manager | Northern Trust:** The primary driver for the recent strong equity returns has been three things: a recovery in earnings, an expansion of the multiple on these earnings and the expectation of an economic recovery. The latter, however, remains uncertain. We believe it will be sustainable, however, not to the extent of past economic recoveries. There are several headwinds facing the economy, the size of the debt being the strongest.



**John Goltermann | Senior VP/portfolio management | Obermeyer Asset Management:** We believe liquidity is driving the stock market. Zero interest rates have a miraculous way of forcing increased risk-taking upon investors, especially institutional investors such as pension funds and endowments, whose liabilities haven't decreased and will not be able to meet their current obligations in this zero-rate environment. To compound the effect, the sovereign debt issues and structural issues in Europe are prompting global investors to move liquidity to U.S.-based assets at the moment, but how long that lasts is unknowable.

**Mark Brown | Managing partner | Brown & Tedstrom Inc.:** The stock market is always a leading economic indicator while unemployment, which is felt most by the public, always lags as a barometer of the economy. The current recovery is being led by business spending and exports, and we expect the consumer to surprise economic forecasters on the upside. The 60 percent-plus stock market advance that happened last year will not be repeated in 2010, and we believe there will be greater volatility and lower returns in the second half of 2010.

**John Trujillo | Senior portfolio manager | UMB Investment & Wealth Management:** Earnings are the primary fundamental reason stock prices increase or decrease, and earnings recently have been strong. Sentiment and momentum have also been positive, which has helped the upward trend. The ability of corporations to continue to produce strong earnings will dictate the sustainability of this move. However, legislative and outstanding political issues will create headline risk and add to volatility.

**Shane Delavan | Market leader/trust investments | Colorado State Bank and Trust:** Actually, we believe that there currently are some signs of economic growth (consumer confidence, corporate profitability and high productivity) mixed with areas of continuing economic weakness (residential/commercial real estate and unemployment). With this said, we believe that the strong recovery in stock prices is partially driven by a bounceback from the doomsday overselling experienced in late 2008 and early 2009, as well as a recognition of those areas of economic growth currently in place. Our anticipation is that this level of stock prices is sustainable and believe that stocks are fairly valued at this time.

#### **Where's the S&P 500 going to be at year's end versus right now: up, down or about the same?**

**John Corney:** I believe that the S&P 500 will be modestly higher at year-end than where it is now.

**Fred Taylor:** I wouldn't be surprised to see the S&P range bound between up 10 percent or down 10 percent in 2010. A lot of it will depend on what the Federal Reserve does with short-term interest rates.

**Jennifer Pierce:** Modestly stronger with significant volatility.

**Gregory Anderson:** As long as overall interest rates remain relatively low (as we expect), we see the S&P 500 gaining at least 8-12 percent for the year. However, a significant increase in interest rates (e.g. 100 basis points) could suppress the market's growth potential, and we could end up flat.

**Trevor Emery:** Of course, there is no guarantee, but we think the market will move higher this year.

**Todd Owen:** It is our feeling that we are only several months into an economic recovery, which historically have lasted an average of 48 months.

**Brooks Rarden:** A reasonable argument could be made for the S&P to trade at slightly higher levels from where it is right now. With year-end earnings coming in near the \$80 level, and a 15 multiple, you get to 1,200. From today's [April 5] close at 1,187, that's a 1 percent gain between now and year-end.

**John Goltermann:** We have no prediction on this. We do, however, continue to invest our client's portfolios into high-quality investments for the long term.

**Mark Brown:** We believe there will be solid returns in the first half of 2010 and lagging returns in the second half of the year, as we are expecting the Fed will be raising interest rates. For the year, there are likely to be modest single-digit gains for the S&P.

**John Trujillo:** We at UMB are calling for a positive year for the S&P 500. Given the recent movement, there may be limited upside from this point so slightly higher by year-end with volatility between now and the close of 2010.

