

At long last the much awaited market 'correction' is upon us. The last four years have been quite unusual. It is not so much that the market has been strong, rising over 50% since the beginning of 2012, those run ups occur with some frequency. The surprise has been the steadiness of the progress. There has not been a 10% fall since 2011; this last August 21, was the first time in 219 consecutive trading days that the market closed 5% below its peak. There has not been such a run in over a decade.

We never know when a fall back will actually occur and this year has made it especially difficult. Up until Thursday, August 20, the market had meandered about in a very narrow range for the entire year. Always staying above the year's beginning level the market would go up 3.5% at most, then move back. After a while financial observers became complacent, some hoping that this cycle was itself the correction. In the Money section of USA Today's August 19, edition a headline read: Wall Street Says Stock Market is Going Nowhere Fast. The next day the S&P 500 index fell 2.2%. Throughout the year a daily move of 1% was a lot. The next day, August 21, the index fell 3.1%, the following Monday it dropped off 3.9%. Next day the market opened like a rocket, going straight up, then managed to lose it all at the close, dropping another 1.3%. In four days the index had fallen over 10%. Mercifully, on the 26th, the market gained back 3.9% and the following



day it was up another 2.3%.

So are we being punished for something? Well, not really. There is no shame in having our collective hand in the cookie jar for such an extended period of time. We have just been lucky. Markets take on a momentum of their own, starting at a point where lots of things are cheap and progressing to a point where a lot of securities are, in the stock market lexicon, 'overvalued'. All along there are 'reasons' why it is going well just as the naysayers have reasons why it should all stop. As long as the forces which are driving the market are in play they will continue to push it up, until they don't. The driving forces have been a federal reserve which has doled out lots of money, an economy that has been steadily though slowly improving, and we are still in the TINA market, which stands for There Is No Alternative.

Whatever problems our stock market might have it is still a lot more attractive than foreign markets. Commodities have been in a free fall and real estate has become much more speculative than stocks.

Just one of the driving forces has abated. The federal reserve has ended its program of 'quantitative easing', which essentially means creating huge amounts of money. Indeed, the fed is now threatening to raise interest rates, although by an amount so tiny that in fact it would be more symbolic than real.

The American economy continues to show signs of improving health. The latest report from the Commerce Department's Bureau of Economic Analysis shows a remarkable rise in economic activity. In the second quarter gross domestic product rose at an annual rate of 3.7%, the initial estimate was 2.3%. A 2% rise has been about the average since the beginning of the recovery in 2009. The improvement is in all major areas of the economy; personal consumption, business investment, government infrastructure expense. The fall in gasoline prices translates into increased retail sales and higher spending for services. Automobile sales are higher than at any time since 2005. Residential housing investment has risen over 8%. Sales of existing homes are at their highest level since 2007. Unemployment claims in July were the lowest since 1973.

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Just one area of the economy is weak--corporate sales and profitability. In the first quarter corporate profit began to slide and in the second quarter it was below the prior year's level, the first time since 2009. For the S&P 500 companies sales are running at a rate 4% below last year and profit is off about 9%.

Why the disjunct between the American economy and America's largest corporations? Because S&P 500 companies' sales are more than 50% overseas, and 10% is to China. The strong dollar has been a problem but the real threat, the thing that has pushed the market over the edge, is China. China has been the engine of world economic growth. Estimates range between one-third and one-half of global growth is due to China.

Now China is beginning to slow down. Real statistics are notoriously hard to come by for the Chinese economy but bits of hard data begin to show a pattern. Electricity generation, railcar loadings, new construction projects are all down. The most telling fact is the collapse of world commodity prices. China is the world's largest importer of raw materials so the following statistics matter a lot: in the first four months of this year its

imports of copper fell 14%, rubber was down 16% and coking coal, used for steel making, was off by 38%.

The financial commentator class is in the midst of much handwringing. China's leaders were the shrewdest business hombres in the whole world not very long ago. Now they are klutzy commies who don't know how to handle the quasi-market economy they have created. Are they going to bring the world down by their own economic collapse? Unlikely. What is really happening is that China is in the midst of a major economic shift. It has been an export led and infrastructure building economy. Now it is one transitioning to a consumer focus. Of course there will be major dislocations. American companies that sell equipment or raw materials will be hurt. Caterpillar Inc.'s second quarter sales in the Asia-Pacific region, mostly China, were down 30%.

The expanding middle class is where the action is. Approximately 147 million households, nearly one-half of the urban population, are now classified as middle class. Western branded goods bring prestige and predictable quality. Dove shampoo and Crest toothpaste, Samsonite and Adidas are where the future lies. Western innovation will continue to create unique products. Apple Computer sales remain strong. The Chinese are eagerly awaiting the opening of Shanghai's Disneyland.

We should not despair that our economy is going to fail or the stock market collapse. We have

had a good run and we are now in a time of consolidation. There will be market turbulence but there is room for optimism. Since 1980 the market had fallen at least 5% in a single week, as it did last week, a total of 29 times. In more than two-thirds of those instances market averages were higher 12 weeks after.

Of course it is possible that this market will move lower for a protracted period and we will not be passive in that event.

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to protect those gains. Every stock has a price point below which we will begin to sell off shares. That will curb serious loss and, as noted, guard profits.



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