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A United States Economic Renaissance

Leads to a new Bull Market for Stocks
What if we are nearing this "Fork in the Road"?
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Ren·ais·sance: A rebirth or revival

Our Thesis: Investors should be prepared for a more optimistic long-term outlook.

We believe we are nearing a new long-term, secular bull market for the United States stock market, which may spill over into the rest of the world. This will end the 14 year bear market that we believe began in 1999, which was punctuated and recognized by investors in which we shall call the "Fear Trade" of 9/11 (September 11, 2001). This bull market will contribute to and be boosted by a US economic renaissance and global growth.

In August 2011, we wrote "Fork in the Road."
In it we drew a distinction between a very cheap stock market and the outlook for the global economy. "Fork in the Road" suggested that investors should recognize attractive stock market valuations, low interest rates, high corporate profits, and high investor pessimism, as creating an attractive entry point into the market. We saw a continued rocky road ahead for the economy; low Gross Domestic Product (GDP), continued high unemployment, stagnant wage growth, government stress and global deleveraging. We did not see a United States Economic Renaissance.

Only with hindsight can we say that we successfully navigated this short-term fork in the road. The S&P 500 has risen 43% from 1,120 on September 30, 2011, to over 1,604 as of June 28, 2013.

Our research is leading us to believe that we are approaching another "Fork in the Road;" which we shall call a long-term (secular) bull market driven by a United States Economic Renaissance.
The Federal Reserve got us through the economic "dog days" and now we foresee an economic renaissance where economic fundamentals continue to lift stocks, allowing the Federal Reserve to normalize.

Long-term (secular) bull markets and a economic renaissance may take time to develop and longer to recognize
For example, we take you back to December 31, 1998, which some believe was the true peak of the broad stock market. In 1999, Investors actually lost money in stocks if they did not own technology and the 10 largest stocks. Remember Y2K? In March 2000, the Internet bubble burst, leading to recognition of a market correction. The overzealous ideals of "irrational exuberance" were gradually being eroded. On 9/11, our national mood and investor psychology changed and a bearish long-term (secular) "fork in the road" was fully taken. This road was cemented by investor pessimism that replaced previous optimism.

In 2002, we wrote an educational presentation called "What If?" We asked, "What if the market psychology does not return to the optimistic 1990's?" and "What should investors do about it over the next 10 years?" Our answer was short: Investors should save more, invest more conservatively and think more globally.

Today, in spite of obvious potential road blocks that could delay or derail this theory, we see the end of that road to pessimism and a "fork in the road" that leads to optimism.

A few of the obvious problems must be noted:
What about rising interest rates?
We could devote an entire paper on what appears to many as an inevitable rise in interest rates. Investors should hope that rates do rise, but rise slowly. Demand for credit due to a more optimistic outlook is healthy. Sudden spikes up (or down) for any reason, only delay our thesis. The technology revolution and a growing global "flat world" labor pool seem to be powerful forces at work that could hold down inflation and interest rates.

Other problems include, but are not limited to; global deleveraging (especially Europe), US Government gridlock and China slowdown. Global demographic trends - birth declines, except in Islamic cultures, and never ending Mid East turmoil - could create waves of pessimism.

Problems have always been with us, but the human condition is resilient and investors gradually swing from optimism to pessimism and back again creating long-term secular cycles. We now ask, "What if it is time to pay attention to what can go right?"

How fast should investors respond, if we are right?
No need to rush. Recognition will take time. We still have plenty of time to return to the days of strategic asset allocation practices and reduce tactical asset allocation, except where appropriate for short time horizons. We note that the bubble of the previous secular bull market did not actually "burst", but took 18 months to "roll over." This new secular bull market will build slowly. Given the problems listed above, and more, there could be moments of rational doubt, giving investors second and third chances.

What could help build investor optimism? We see a number of drivers of a US economic renaissance.