**Shane Delavan:** Our sense of stock values at this point is that the S&P 500 will be up modestly from current levels. We think that most of the anticipated stock returns for this year have already accumulated and that we'll see returns moderate for the rest of the year. While we may experience periods of short-term correction over the remainder of the year, our expectation is for continued economic stabilization to support stock values at the current level. We will note that our confidence in the market is based on the cyclical benefits related to being in the early stages of an economic recovery and the positive lift associated with stimulus spending. At this point, we are less positive on stock values beyond the next year or two as we confront the structural challenges of high federal deficit levels and the challenges of an aging population.

#### **What do you think is going to turn out to be the biggest investor mistake of 2010?**

**John Cormey:** The biggest investor mistake in 2010 will be the same as 2009, being out of or underweight stocks. Mutual fund flows indicate that investors have continued to withdraw funds from equities and pour money into bonds. At near-record low interest rates, bonds look vulnerable.

**Fred Taylor:** The biggest investor mistake has already occurred. Too many Americans over the past three years have sold their stock funds and put all of their money in long-duration bond funds. Once interest rates rise, these same investors who bailed out of the stock market in 2008 and 2009 will see massive losses in their bond funds.

**Jennifer Pierce:** Investors significantly reduced their risk appetites in the aftermath of 2007-2009 and may wish they had purchased more “risk” assets than “safety” assets, as “risk” assets are likely to prove more beneficial (in terms of both risk and return) to portfolios. “Safety” assets could possibly anchor and diminish value in the environment ahead.

**Gregory Anderson:** At the end of 2010, we believe many investors are going to regret that they did not invest more heavily in equities. We see that investors generally remain cautious, and they are still holding on to too much cash. We point out to our clients that equities are relatively cheap, creating opportunities for near-term gains.

**Trevor Emery:** Staying in cash at zero percent to avoid risk completely. Choosing to remain on the sideline without any risk built into portfolios will be costly if the markets move higher. Even conservative investors need some equity exposure.

**Todd Owen:** That people stay on the sidelines with cash and do not invest in the financial markets, and are not diversified enough with their current investments as relates to risk and to their longer-term investment goals.

**Brooks Rarden:** So often the biggest mistake for investors is to extrapolate the current momentum/direction of the market into the future. Just because the market is up over the past three, six or nine months doesn't mean it will continue into the future. One must look at earnings growth and valuation.

**John Goltermann:** We see the underweighting of what is likely to be the best-performing asset class, equity positions in unhedged natural resources in politically secure areas. These equity positions represent future scarcities that future investors will have wished they had a claim on at prices that are available today.

**Mark Brown:** Mistakes usually occur for two reasons: first, not having a plan or strategy matched to your circumstances and second, letting short-term emotions drive long-term investment goals. We suspect that normal corrections of 10 percent will cause investors to head for the exits based on the fear that 2008 caused.

**John Trujillo:** The largest mistake will be a lack of a disciplined approach to investing. Oftentimes, investors will act (or not act) based on short-term data and thereby completely miss opportunities. Staying focused on long-term objectives and maintaining high-quality assets will prove profitable over time.

**Shane Delavan:** We believe that a large number of investors that focus on price stability and moderate income accumulation (usually investing in money-market funds and bank CDs) have migrated from their typical investment options to bond mutual funds over the past year in an attempt to earn a higher yield. We are concerned that these investors are unknowingly increasing the risk of their portfolios, and with interest rates expected to rise in the near term, will experience unanticipated principal erosion — contrary to their inherent desire for principal preservation.

#### **What are you counseling your clients regarding the bond market?**

**John Cormey:** We have been counseling clients to keep a barbell portfolio of bonds with an emphasis on corporates vs. Treasuries. Because the yield curve is so steep, the most attractive yields are out in the 10-year area. These are also the most susceptible to rising rates.

**Fred Taylor:** Duration. Duration. Duration. To protect against rising interest rates and falling bond prices, you need to keep your duration short. The best way to do this is to build a bond ladder. You do this by buying individual bonds and ladder them with bonds maturing every year.

**Jennifer Pierce:** We are counseling clients to underweight Treasuries and to be very selective when it comes to corporate debt and municipal bonds. The decline in interest rates found bottom earlier this year, and the forthcoming environment will likely require investors to utilize more active fixed-income managers than passive managers in their portfolios.

