Market Observations

February 2016

FALLING SHORT

Recent examples of falling short include:

- Carolina Panthers
- Netflix ("NFLX")
- Dow Jones Industrial Average ("DJIA")
- U.S. Economy

Some context is helpful for each of these examples.

Perspective

In spite of the Super Bowl loss, the Panthers had a great regular season finishing with a record of 15 – 1. While NFLX's price declined –37% in the past two months (Chart I), the stock returned +29% to investors over the past twelve months. Stock markets around the world have struggled in recent months. Chart II shows DJIA returns for the twelve months ended 1/31/16 both by month and cumulatively. The latter at -1.7% is disappointing but the historical yearly average remains favorable at +8.7%. The sluggish recovery of the U.S. economy over the six years since the great recession has been reported widely and mentioned frequently in the current presidential campaigns. Chart III shows the magnitude of this shortfall with growth averaging only 60% of the long-term average. Consensus expectations are for growth in the U.S. economy to remain below average for the foreseeable future but positive nonetheless.

The relationship between economic growth and investment returns, while direct in theory, has been quite variable in reality. For stock markets, the linkages are among economic growth, profits growth, and stock returns. The yearly relationship between economic growth and profits growth is relatively strong but the yearly relationship between profits growth and stock market returns is less so. Other factors are at work. The economy is more than just corporate activity. Stock returns incorporate dividends, valuations and future expectations along with profits growth.

Investment Implications

While stronger economic growth is desirable for many reasons, the growth outcome for stocks is not solely dependent on the growth outcome of the economy. Stock investments are a portfolio's growth component (bonds are primarily for income and money markets are primarily for preservation). Consequently, stock returns can determine for many investors whether they fall short of reaching financial goals. This is the greatest risk for investors. Avoiding this risk requires setting objectives and time horizons in the context of potential returns and risks. Through a disciplined approach, investors can reduce their odds of falling short well below the falling-short odds for any sports team or for any individual stock.

Chart I

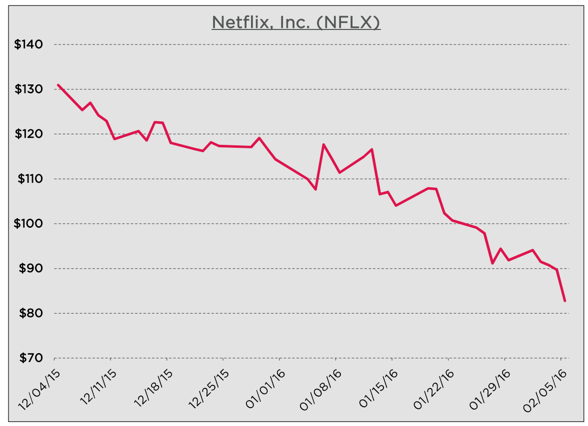

Chart II

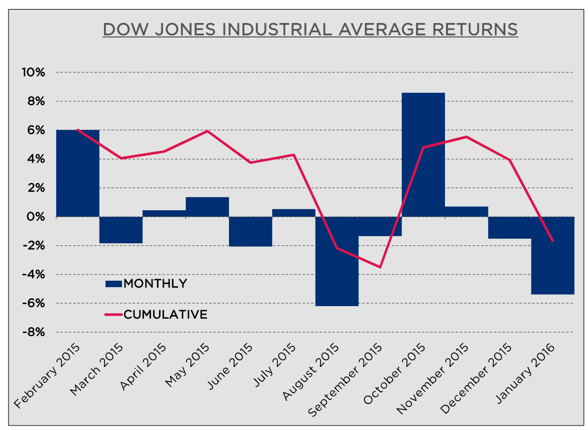

Chart III