In the US, oil and natural gas may revolutionize America's energy future.
The technology revolution has helped create new found oil and gas reserves. This could help stabilize energy prices and potentially improve our environmental outlook as we reduce reliance on coal. Energy experts are forecasting an infrastructure "build-out" which ultimately, includes the United States becoming an exporter of liquid natural gas (LNG).

What if the United States finally achieves energy-source independence?
The nation's energy landscape could begin to shift from an import to an export nation, as production exceeds our needs. In the last three years, the United States has reduced imports from OPEC by more than 20%. New technology reduces the need of each unit of energy to create a unit of GDP, reducing dependency. In the short-term, demand for energy in developing countries outstrips production. United States could help to meet that global demand. If global production ultimately exceeds demand, global consumers have more money to spend.

What if the United States has a competitive manufacturing cost advantage over the rest of the world due to cheap natural gas?
This present-day reality is benefitting production and manufacturing facilities that have access to, and benefit from today's cheap natural gas supplies. The cost of natural gas in the United States is less than half of the European cost for natural gas, and is one third the cost of natural gas in Japan. Not every industry will benefit. Nevertheless, an infrastructure "build-out" could be a driver of economic growth for the next ten years or so.

Are investors starting to get less pessimistic and more optimistic?
The "fear trade" of 9/11 appears to be ending. While we do not claim to be a sophisticate on this subject, to us, more people seem to be looking forward to better days.

Investors are starting to return to stocks.
The 10 year United States Treasury yield was less than the dividend yield of stocks as of March 31, 2013. Money market interest rates have yielded less than inflation since October 2008 – four and a half years. As fear subsides and confidence builds, we can see investors seeking higher returns by selling bonds, money market funds and commodities such as gold, in favor of owning stocks.

Consumers are starting to spend. Having refinanced their debt, cash flows have improved.
A little more confidence spurs consumer spending and risk taking. Corporations have hoarded cash, but could respond to consumers. US corporations may have clarity on healthcare costs soon. Clarity in corporate board rooms could spur investment and hiring.

Housing is on the verge of growth.
The age group between 18 and 35 has been called the "boomerang" generation, because they have returned home to live with their parents. These children of Baby Boomers, also known as the Millennial Generation or Generation Y, outnumber their parents and desperately need housing and automobiles. New household formations have been stagnant for the last five to ten years. Young and restless, they too, could be encouraged by low interest rates and a stable economic environment. Also, we read that the average age of a car today is 11 years old. We also admit that we still need an answer for student debt!

Globally, America could be again achieving "a shining city on the hill" status.
"What if our production and exportation of oil and liquid natural gas are new sources for jobs, GDP growth, and tax revenue?" US tax revenues are already catching up with government spending. We could see a shift from government stimulated economy to business and consumer stimulated economy. America's "Rule of Law," potential new immigration policies, and a revamping of our educational system could make the United States an even more compelling choice for investor dollars.

We also encourage local readers to study the anticipated 2016 completion of the widening of the Panama Canal and the impact it could have on our hometown of Charlotte, North Carolina, as well as global trade.

The next wave of global growth also is encouraging.
A booming consumer class in the developing world could contribute to growth, according to the McKinsey Global Institute. The global middle class is expected to swell from 2.4 billion today to 4.2 billion by 2025, when the world's population is expected to be about 7.9 billion. For the first

time in history, more people will be middle class than lower class. This is in part our rationale for investing in the emerging markets.

What do all the above observations mean to you, our client?
We believe you could realize a better future than the one that is presently being portrayed in the popular media. Having endured the 14 year bear market for stocks and having spent the last few years building stronger balance sheets, many will now be able to dream of a bigger future, in spite of the global issues before us.

We acknowledge the issues that lie ahead are significant and we could be sorely tested by short-term market dislocations. Yet, we should not lose sight of developments that spur growth and impact the price investors pay for that growth. Our main point of this paper is to speak to the hope that we see a brighter financial future for many.

This "fork in the road" leads to both a United States Economic Renaissance and a long-term bull market for stocks.

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