

# Scout Investments

## Economic and Market Outlook

### Short-Term Risks Rising

January 26, 2011

William B. Greiner, CFA  
President and  
Chief Investment Officer  
[william.greiner@scout-ia.com](mailto:william.greiner@scout-ia.com)

#### 2011 Outlook

**GDP GROWTH:**  
3.2%

**UNEMPLOYMENT:**  
9.4%

**INFLATION:**  
1.75%

**FED FUNDS RATE:**  
0.35%

#### Correction in the Making?

The economy and corporate profits are rising. According to Macro Advisors, gross domestic product (GDP) is currently rising at a 3 to 4 percent annualized rate. Inflation is reasonably low. Interest rates, while up, appear to be reasonably well contained. Politically, our leaders seem to be "vectoring" their views towards the center of the spectrum. All-in-all it is a productive time for stocks.

In September, we suggested a short-to-intermediate term trend was emerging in which the stock market may produce reasonably good returns. Since that time, stock prices, as measured by the Standard and Poor's 500 Index, have generated a return of 13.4 percent to last night's close. This move in stock prices represents an annualized return of 41.4 percent. Over the long-term, stock prices have risen by an average of roughly seven percent annually. So, to say this upward move has been strong is an understatement!

Fundamentally, we have a hard time making a strong case as to a major correction in stock prices. As stated above, the picture is pretty clear – this has turned into a good investment environment for U.S. and worldwide equity markets.

#### Technically Stretched

To many investors, "technical" analysis is like attempting to predict stock prices by reading the stars. We disagree with these thoughts and attempt to keep technical analysis in its proper place. What is technical analysis? Basically, it is studying patterns and trends in stock price chart formations (or entire market price formations). From a historical standpoint, certain types of formations or price violations tend to raise the probability of a certain outcome occurring. Why? Much of this has to do with investor psychology. But investor psychology is very important – as psychology tends to drive behavior over short periods of time.

Where are we? From a technical standpoint, this market has moved up, a lot, over a reasonably short period of time. Has the move been excessive? Please consider the following:

1. The Standard and Poor's Index is currently trading at 10.1 percent above its 200-day moving average. In April of last year, the market was trading at 11.4 percent above its 200-day. Over the next two and a half months, the market corrected by 15.6 percent in value. Back in October of 2007 (at the all-time market peak), the market was selling at 13.3 percent above its 200-day moving average. We all know what happened following that peak. From a historical standpoint, the market has a hard time maintaining an uptrend when the short-term trajectory of the market move is this high above its 200-day moving average.
2. The S&P 500 has been trading for 105 days without closing below its 50-day moving average. This has only happened on 17 other periods – since 1928.
3. Since the low in March, 2009, the market has traded in “waves” – moves upward and downward. We are in the middle of the 4<sup>th</sup> upward “wave.” The following is data from the first three “waves”:

<u>Date</u>	<u>% Upward Move</u>	<u>Date</u>	<u>% Downward Move</u>
3/6/09 – 6/11/09	38.3%	6/11/09 – 7/10/09	-7.0%
7/10/09 – 1/14/10	30.6%	1/14/10 – 2/8/10	-8.0%
2/8/10 – 4/23/10	15.2%	4/23/10 – 7/2/10	-16.0%
Average	28.0%	Average	-10.3%
7/2/10 – 1/18/11 (current move)	26.6%		

This data is self-evident that based on the last two years of market activity, the current move may be a little “long in the tooth.”

4. According to Ned Davis Research, the “Crowd Sentiment” poll is now at 71.8 percent bullish. Basically, this means that of those folks polled, almost 72 percent believe stock prices will move higher. This matches the bullish sentiment on three other occasions over the last number of years, the last being in October of 2007 – at the all time high. Why is this important? Basically, the theory goes - If the vast majority of folks are positive on stock prices, there are few investors left to continue purchasing stocks, and supposedly the next move should be to the downside.

## Final Word

We don't pretend to know where and how the market is going to trade. However, based on historical standards, risks appear to be rising for at least a temporary setback in stock prices to occur. We believe over the long-term; the market is driven by fundamentals – earnings, interest rates, political environment, etc. The majority of these fundamental trends are positive. However, over short periods of time, technical considerations need to be recognized.

Is the market setting itself up for a correction? Perhaps. At this time, if this comes to pass, we would treat weakness in the market as a short-term, but perhaps worrying trend.



William B Greiner, CFA  
President and Chief Investment Officer  
Scout Investments

#### **DISCLOSURE AND IMPORTANT CONSIDERATIONS**

Scout Investments offers an array of investment management services for institutional separate accounts and mutual funds through a stable of institutional asset managers. Equity solutions in domestic large cap, mid cap, small cap, international, international small/mid-cap and global equity portfolios are offered through Scout Investment Advisors. Fixed income products in core plus, core, intermediate, long duration, low duration, absolute return and real return (TIPS) are offered through Reams Asset Management. Scout Investments, Inc. is a subsidiary of UMB Financial Corporation.

This report is provided for informational purposes only and contains no investment advice or recommendations to buy or sell any specific securities. Statements in this report are based on the opinions of Scout Investments and the information available at the time this report was published.

All opinions represent our judgments as of the date of this report and are subject to change at any time without notice. You should not use this report as a substitute for your own judgment, and you should consult professional advisors before making any tax, legal, financial planning or investment decisions. This report contains no investment recommendations and you should not interpret the statements in this report as investment, tax, legal, or financial planning advice. Scout Investments obtained information used in this report from third party sources it believes to be reliable, but this information is not necessarily comprehensive and Scout Investments does not guarantee that it is accurate.

All investments involve risk, including the possible loss of principal. Past performance is no guarantee of future results. Neither Scout Investments nor its affiliates, directors, officers, employees or agents accepts any liability for any loss or damage arising out of your use of all or any part of this report.

“UMB,” “Scout” and the “Scout” design – Reg. U.S. Pat. & Tm. Off. UMB Financial Corporation claims service mark right in “Scout Investments” and “See Further.”

Copyright © 2011. UMB Financial Corporation. All Rights Reserved.

**NOT FDIC INSURED/ NO BANK GUARANTEE/ MAY LOSE VALUE**



See Further