LONGRUN CAPITAL MANAGEMENT

Is It Safe?

Movie buffs will feel an involuntary twinge recalling the scene from Marathon Man where Sir Laurence Olivier, as the ex-Nazi, Dr. Szell, is performing anesthetic-free dentistry on Dustin Hoffman's character Babe. Szell has come to New York to retrieve a cache of diamonds stolen from Jewish war prisoners and thinks that Babe has information about a plan to capture him. Unfortunately, the unwitting Babe doesn't know anything so the session is rather agonizing.

Investors around the globe have to be asking the same question these days. Is it safe to plow more money into the equity markets even as they have recovered 25% or more from their October lows? Here's my list of three things that would make me comfortable having a lot of equity exposure.

It's safe if US corporate profits remain at record levels as a percentage of GDP. Take note that part of the reason profits are so high is that wages/salaries as a % of GDP are as low as they've ever been. These trends could go on for a while but profits tend to run in cycles and any downward move would hurt equity valuations.

It's safe so long as Washington continues to provide some significant combination of monetary easing and/or fiscal spending to bolster confidence in a recovery. The Fed is signaling that it wants to pull back on the QE programs and Bernanke is telling Congress to set a path to lower deficits. Notice that equity markets reacted badly to the Fed's latest messaging. Meanwhile, Geithner is advocating ***more*** government spending (deeper deficits). With an election in November you would expect action on one or both fronts to avoid any major market disruption. Just don't forget that our last Presidential election was in 2008. I don't think that went according to the Bush playbook.

It's safe to the extent that the "firewall" being constructed in Europe can contain potential defaults by Greece, Portugal and Spain (and maybe Italy). David Kotok of Cumberland Advisors is a very connected observer and has long believed that Europe would work through its problems and keep the Euro intact. After being on-site a week ago, he is deeply concerned that Portugal is in worse shape than markets understand and that it could trigger a systemic crisis too big for the EU bureaucrats to handle.

Any of you reading this may have other items on your list (Middle East, China, Sarah Palin back as Veep candidate). The three above are enough for me. Putting myself in Babe's position, how do I answer the question? Can't do it. I simply don't know how these issues will sort themselves out or even when the answers will emerge. You can't beat it out of me! This time last year, my tactical strategies were 100% long equities and that's pretty much where we are now. By June of last year, we were getting defensive and fully battened down the hatches in July. Will we repeat that pattern this year? I don't know, but I wouldn't be surprised. You shouldn't allow yourself to be surprised either.