**Gregory Anderson:** We do expect interest rates to rise, although not significantly this year. Those rates are so low, there is almost only one direction they can go. But as the Fed eschews those mortgage packages, they then become excellent opportunities for investors, with safe and higher returns.

**Trevor Emery:** We feel an inevitability to Treasury yields going higher given their current rates. We advise clients to have a “what if” hedge ready to implement in their portfolios.

**Todd Owen:** We are counseling our clients to be short-to-intermediate on new purchases. Treasuries are the most overvalued currently, corporate bonds still have pockets of value, and the municipal market is still firm due to the supply/demand equation created by massive amounts of maturing bonds that need to be re-invested.

**Brooks Rarden:** Depending on the client's tax situation, risk tolerance and cash-flow needs, we believe there is a place in most

portfolios for bonds. We'll use the necessary class of bonds to meet the client's needs.

**John Goltermann:** There is high risk in many different types of bonds. We view the risk/reward tradeoff as terrible — lots of downside for what at best would be limited upside. We are being very opportunistic in a variety of areas looking for high-quality, short-term assets.

**Mark Brown:** We favor spread investments that will provide cushion in a rising rate environment, such as corporates and munis. We would avoid Treasuries altogether.

**John Trujillo:** We have continually advised our fixed-income clients to maintain high-quality and short-maturity bonds in their portfolios. Recently, we have seen a move up in bond rates, which indicates the need for the government to move off of the excessively low-interest-rate policy they have had recently.

**Shane Delavan:** We are underweighting bonds in our clients' portfolios and keeping average maturities relatively short. Treasury bonds have remained fully valued and do not appear attractive at this time — especially with significant supply expected over the next several years. High-quality bonds with some credit exposure have hugged the Treasury yield curve pretty closely and do not present much opportunity, while bonds with greater credit risk may present ongoing investment opportunity in the short term to investors comfortable with greater risk. We believe that municipal bonds are of mixed attractiveness, as we have concerns in the near term for higher credit risk yet believe there is increased attractiveness due to anticipated increases in tax rates in the next couple of years. It will be increasingly important to closely monitor financial strength of each municipal issuer in the near term.

#### **What are your thoughts on the financial reform bills moving through Congress?**

**John Cormey:** We need reforms. We can't have firms that are too big to fail, which enables them to take inordinate risks, benefiting if they work out, and being bailed out by the taxpayers if they don't. We need to at least properly staff the existing regulators. We also need to find ways to protect people from predatory lending practices.

**Fred Taylor:** Financial reform that protects consumers and investors, and prevents the abuses promulgated by Wall Street as a result of the subprime debacle, would be a huge positive development coming out of Washington.

**Jennifer Pierce:** Certainly there is a strong political appetite for reform, but institutions should be able to adapt to the regulatory environment.

**Gregory Anderson:** We would rather see a more gradual change in regulations, as opposed to the knee-jerk reaction that Congress is proposing. For years, we have been advocating the need for current agencies to enforce current regulations before we begin adding agencies and reforming regulations. However, we concede that some changes in regulations and rules will foster greater transparency for investors, making decisions easier for them.

**Trevor Emery:** Personally, I think Wall Street created the problems by overleveraging itself. However, I believe that Wall Street needs to be allowed to operate as a free market. The focus on reform should be directed towards protecting investors from fraud and other misleading and criminal events.

**Todd Owen:** The current environment seems to be to look for someone or something to blame for the current economic woes. There are several proposals on the table. There is a push from our former Fed chairman to reinstate the laws that separate banking from brokerage. It is too soon to tell exactly if that can and will gain momentum, and what it will eventually look like.

**Brooks Rarden:** The good, bad and ugly of financial reform will depend on what is signed into law. Given the political environment we're in right now, it's challenging to determine the impact on the financial sector.

