



Napa Wealth Management's The Sensible Investor

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A Perspective from Two Professors

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In early June, I had the pleasure of attending a conference where Yale professor Dr. Robert Shiller and Wharton professor Dr. Jeremy Siegel were keynote speakers. Both gave their outlook for both the real estate and stock market.

Dr. Shiller, author of *Irrational Exuberance*, an analysis of speculative bubbles in the stock market and real estate, released in May of 2006, accurately predicted the housing bubble. He began his talk outlining his research on the market. He explained that the economic expansion in the 1920s was due to technological advancements - radio and telephone - similar to the technological boom of the 1990s. "Although market timing has a bad reputation on a day-to-day basis, on a decade to decade basis, it is a good predictor. What goes up must come down and what comes down must go up."

Shiller displayed a graph which highlighted people's feelings about real estate as an investment. A survey starting in 2002 asked people the following question, "Do you agree with the following statement: Real estate is the best investment for long-term holders, who can just buy and hold through the ups and downs of the market."

From 2002-2003, existing home owners' hopeful feelings about their real estate investment dropped. By the end of 2003 the trend reversed and for the next three years existing owners' sense of real estate being the best investment for the long-term increased steadily until peaking in 2006. It dropped from 2006-2007, where it stabilized before taking a dive from 2008 to date. The perspective for first time real estate buyers dropped from 2004 on. They did not view real estate as the best investment for long term holders.

"Although housing prices are well off their peak hit in 2006," stated Shiller, "futures are predicting no-change in home prices in the near term through 2012 and only a slight increase into 2013-2014 (source: www.homepricefutures.com). In a report released by Realty Trac (July 29), "Foreclosures rose in 75% of big cities in the first half of 2010, preventing sustained home price

gains for at least three years. We don't see a double dip in housing, but we think it's going to be a long painful recovery".

Known for being a stock market bear, Shiller continues to be cautious about our economy's recovery, especially when referring to the housing market, which is a key component to sustainable economical growth. In closing, Dr. Shiller said that this could be a very tumultuous time and he fears a double dip recession. Ironically, on July 29, James Bullard of the Federal Reserve Bank of St. Louis warned that the U.S. economy could be headed for a "Japanese-style outcome." Japan's economy has suffered stagnation for about 20 years.

In contrast to Dr. Shiller's sobering talk, University of Pennsylvania and Wharton Business School's icon Jeremy Siegel offered a more optimistic outlook for the stock market. Dr. Siegel displayed a chart that outlined total real returns (after inflation) for stocks, bonds, Treasury bills, gold, and the dollar from 1802-2009 (now *there's* a long-term time horizon!). Stocks won with a 6.6% real return and bonds a distant second at 3.6%, T-bills 2.8%, gold 0.5% and the dollar was negative. Dr. Siegel pointed out that currently, stocks are approximately 27% below the long term trend line (a technical perspective for stock market analysis). Since Siegel's extremely long-term analysis highlights the fact that stocks typically follow the long-term trend line very closely, he concludes that stocks are poised to move higher to complete this trend.

Dr. Siegel pointed to the bond market as a contrast to stocks. He analyzed Treasury bond yields in the late 1970s - early 1980s when rates were extraordinarily high. The 30-year Treasury bond was yielding 15% in 1981, which was, in Siegel's words, "a bit of competition for stocks." He continues to say, "Currently the 10-year Treasury is yielding 3.2% (as of June 10, 2010)," inferring that the bond market is not as attractive as stocks due to the low returns (yields) that accompany a low interest rate environment. "We have not seen an environment this favorable for stocks vs. bonds since the 1950s." This was another point Siegel made to support his bullish outlook for stocks.

Siegel turned to the international markets and analyzed the price to earnings (P/E) ratio, a valuation method used to determine the over or under-pricing of stocks relative to their earnings. A high P/E indicates stocks are overpriced while a low P/E means they're underpriced relative to their earnings. "Emerging markets' P/E ratios are in their low teens which points to higher stock prices," Siegel said. He continued, "We have seen the worst recession in over 50 years and the emerging markets came back fast. They recovered faster than developed economies."

In closing his talk, the seemingly intransigent Dr. Siegel told his audience, "The market is not always efficient. It is not always right and can miss in the short-run."

Note: Dr. Siegel's outlook for 2008 was as follows (posted 12/17/07):

I think the stock market will have another winning year in 2008. For every percentage point that stock returns fall

below 8% (my prediction) this year, they should exceed 8% next year (meaning, for example, if stocks gain 6% this year, they should finish 2008 up 10%).

And I believe that financial stocks, which have plummeted 18% so far this year, will outperform the S&P 500 Index next year as the credit crisis fades.

We all know how wrong he was with the above projection. This demonstrates how difficult making projections can be, even for the experts. At Napa Wealth Management, we listen to the experts and watch market and economic indicators (indicators have no emotions). The housing industry historically leads the economy out of a recession. The lack of a recovery in the housing sector is a key indicator pointing to an economy that is not out of the woods. We continue to remain cautious about the stock market.

Keep looking up,

George

Goodbye Miguel

After two short years Napa Wealth Management is saying goodbye to our friend and Client Services Manager, Miguel. His cheerful attitude and attention to details will be missed. Miguel is pursuing a career opportunity with a large investment management company in the Bay Area.

Brandi Meyer will be taking over as our client services manager beginning August 16. Brandi is moving to Napa from San Diego to join our firm. We will be hosting an open house on September 24 where you will be invited to meet our newest associate.

Fall Open House

Friday, September 24

5pm – 8pm

We will enjoy live jazz

by Canned Music Trio

Save the date!

Comments/Suggestions

Napa Wealth Management is dedicated to delivering you a newsletter full of insights and interesting articles.

If you have suggestions or topics that you would like us to address, please email George at George@napawealth.com.

