

BY STEPHEN BRENNAN

CURVES AHEAD

AS THIS YEAR NEARS AN END, I CAN'T HELP but think that much of the easy stock market money is now behind us. The start of this year was marked by extreme pessimism, which is always a good time to buy. In fact, my January column commented that cash on the sidelines and depressed prices, along with overlooked trends for sustainable growth and history all boded well for stocks. Pessimism and history also told you what to buy. My column recommendations included technology stocks, which had been among the most heavily sold stocks. I also touted small cap stocks, which typically perform well in the early part of a bull market. However, as I write this column at the end of October, extreme pessimism is behind us, while technology and small cap stocks have now posted impressive performance.

SHIFTING GEARS

If someone were to ask me what U.S. stocks to invest in today, my general advice would not be as simple as to load up on tech and small cap growth stocks. I expect that both still have some more outperformance ahead, but people no longer look at me like I'm insane for liking these stocks. That makes me uncomfortable owning them. No class of securities outperforms forever. Over the long term the stock market is efficient. Right now a lot of the money that could flow into tech stocks and small growth stocks has already done so. At some point, that will stop, and I would recommend investors who are overweight in technology stocks at the moment to begin the process of taking some profits. While small cap growth stocks only began their outperformance in March, technology stocks have been leading the market higher for over a full year now.

STILL FAVORING FOREIGN

Despite my concerns about the longevity of continuing outperformance for technology and small growth stocks, I remain very bullish on the long-term prospects for foreign stocks in Japan and the Eurozone. When looking at foreign markets, it is vital to remember that it is not important that these economies outperform the U.S. or some other benchmark. It is only important that they outperform the bar of investor expectations. For this reason, I especially like Japan and Germany, where expectations remain relatively low, but where real structural reforms are now underway. At the close of October, both of these markets have easily surpassed the current calen-

dar year performance of the S&P 500 U.S. stock market index. I expect the trend of foreign outperformance to continue for quite a while longer. Although momentum has turned to favor reforms in Japan and Europe, there is not much impetus for meaningful structural reform in America. Furthermore, I believe that a long-term reversal in currency flows away from the dollar is underway, which should benefit foreign stocks.

POTHOLES IN THE ROAD

Not only do I expect the roadmap for navigating this stock market to change in the not so distant future, but I also expect that things will soon get bumpier. Although I believe we are in a bull market and the odds favor a strong finish for the year, even bull markets don't go straight up for long. Yet, as I write this column it's been a relatively long time since we had a scary sell-off in the stock market. In all honesty I have no idea when the first nasty correction will occur. My inclination would be to treat it as a buying opportunity, just as soon as most of the pundits begin urging investors to get cautious. That's not a typo, by the way. Cast your mind back to the beginning of the year, and recall that when the talking heads were last strongly urging caution, it was a great time to do some buying.

Looking ahead to next year, my expectation is that stocks will continue to rise, but that it will not be as smooth of a ride as the one we have enjoyed coming off the March bottom. The simple fact is that you don't get too many chances to invest off the end of a three-year bear market, and that opportunity is now behind us. You can expect another chance in about half a century, when all the lessons of a bubble are relearned by another generation. As a contrarian I am going to miss the extreme sentiment we just experienced as I must now focus on judging shades of gray instead. ☞

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