Hope and Fear Head Fake

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As the Euro-zone teeters back and forth between hope and fear, headline news risk impacting the markets has dealt investors a series of head fakes over the past several months.

After the downturn for stocks in September, stocks rallied in October on the hope for the "Merkozy Plan" – a deal to be struck between Merkel and Sarkozy that was to solve Greece's problems, recapitalize European banks, and address the overall sovereign debt problems of European countries. By late November, however, hope had again turned to fear as bond yields in Italy, Spain, and even France continued to climb when these governments found it increasingly difficult to find buyers for their debt.

Europe's problems are solvable with their resources alone if that continent's leaders can demonstrate the political will to do so. At this point, the solution for the Euro-zone largely hinges on Germany's willingness to bail out the rest of the region. The challenge is that Germany's leaders want to wait until they have wrung out all of the concessions they desire from the countries they must backstop, risking that they may wait too long.

On this side of the pond, confidence in our political leaders to solve our country's structural debt problems is not any better. The "Super Committee" in Congress recently adjourned, unable to accomplish anything at all in terms of deficit reduction.

So, as with last summer, many had "hoped" for the political will in Europe and the political will in the U.S. to find real solutions to sovereign debt issues only to be let down again. The markets teetered back to "fear", setting up investors for yet another head fake.

On the bright side, the third quarter earnings season is going well, with 83% of S&P 500 companies (that have reported) beating expectations. The current estimate for GDP growth in the third quarter stands at 2.0%. While not as strong a growth rate as we would like to see, it is certainly not recessionary either.

As tactical asset allocators we must recognize the ongoing concerns for the economy and markets, weigh them against good company fundamentals, and invest accordingly. Doing so can be especially frustrating given head fake after head fake that headline news has dealt investors.

In this environment, a stock's dividend yield may prove to be an important cushion against market volatility. Plenty of companies are performing well this year and are seeing their share prices hold up and even advance, with the added bonus of rewarding shareholders by paying dividends. With U.S. government bonds yielding next to nothing, an income stream from a dividend paying stock is even more attractive.

Additionally, we still like gold as an appreciating asset that also provides a hedge for our portfolios. With the sovereign debt issues of developed nations and the inflationary money printing that is an inevitable solution, gold continues to shine. In the third quarter, central banks around the world bought a record 148 million metric tons of gold bullion* as they stepped up their diversification away from fiat currencies.

What other growth asset class has had a positive return in each of the past eleven calendar quarters?

*Source: World Gold Council

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