DOMINION WEALTH
MANAGEMENT

December 2013 Newsletter

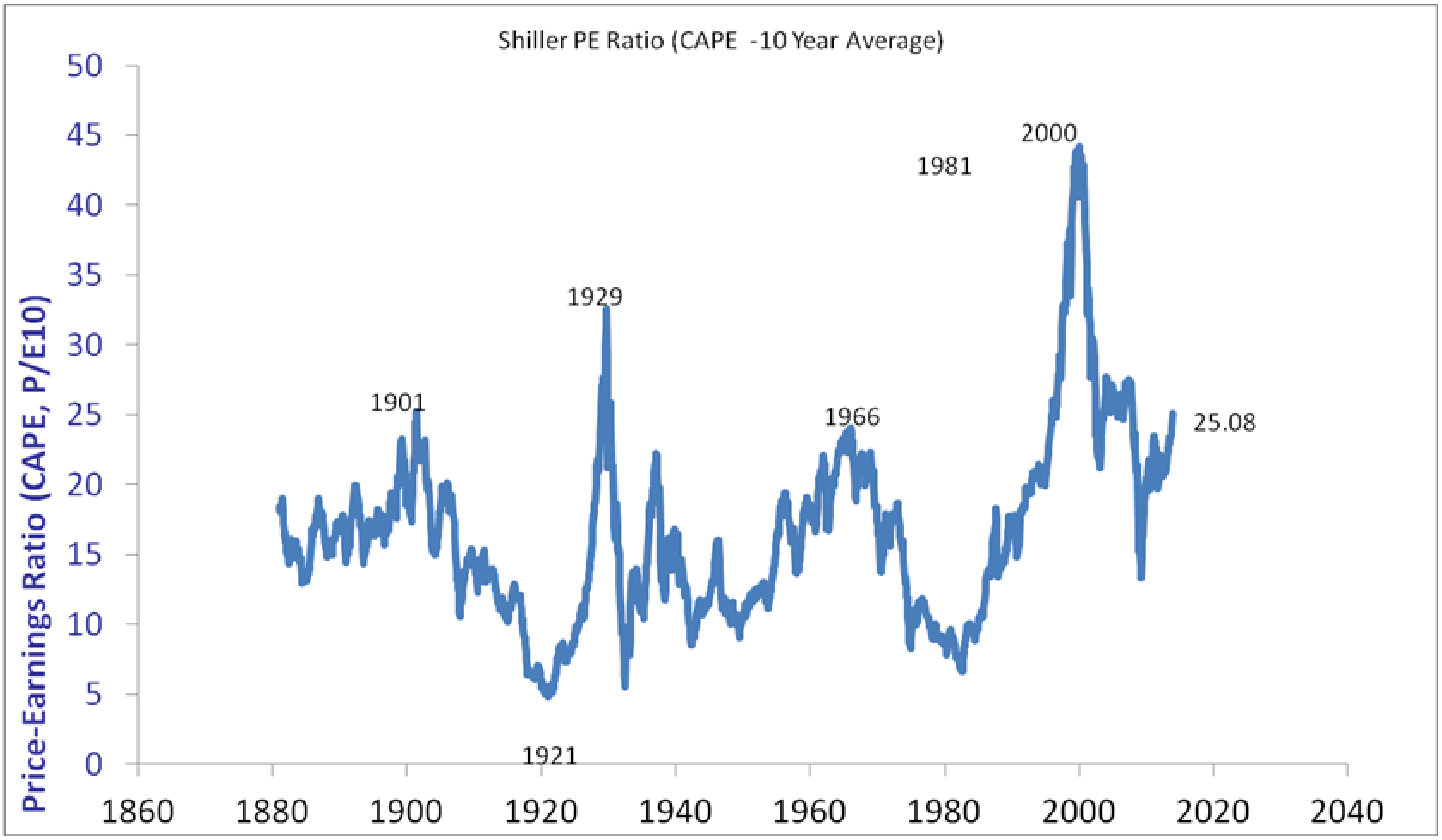
Removing Life Support

NEW YORK (MarketWatch) — U.S. stock indexes traded near unchanged Monday, making up losses in the wake of a stronger-than-expected reading on November manufacturing activity that reinforced expectations the Federal Reserve will move sooner rather than later to trim its bond-buying program.
Link: http://www.marketwatch.com/story/stocks-slip-as-investors-eye-shoppers-data-2013-12-02?siteid=bigcharts&dist=bigcharts

You may read that headline again and scratch your head (at least I do) and ask how does that make sense? The "patient's" health is improving. The doctors may be able to remove "life support". In this case, the patient is the US economy and the life support is the torrent of cash flooding the system via the Federal Reserve Bank's policy of buying $85 billion worth of bonds per month with their own private credit card. This method of creating money, known as quantitative easing (QE), has taken approximately eight cents from the value every dollar-dominated asset you own over the last five years. This is over and above inflation losses in purchasing power. While the discussion of quantitative easing is plenty of fodder for a newsletter, we will instead be focusing this letter on the current perverseness in the investment marketplace.)

The economy is improving and the players in the investment markets bid lower for the investments that should do better as the economy improves. Does that make sense to you? It does not make sense to me. A lot of what is going on in the investment markets does not make sense to me right now. Sober analysts like Dr. Robert Shiller agree. Shiller, professor of finance at Yale University, developed a measure of stock market valuation that helps provide a degree of perspective. His estimate is that the stock market is currently 50% overvalued relative to historical norms. The problem is he can't say or see what might bring these values back to a normal range.
http://blogs.marketwatch.com/thetell/2013/12/02/robert-shiller-most-worried-about-bubble-in-u-s-stock-market/

Historically, the stock market has not provided normal returns from abnormally high points of valuation. The historic average Price to Earnings ratio of the S&P 500 Index is around 16.5. Presently, the Shiller P/E rolling 10 year average is close to a level of 25. This is using the ten-year average of company earnings divided by their price. This is important to note now because of the urge to rush into the party of perverse pricing. There is a lower probability of historically normal returns to continue at this pace from this very high point of valuations. The chart below may paint the picture best.



I look forward to sharing these insights as part of our ongoing management of your wealth and retirement income.

Have a safe and happy holiday season,

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