EASTERN ◆ PENNSYLVANIA
Business Journal
December 13, 2010 Vol. 21, No. 50 $1.50
www.epbj.com

Market looks good, but beware of debt in 2011

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The stock market has been on a pretty wild ride this year. Some events such as the debt crisis in Greece and rising tensions in Korea sent it down only to recover when retail sales were better than expected in November and profit margins helped some companies to report better-than-expected profits for seven straight quarters.

The market looks like it will have a good December and could finish the year at highs not seen since the crash of 2008.

Does all this bode well for the market in 2011?

Area financial planners and economists are mildly optimistic. Most said they expect the market to do well in 2011 — at least for the first half of the year.

Michael Ippoliti, CFP, of Valley National Financial Advisors in Bethlehem, sees "slight upward potential for the balance of 2010 ... and continued market improvement for 2011. Me being very much an optimist, I would say I see very good opportunities in 2011 for equities. I see more positives than negatives at this stage in the game."

One of the key reasons he is optimistic is that Congress appears to have reached a compromise on the Bush-era tax cuts that were set to expire at the end of the year.

Republicans had wanted to extend the tax cuts to everyone, while the Democrats wanted to extend them to only those families earning less than $250,000. The compromise, which is likely to be enacted despite Democratic opposition, will extend the tax cuts to everyone and include a new 2 percent payroll tax cut.

Investors anticipated that the tax cuts were likely after the November election, when Republicans gained control of the House. "We saw an upturn in the market in October, prior to the elections, in anticipation that would happen," Ippoliti said. "After the election, when President Obama said he was going to compromise, it created another upward tick in the market."

Last week, when the compromise was reached, the market also reacted favorably.

Reaching a compromise on this critical issue reduces the uncertainty that had made some investors jittery, Ippoliti said. While most of the tax changes were already accounted for, he said, had Congress not reached a compromise and extended the tax cuts, the market likely could have tumbled.

Ippoliti

Another reason Ippoliti is optimistic is that corporations appear to be doing well — largely because in anticipation of Armageddon, they cut their operating expenses (mostly the number of employees) and have learned to produce more with less, he said.

Ippoliti said he expects that next year, companies will begin to spend some of their profits as they begin to feel more comfortable and are convinced that a "slow and steady recovery" is under way.

"There is a lot of money sitting in their balance sheets," Ippoliti said, "and some is going to go into mergers and acquisitions, which is a positive for the market."

Companies also could begin to use their profits to invest in plant and equipment, which could lead to more jobs and a stronger market, he said. The Federal Reserve has kept interest rates low so they could borrow for their investments if they needed to, Ippoliti said.

"As companies are controlling their costs, their profits and stock prices will follow in lock step," Ippoliti said. "I easily see another 10 percent appreciation year in 2011."

However, Ippoliti said with caution, "it's not going to be a straight line. When we talk about volatility, that is a relative term." Unforeseen world events in this global economy could easily shake the markets in the U.S. and abroad, he said.

Still, he said, although he doesn't have a crystal ball, he expects market conditions in 2011 "certainly will be no worse than we saw this summer and nowhere near what we saw in 2008 and 2009 when we had 30 percent changes in the market."

Jones

Christopher Jones of Sparrow Wealth Management in Easton agreed that the election that gave Republicans control of the House bodes well for the market. "Compromising on extending the Bush-era tax cuts and keeping tax rates low is a good thing," he said. Given the economy, he said, "right now is not the right time to be raising taxes."

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~ Michael Ippoliti
Valley National Financial Advisors
Bethlehem

Like Ippoliti, Jones also said that "it's hard to know what's lying below the surface … and events such as the European debt crisis could" rear their heads in 2011 and change the market direction quickly.

Jones said he is somewhat concerned that "a lot of the issues" that caused the downturns in 2008 and 2009 "weren't fully resolved. We put a lot of Band-Aids on things," he said, "and you don't know whether they will crop up — short term or longer term. It's hard to know."

Scott Ballantyne, an associate professor of business at Alvernia University in Reading, said had lawmakers not extended the Bush-era tax cuts, "there would have been a giant sell-off" before Dec. 31 as investors would want to take advantage of the lower capital gains rate.

Thanks to the compromise, he said, "the investing public can be rest assured … and it has no need to do that."

Ballantyne is hopeful that the 2 percent reduction in payroll taxes will generate demand as workers have more money to spend. Hopefully, he said, consumers will spend the money creating demand for products and services, and this will result in companies having to hire more employees to meet that demand.

The fact that government's support of General Motors and AIG has worked out well "also bodes well for consumer confidence," Ballantyne said.

Savage

Like the others, Mike Savage, ChFC, founder of Savage Financial Group in East Stroudsburg, is predicting a good year for stocks in 2011. However, he said that although he believes the first half of the year promises to be pretty bullish, he's not so sure about the second half of the year.

"Over the second half, I'd be nervous," he said, "because there are too many landmines out there."

Savage said he is most concerned about the huge debt that state and municipal governments face. They can't print money to pay their bills, he said. "They have to cut back and go on austerity measures like we've seen happening overseas."

Savage said it may not be a problem earlier in the year "because their feet won't be held to the fire until later." But when they have to make contributions to pension and other funds and don't have the money, crises could occur especially in states such as Illinois and California, which have huge debts.

Commodity prices, which have been climbing, also could be a fly in the ointment, Savage said. "Rising oil prices will be a drag on the economy." However, he said, "remember there are a lot of energy stocks in the Standard & Poors (S&P) 500."