MAINSTAY CAPITAL MANAGEMENT LLC

Bad Macro, Good Micro

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While many investors were trying to enjoy the final weeks of summer, the stock market embarked on a wild roller coaster ride. In August alone, the Dow Jones Industrial Average experienced seven daily swings of more than 500 points.

Why is market volatility so high? We believe that it's largely attributable to a case of "bad macro, good micro". While the micro-economic story of corporate earnings reports were positive, news affecting the overall global marketplace, or the macro-economic environment, has been decidedly negative.

Many issues have surfaced, but we believe that two factors in particular are leading to a "crisis of confidence" among investors. First, GDP growth expectations have been revised downward to a rate where meaningful job creation - and a resulting drop in the high unemployment rate - appears unlikely this year.

Some market participants look at the latest numbers and see a temporary mid-cycle slowdown, while others see the same numbers and predict a double-dip recession. Either scenario is possible at this point, and the day-to-day movement of the markets seems to result from speculators in one camp or the other.

Second, the risk of a widespread default of European sovereign debt, which has been roiling markets worldwide for some time, is reaching a critical point. What started in Greece has spread to the much larger economies of Italy, Spain, and even France. The lack of coordination and inability to agree on a policy to avert default has caused the situation there to continuously teeter back and forth between periods of relative calm and outright panic.

What's most troubling is the lack of urgency among central bankers and political leaders to forge a real plan to address the problem. Viewpoints are far apart and time is running out. None of these countries can afford to "kick the can down the road" much longer, as their debt issues are much more short-term when compared to the U.S.

So with the flow of news and global economic outlook so uncertain, more market volatility in the coming weeks is inevitable. However, investors should not lose sight of the good micro story as it relates to U.S. companies.

Throughout the reporting period for second quarter earnings, company after company was beating expectations and signaling a healthy sales outlook for key products. Balance sheets are the strongest they've been in years, with a great deal of cash in the coffers. The ability of firms to use technology to increase productivity and efficiency has temporarily hurt job growth, since companies can eliminate the need for more workers while still growing. These advancements, however, have certainly benefited the bottom line earnings of corporations. With corporate profits holding up in a troubling macro environment, stocks are certainly not expensive at these levels compared to historical valuations.

So with a list of uncertainties on the macro level, but with strong fundamentals at the micro level, how should an investor proceed? In this environment, a stock's dividend yield may prove to be an important cushion against market volatility. Plenty of companies are performing well this year and are seeing their share prices hold up and even advance, with the added bonus of rewarding shareholders by paying dividends. With bonds yielding next to nothing, an income stream from a dividend paying stock is even more attractive.
