McLEAN ASSET MANAGEMENT CORPORATION

# Occam's Razor

January 2014

**WHAT IS OCCAM'S RAZOR?**

Occam's Razor is a principle attributed to William Occam, a 14th century philosopher. He stressed that explanations must not be multiplied beyond what is necessary. Thus, Occam's Razor is a term used to "shave off" or dismiss superfluous explanations for a given event. This concept is largely ignored within the investment management landscape. This newsletter will "shave off " popular investment misinformation and present what is important for achieving long-term investment success.

## 2013—A great year for stocks, but…

# Are we in a bubble?

Fear and loathing is one way to describe the sentiment for the 2013 stock market. Before the year began, Barron's Magazine called for a US recession and Time Magazine proclaimed stocks dead in 2013. Throughout the year, many were concerned with the United States' sluggish recovery, recessions in China and Japan, and threats of a US Government shutdown. Additional market angst was caused by the United States' possible involvement with the civil war in Syria and tensions in Iran. Yet, despite these concerns, the market moved significantly higher. The S&P 500 closed the year with a total return in excess of 32% and international markets, represented by the MSCI-EAFE Index, returned over 18% for the year. 2013 was a classic example of a "climbing a wall of worry" market.

For a full 2013 Economy and Market Review, click here.

For a 4th Quarter Market Review, click here.

This rise, though, has inevitably stoked increased concerns of "Are We in A Bubble?" While we are not in the prediction or market timing business, our thinking is a bubble does not exist in the market at this time, though we think there is a bubble in bubble talk. Some of the reasons we think there is no bubble include:

- **Reasonable valuation of the market:** Stocks continue to look fairly valued. Market valuations have gone from what is considered cheap to slightly expensive. The S&P 500 currently trades within "normal ranges" at nearly 15 times next year's earnings estimates, up from about 12 at the beginning of 2013.

- **Economic growth, while not robust, is solid**: Consensus economic projections call for improved U.S. GDP growth of up to 3% in 2014. If 3% growth occurs, this will be a considerable improvement over the 2% average growth since the recession of 2008. A case in point in the improved outlook is the recent Institute for Supply Management's (ISM) Manufacturing Index. In December, the index posted a solid 57% reading, the highest reading since 2011. (Any reading above 50% indicates a positive improvement in the underlying components of the index.)

- **Lack of froth:** During past bubbles, the individual investor piled into the market during the latter stages of the bull run. Through October of last year, investors have put $111 billion into U.S. stock mutual funds and exchange-traded funds, according to research firm Morningstar. That doesn't yet make up for the $134 billion they have taken out of stocks since 2009. In fact, flows into equities only turned positive in the first quarter of 2013 after five years of outflows. From a personal Occam's perspective, we have not seen excessive optimism from our clients either. Quite the contrary, the crisis of 2008 and 2009 is still top of mind for many of our clients.

- **The current bull market is not unusual in length or duration**: Since March 2009, the market has gained 167%. This compares to an average 185% gain in the 12 bull markets since 1930. The current bull market is in its 56th month and that compares to the average of 61 months. This means that while the bull market is getting to "average" levels, it is not extended based on history. Others also point to the idea that if you have a 20% plus return one year, it is likely the next year will be negative. This is not true and, in fact, going all the way back to 1870 there were 30 years when the Dow returned 25% or more and in the subsequent year, 23 or 77% were positive with a mean return of 12%.

Finally, Nobel Prize winner Eugene Fama argues that there is no such thing as a bubble as markets are efficiently priced.

For more on Fama's thoughts on bubbles, [click here].

This is not to say we won't experience a correction at some point. We will. It could be this year or next year after another 20% run up. Our belief and strategy is that you cannot predict when a correction will happen, but that because of our diversified customized portfolios, we will weather the inevitable ups and downs of the market and be positioned well for the inevitable bull market that follows.

Occam's wishes you the best for 2014.

**Note to Readers**

The content of this publication reflects the views of McLean Asset Management Corporation and sources deemed by McLean Asset Management Corporation to be reliable. No representation or warranty is made concerning the accuracy of any information contained in this publication. In addition, there can be no guarantee that any projection, forecast, or opinion in these materials will be realized. Past performance is neither indicative of, nor a guarantee of, future results. Historical performance results for investment indexes and/or categories generally do not reflect the deduction of transaction and/or custodial charges or the deduction of an investment-management fee, the incurrence of which would have the effect of decreasing historical performance results.

The views expressed herein may change at any time subsequent to the date of this publication. All material contained in this publication is for informational purposes only, and shall not be construed as investment advice.

McLean Asset Management Corporation only transacts business in states where it is properly registered, or excluded or exempted from registration requirements. McLean Asset Management Corporation does not provide tax, legal, or accounting advice. The information contained herein does not take into account your particular investment objectives, financial situation, or needs, and you should, in considering this material, discuss your individual circumstances with professionals in those areas before making any decisions. Any information contained herein may not be construed as any sales or marketing materials or an offer or solicitation for the purchase or sale of, any financial product or service sponsored or provided by McLean Asset Management Corporation.

©2014 McLean Asset Management Corporation

**This newsletter is published by:**

**McLean Asset Management Corporation**
**(866) 827-0636 | www.mcleanam.com**