

Market comparisons still show volatility on Wall Street

Investment markets and the global economy continue to unveil conflicting signals – some exhibiting hope, others diminishing confidence. The 40 percent rally in the S&P 500 has provided some relief to weary investors. But uncertainty remains heightened as questions are more plentiful than answers.

Given that many stock and bond market indexes have extended strong gains into the middle of the year, many investors are wondering if markets are now overvalued, still undervalued or fairly priced. The answer looks very different depending on which type of investment you're looking at. Some sprinted to what could be considered a fair value. Other types of assets have continued to slog along with very little recovery.



Gary Brooks

Global stock and bond markets as a whole have periods of efficiency where they are fairly priced but there are always underlying segments of markets that get out of whack because of a variety of conditions and psychology that drive securities prices, both up and down, over time.

Consider the range of response to economic stimulus and investor perception that various market segments have experienced:

• U.S. small growth stocks vs. large value stocks

The Russell Microcap Growth Index represents the smallest publicly traded companies in the U.S., mostly unrecognizable names. Through June, this segment of the U.S. market posted an 18.47 percent year-to-date gain.

Their opposite, blue chip, largely dividend-paying U.S. stocks in the Russell Top 200 Value Index, were down 5.02 percent through midyear. If you were positioned

in these companies that had a larger perceived margin of safety amid recession, you might not have experienced any recovery while others found some relief.

Even if you eliminate these outliers and look at growth stocks (expanding companies, focus on appreciation of stock price) compared with value stocks (mature companies, many of which pay dividends) across all sizes of companies, growth held a 15 percent lead through the first half of the year.

• High-quality bonds vs. low-quality bonds

Disparity is even greater in some segments of the bond world. Many people consider bonds to have more consistency of returns from one type to the next. But ask people who tilted their portfolio toward "high-quality" government bonds how they feel compared with someone with a more diversified portfolio that included "low-quality" or "high-yield" bonds.

Through July 17, there was a 54 percent difference in the return of the Barclays Capital Long High Yield Index (41.52) and the Barclays Long Government Index (-13.34). Applying a large portion of your portfolio to high-yield bonds would be foolish because of the risk involved. But the disparity in returns is yet another lesson in the merits of diversification.

• Emerging market stocks vs. developed international market stocks

International markets represent 54 percent of the total market capitalization of all publicly traded stocks. They are strategically important in a balanced investment strategy. But variance in international market segments are typically greater than in the U.S.

While small companies in emerging markets were up more than 40 percent year-to-date through July 9, larger, more established companies in mature

Eurozone markets had gained just 1.1 percent over the same time.

Through July 20, analysts at investment research firm Morningstar, determined that the roughly 2,000 U.S. stocks they evaluate were collectively undervalued, but much less so than they were in March. With a 1.0 rating being fairly valued, their recent estimate put market valuation at 0.96. This is well above the all-time low of 0.55 aligned with the market bottom of November 20, 2008.

For the most part, today's snapshot of market value isn't as important as the future expectation for market performance. If you have goals that you need to save for and they require you to outpace inflation and taxes, you probably need to invest today and on into the future.

Of course, your chosen strategy and emphasis toward certain investments should vary depending on your goal.

Whether you believe markets represent good value or questionable risk today, it is wise to position your investments and your financial plan with a core strategy that fits your long-term goals and enough flexibility to be opportunistic when certain segments become more or less attractive.

Currently, that approach leads me to think that a globally diversified portfolio might benefit from slight tilts toward value stocks, emerging international markets and high-quality corporate bonds.

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