**John Goltermann:** We are in favor of financial reform. Anything that restores confidence to the finance system and shrinks the financial sector's relative weighting in our economy will be a good thing structurally. The problem is Congress itself is trying to manipulate financial market outcomes in a myriad of ways. Wall Street still has way too much influence in Congress, and we are skeptical that any real reform will get done.

**Mark Brown:** The Glass-Steagall Act was a law put into place after the 1929 crash. We thought that repealing Glass-Steagall, a Citigroup initiative, was probably unwise. Managing banks, insurance companies and investment banks under one roof has shown and proved to be easier said than done. We support financial reform that is well-constructed, yet still allows the U.S. financial services industry to compete in world markets.

**John Trujillo:** The systematic financial issues remain a concern, and the policy we create as a nation will touch every one of us, which is why there will always be aggressive discussion about the viability of any bill proposed. The success will lie in the ability to allow small business to continue to finance growth and allow our economy to add jobs.

**Shane Delavan:** Financial reform is necessary in order for markets, institutions and governments to restore confidence between themselves and the marketplace. As reform is discussed, flexibility is required in order to assure investors that their capital investments are not placed at risk. Also, the public needs assurance that the deployment of private capital does not jeopardize long-term social or economic stability. Great care must be taken to balance both of these interests.

#### **Will health care reform affect the stock market and if so, how?**

**John Cormey:** The biggest impact on the stock market of the health care reform passing will be the removal of a big unknown. The

market hates uncertainty, and it will therefore probably be a net positive. It will also allow analysts to figure out the probable winners and losers in health care and medical-related businesses and their stocks.

**Fred Taylor:** The surprise winners in the stock market could be the large pharmaceutical companies. With so many more Americans having health insurance in the future, they will also need to buy more prescription drugs. The stock market has had well over a year to figure out the eventual winners and losers in this bill.

**Jennifer Pierce:** Companies, across all sectors, have already begun factoring in the costs of the new health care bill into their earnings projections, affecting analyst projections and investor expectations. However, the resultant impact of taxation to individuals is only beginning to be understood and priced effectively into portfolios.

**Gregory Anderson:** We have seen gains in many health care stocks as a result of the reform, and investors are likely to appreciate the way regulation will make this industry more predictable in terms of revenue growth and profits. However, there are some short-term hurdles to consider, such as the writedowns by companies such as AT&T and Xcel Energy on prescription drug benefits for retirees.

**Trevor Emery:** Probably. Changes that are as complex as the current health care reform are bound to make an impact. It really is too soon to speculate on exactly what the effect will be.

**Todd Owen:** The costs associated with the bill are set to be phased in over the next two to five years. The most immediate response involved several corporations recognizing those new health care expenses on their recent financial reports.

**Brooks Rarden:** Yes, it will have an impact not only on the stock market, but it will impact the economy as a whole. There will be winners and losers for stock investors. Pharma stocks as well as managed-care stocks have bounced around over the past six months. Companies that can help make the health care system more efficient will most likely outperform on a relative basis.

**John Goltermann:** Health care probably won't affect the stock market much from this point as it's yesterday's news. We see a great deal of pricing already reflected into stock market valuations.

**Mark Brown:** It is not really clear whether health care reform will really slow economic growth that much. Most of the tax provisions don't kick in until 2013, and the mandates on businesses and individuals don't kick in, in a big way, until 2016. Many companies are taking charge-offs for health care reform expenses, which will affect corporate earnings.

**John Trujillo:** The stock market will certainly have volatility as a result of the headline news related to health care reform. Over time, however, the specifics of which companies will be helped or hurt will depend on what health care reforms are implemented. The "how" is largely a function of details that have not been created or agreed upon, so it is difficult to predict with any level of certainty.

**Shane Delavan:** Health care reform will affect the market in one of three ways. First, it changes the operating cost structure of individual businesses (and governments); in some cases, increasing short-term operating costs, but decreasing long-term variability in those costs. Second, it changes the marketplace for health care-related companies — increasing demand for services and potentially creating new opportunities. Finally, with respect to the market, health care reform has been an unknown variable for several years. With the rules now known, the market can properly evaluate risks associated with health care (both for private companies and public entities), and price that risk accordingly.

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