The Market Did What?

Once again, our "friends" in the media have been busy. They described the financial markets in August with words like "chaos" and "Armageddon". Really…..Armageddon??? Admittedly, the heat and the drought are bad—but I highly doubt that the end of time is upon us.

The major stock indices had their worst August in a decade. The Dow dropped 4.4% for the month.

Thank God that we are not investing for just one month. Again, to listen to the news you would truly think that we have had a full system failure.

Despite the drama and the volatility that came with it, the Dow is actually positive for the year. We know—the headlines would make you think that we are down 20% for the year. Sorry to disappoint you.

We did have plenty to digest with the debate over the debt ceiling (a political non-event), the downgrade of the U.S. government's credit rating (we can still pay our bills), continued weakness in the U.S. economy (no surprise with high unemployment) and Europe's debt woes (a problem still not solved). These issues added fuel to the fire and at one point the Dow swung by more than 400 points on four consecutive days, for its first time ever.

During the month the Dow was as high as 12,132 and as low of 10,719 in the span of just 23 trading days—an 11% change. Does anyone really think that Pepsi, Wal-Mart, Johnson & Johnson, Proctor & Gamble, etc. all of the sudden were 11% less profitable? Obviously not.

When we see volatility of this nature we are reminded of a favorite Warren Buffett quote***—"the markets are there to serve you—not instruct you."*** As such, if you don't like the irrationality of the markets you can simply ignore their foolish behavior.

This pessimism has provided some interesting opportunities.

Currently, the largest 50 companies in the S&P 500 index are now cheaper than during the 2008-2009 market meltdown. Even as S&P 500 earnings soar past Wall Street estimates quarter after quarter, the lack of investor confidence has dropped the forward price-to-earnings ratio of at least 50 of the largest U.S. companies below their crisis lows, according to Thomson Reuters data.

Further data from Thompson Reuters shows that 72% of the S&P 500 components beat earnings expectations in the second quarter. ***Estimates expect full-year earnings growth to be 14.1% for 2012***. That certainly does not seem to be the doom and gloom that is thrown about.

We thank the market for serving up these opportunities.

The stock market opportunities are even more enticing when comparing dividend yields versus something like a 10 year US Treasury Note. In spite of a historic credit downgrade of the U.S. government, demand for Treasuries has been unprecedented. ***This demand pushed the 10 year yield briefly below 2%*** on August 18th, the first time it has hit that level since at least the 1960s. This makes us wonder who in their right mind would lend money to our government for ten years and only receive 2% interest per year. That seems to be a truly high risk investment.

We would much rather own a diversified portfolio of multi-national blue chip companies. Not only are they cheap, but they also ***often have dividend yields that are 50% higher than the current interest offered by a 10 year Treasury***. Furthermore, these blue chips have a consistent habit of increasing their dividend payments on a regular basis. The Treasury will never do that for you.

If you have any questions, comments or concerns please don't hesitate to stop by, call or email us.

Sincerely,

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