So here we are in May and the markets have been back and forth the entire year. One month things move down and the next things move up. A lot of back and forth, but pretty much not really any forward progress for the Dow Jones Industrial Average. As I write this letter the Dow stands at just a small touch over 18,000 after having started the year at 17,900. So essentially five months have passed and the overall market has budged about 150 or less than 1%. (Dow Jones Industrial Average) As you know a 1% move is essentially the movement that we now experience just about every single day.

Now even with not much volatility and movement for the markets, much has been written in the financial media lately about the stock market being wildly overvalued and ready for a significant pullback. In fact, I just read an article today talking about how it's been nearly four years since the market has suffered a 10 percent correction — the third longest run since 1960. (Wall Street Journal) Investors are complacent they say and that we're moving into mania territory last seen in the 2000's, based on the ratio of the price-to-earnings multiple and the CBOE Volatility Index. They say that valuations are high and are at levels that were only seen during the 1929 and 2000 market bubbles. Other articles I read reference that mutual fund investors are taking more money out of stocks than is being put in and that this is a negative sign for stocks going forward. (WSJ) I read very little in the financial press that suggests that things are looking good for the future of the market.

While these points are well taken I want to put things in perspective for a moment. I'm not going to say that the market is not going to have a 10% or greater correction because, I believe, it will. This is just a matter of time. However anyone that thinks that these things can be timed is clearly missing the boat. Consider the argument that the market is due to correct right now because it has gone 3.8 years without a 10% correction or more. Well using this logic an investor would have missed out on nearly three years of the market advance from October 1990-October 1997. During this time period the market went a full seven years without a 10% correction. In 1995 the Dow Jones was at 4,000 and by 1997 it was at 8,400.(DJIA) So sitting on the fence waiting for a pullback caused an investor to miss over 100% of upside in just about three years.

Well, you could argue that, yes, the eventual downturn did come (we all remember 2000-2002), but if you got out of the market in 1995 at 4,000 you missed the run all the way up to 12,000 on the Dow Jones in early 2000. After the correction, the best that you could have bought back in at was 7,950 (this is if you were lucky enough to time the exact bottom). So even in getting back in at the best time possible an investor still lost the opportunity to double their money in the markets from 1995-2002. That is a lot of return to miss out on waiting for the "expected" pullback.

Now this gets me to another point. There are those that are saying that valuations today (read Price to Earnings or PE Ratios) are at extreme levels and therefore the market is overvalued. Well, PE ratios today are at about 16 which granted is a little higher than the historical average of 15. However, keep in mind that at previous climax points in the markets PE ratios have been much higher. Using the Year 2000 reference point that many like to use as the mother of all

overvaluations in our lifetime, the PE ratio on the market then was 26. This is over 50% higher than where the PE Ratio is today. This means that for us to be in the same realm of overvaluation, the Dow Jones would have to be at least at 27,000 to even begin to compare. I know some are thinking well what about 2007…. (WSJ) Using the market top in 2007 we then had a PE Ratio of 22 (lower than in 2000, but still nowhere near today's 16. (DJIA) So suffice to say, I believe, that the market is nowhere near the overvaluation levels that it has been at previous peaks, but yet for some reason so many want to classify this market as very overvalued.

The truly amazing thing to me is the last thing that I want to talk about in this letter. Remember that in order for investors to sell they have to have a reason. The two most obvious reasons that investors sell is because they are 1) scared or 2) have something better to do with the money that is invested in the market. Well with the market at new fresh record highs virtually no one is scared because nobody is losing money. People begin to get scared when things start going down. Not while the markets are still climbing. Pretty easy. Yes there will be the few that are scared because they think the bottom is going to drop out, but honestly many of these folks have been selling along the way at 10,000, 12,000, 14,000, etc. and so there may be a few left to sell at the margin, but not enough to make a real difference in the markets. This takes us to the second reason that people sell. There is something else to do with the money pulled out of the markets.

Today, as we know, interest rates are next to nothing. In fact, as I write this the national average on FDIC Insured Certificates of Deposit is as follows: (Rueters)

One Year 1%
Two Year 1.19%
Five Year 1.68%

This is not exactly a lot to get people excited about selling out of stocks that are continuing to go up in price. As you reflect back to the year 2000, for example, the rates on FDIC Insured CDs were as follows:

One Year 7.5%
Two Year 7.25%
Five Year 7.0%

Now consider that people in 2000 loved stocks so much that they were willing to forego an opportunity to get these kinds of interest rates on a guaranteed investment. Now, in my opinion, that is when a bubble is brewing in stocks. When the stock market is sitting at a Price Earnings Ratio of 26 (historical average again is 16) and investors can get an FDIC Insured investment at 7% and they choose not to, then you have an argument that stocks are overvalued. However, consider that today we sit with a PE Ratio of 16 and an FDIC Insured investment gets you in the 1% range, I would say that I just can't see the argument that stocks are in a bubble and that the market is very overvalued. But today, anyone selling out of the

markets has at their disposal a guaranteed investment of a pittance. How many are going to be willing to sell in droves (what it takes to get a significant decline) in exchange for getting this kind of return on capital. I just don't see it.

So in short, until the trend changes the line of least resistance is for stocks to continue moving up. While there will be stops and starts along the way I think that by the end of this year we will have another positive year for the market and not until interest rates begin to move higher in a meaningful way do I think that the doomsayers will have their viewpoints vindicated. This could take a very long time.

As always, thank you for your continued trust. It is much appreciated and never taken for granted.

Shawn

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Dow Jones Industrial Average is a price-weighted index of the 30 "blue-chip" stocks and serves as a measure of the U.S. market, covering such diverse industries as financial services, technology, retail, entertainment and consumer goods. An investment cannot be made directly in a market index.

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