Market Comment: Don't Fight the Tape
November 1, 2017

There is an old market saying that may sum up this historic market rally, "Don't Fight the Tape". This, of course, is in reference to the ticker tapes used before the computers and electronic devices of today. It served as a reminder to traders that sometimes the best way to make money is to not fight the trend, but allow your money to continue to follow the trend. The recent trend in today's market has us witnessing some very rare trends, some of which are occurring for the first time.

In our prior *Market Comment* we talked about volatility, or the measure of dispersion between returns of a market index. We questioned whether we would finally start to see a return of volatility in the markets (*Market Comment: Is this the return of Volatility? August 11th, 2017*). But since that time, the market has continued to trade within a 0.3% daily range, and volatility remains at all-time lows. The last time the market saw such minimal volatility was in the early 1960's, over 50 years ago.

Another interesting characteristic of today's market is the lack of any meaningful pull-back. The last time the market had a 5% or more decline was during the Brexit Vote in June of 2016 which is now over 16 months ago. In addition, the last time the market saw a 3% decline was in March of 2017, which is now over 7 months ago. This is the longest such period on record without a 3% decline.

This secular bull market began a little over 8 ½ years ago, and there has only been one other time the market has advanced without a 20% or more decline since 1930. The longest bull market took place in the 1990's and finished with the dot-com bubble collapse in March of 2000.

The lessons learned in the past can often help with current market conditions: first, expensive valuations do not necessarily mean markets will go down; second, investor sentiment has been a poor indicator of future market performance generally indicating the opposite; and third, reversals are often the result of major economic changes either from Fed policy, global economies, tax policy, or geopolitical issues.

Throughout the late-90's we saw valuations at historically high levels but the bull market continued to move higher. This is evident by looking at the Shiller PE Ratio which measures price-to-earnings (PE) ratios of companies adjusted for inflation, a higher number equals more expensive valuations. In January 1995, the Shiller PE Ratio was around 20 with the S&P 500 index trading around 460. By January of 2000 the Shiller PE Ratio was around 43 with the S&P 500 index trading around 1455. Today the Shiller PE Ratio is around 31 and the S&P 500 index is around 2575. There could be more room to run but, historically, the average Shiller PE Ratio is around 18 and we are considerably higher today.

And today's bull market has been met by many skeptical investors, although recent sentiment is changing. Investor sentiment has often been a contrarian sign of market performance. In fact, many market tops occur when most investors feel good about the future of the markets and vise-versa about market bottoms. Recent news from Investor Advisory Services, a firm that keeps data on the spread ratios between bulls and bears indicating sentiment, shows recent optimism hitting levels not seen since the Crash of 1987. Perhaps the financial crisis of 2008 has finally worn off, but this could actually be an early contrarian indicator of potential problems if bullish sentiment continues to increase.

Lastly, good corporate earnings and strong global economies have created the foundation for this bull market to continue to move higher; however, most major reversals occur just before a major economic change. We are watching a few areas for this possible change. First, the Fed and other central banks have pumped over $13 trillion into stimulus since 2008. The recent unwinding and reversal of these policies could reverse today's bull market. Second, tax policy is another area to watch heading into year-end. We believe tax reform will pass but believe much of the news is already priced into the market. And third, the market is currently ignoring any geopolitical threat and does not believe the probability of a major disruption to the world economies exists in the near future. North Korea or any other major conflict is not derailing this bull market. Therefore, for the time being, we will not "Fight the Tape", but will watch closely as this bull market moves forward.
