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Betwixt and between

Wary investors balance predictions of rebound against storm warnings

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The fortunetellers already have figured out what's going to happen with the financial markets next year. We're either on the cusp of a charging bull market -- or we're not.

An economic storm unlike any the world has seen tends to cloud crystal balls, making it especially vital for investors to move ahead cautiously, but still keep watch for the many opportunities that doubtlessly lurk, market watchers say.

The unprecedented and far-reaching tremors of Wall Street's implosion tend to blur the true picture of where we are and where we will go, they say -- things that seem rather good right now could end up rather badly; things that seem perilous may be no more than phantom threats.

Even the things that seem certain come with counterpoints these days: Some stocks *do* remain undervalued -- just as some stocks are surely overvalued. People *are* growing more confident -- and many investors may be a bit *too* confident.

From where these experts sit, only so much can be said without assurances of where some key indicators will lead. Government money is helping sustain gains, but we have to wonder what will happen when it's gone. The dollar is gaining traction after a perilous slip, but could do real damage should it lose grip again. And lurking behind it all is the specter of inflation, which could stop that raging bull in his tracks.

The good news is, much of the bad news has already been factored in to capital market pricing, many observers believe. "Unless we get some significant unknown problems, I feel the market has priced in the source of the current worries," said Paul S. Baumbach, a principal at Mallard Advisors in Newark.

"You'd have to paint a pretty dire picture to make it worse than we already know," said Andrew Hopkins, vice president and director of equity management for Wilmington Trust. "When the market already knows about something, it's much more comfortable moving forward."

It's a journey that demands the right pace, however. It's risky to get too bullish with the gains of the past few months already behind us, said Baumbach, who's being careful not to push customers' cash into stocks too fast.

It's also risky to give a company too much credit for a healthy bottom line when its top line -- the revenue it's bringing in -- also isn't thriving, said Judy Lau, president and founder of Lau Associates, a Wilmington investment management firm.

Part of the ongoing rally has tended to favor companies that achieved good results only with the help of a sharp cost-cutting knife. That's not the best gauge of true vigor, she suspects, and it's not one that likely is to be sustained.

"We are thrilled that the market is up," she said. "Our clients have made back some of what they lost, and that's fabulous. The question is, is it really sustainable at this level? We don't think it is."

In a market that Lau suspects will be fraught with uncertainty and variability for some time, investors should keep their liquidity high and their options open, she believes. "It's a time that pays to be prudent, so we are looking at those things which generate real income, those things that have downside protection," she said.

Others already are betting that the run-up will be bound to draw in more of the mountains of cash that investors have been holding on the sidelines, especially as more tangible evidence of a recovery emerges.

"I suspect that the pendulum will keep swinging on the positive side for a while, because of how extreme it got on the negative side," Baumbach said, noting that 70 percent of federal stimulus has yet to hit the economy. "That, I think, is going to be a real tailwind for the next 18 months."

The cyclicals -- things like cars, houses and other big purchases a cash-stressed consumer could defer -- could mount quite a comeback when those consumers become confident enough to spend again, Hopkins said.

That in turn, will depend on them becoming more confident about jobs -- something Hopkins senses will start to turn positive by the end of the first quarter.

"Right now, it looks to us that the economy is recovering," he said. "We're coming off the bottom, but were coming off the bottom slowly right now. The question is, does that build?"

If it does, many companies that have made themselves "lean and mean" through cost-cutting could find that their newly revived top-line revenue goes straight to their bottom line, he said. If that's the case, valuations could be a relative bargain now in some instances.

Even if it takes a year or two to get back to the stock market's peak, an investor who positions themselves today would probably see a 10 percent to 15 percent gain, far better than many alternatives, Baumbach said. At the same time, investors must be cautious of how the current momentum is being driven -- partly with the help of a government that's printing money, digging itself deeper into the deficit hole, and consequently heightening the risk of inflation, Lau said.

"We don't think were going to look at the abyss again. We could be wrong, but we do think the markets are going to bounce around" as they seek equilibrium in a market environment unlike anything before, she said. She's advising people to tamp down their pre-recession expectations of generous returns, and prepare for a "new normal: of slower, bumpier growth.

It's also a time to look outside the U.S. borders for that growth, observers say, so long as investors are willing to be patient. "It is absolutely the long-term story," Baumbach said. "It's not a smooth ride, but it appears the long-term trend is going to be higher than U.S. stocks."

"We think there's more opportunity in the international arena than the U.S. arena, said Lau, who nonetheless keeps a wary eye on all that is unsettled, and will be for a time.

"So were looking at hedging all kinds of things. Hedging risk, hedging the decline of the dollar ... you name it," she said.

As the world learned last year, it doesn't take much time for dark clouds to sweep in. Observers like Hopkins have their eye on the horizon -- looking for signs that the dollar is faltering, or that interest rates are getting jumpy.

Still, it's a world that seems a much more serene place than in did.

"It's much easier to come to work today than it was nine, 10 months ago," Baumbach said.
