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Happy Birthday Bull Market

March 8, 2017

Eight years ago tomorrow, the S&P 500 closed at its lowest level of the financial crisis, marking the end of the worst bear market since the Great Depression (down 57% from the highs). Going back to WWII[1], this is now the second-longest bull market ever at 97 months, with only the bull market during the 1990s longer. The S&P 500 is up 250.0% since the 2009 lows. This ranks as the third-best return during a bull market since WWII, with only the 1950s and 1990s bull markets up more.

Once again, the obvious question: How long can this last?

We are still forecasting additional market gains for the S&P 500 in 2017, consistent with historical mid-to-late economic cycle performance. We expect S&P 500 gains to be driven by: 1) a pickup in U.S. economic growth partially due to fiscal stimulus; 2) mid- to high-single-digit earnings gains as corporate America emerges from its year-long earnings recession; 3) an expansion in bank lending; and 4) a stable price-to-earnings ratio (PE) of 18 - 19. We expect gains will likely come with increased volatility, which leads us to maintain our year-end stock market target despite the strong start to 2017, as the economic cycle ages and the Fed likely raises interest rates more aggressively. In the near term, following strong post-election gains, stock valuations may be pricing in an overly optimistic scenario for pro-growth initiatives such as tax reform given the risk of protectionist trade policies and the challenges associated with getting laws passed through Congress.

Finally, a 1% close higher.

On March 1st, the S&P 500 jumped 1.4% to a new all-time high and this was the first 1% close (higher or lower) since the day after the U.S. election (55 trading days). In fact it was the longest streak without a 1% close higher or lower since a 62 stretch during the summer of 2016. Since 1970, there have been six other streaks that went at least 50 days without a 1% close higher or lower. Three of those ended with a gain and three ended with a loss. On average, the S&P was up 1.5% a month after the 1% gains, and up 3.1% three months after. How about when the streak ended with a 1% drop? On average, the index was up 0.7% a month later and up 0.8% three months later. The S&P still hasn't closed 1% lower for 96 consecutive days, its longest streak since 105 in 1995.

Another monthly gain.

The S&P 500 gained 3.7% in February (best monthly gain since 6.6% in March 2016) for its fourth consecutive monthly win. In 2016, the S&P 500 had a five-month win streak from March to July followed by a three-month losing streak from August to October. It was a great month for financials and healthcare, as both groups gained more than five percent. What stood out as peculiar was utilities also gained more than five percent. We are watching this development closely as utilities are usually more defensive. Energy and telecom were the only groups in the red on the month.

Here comes March.

March is the fourth-best month of the year on average for the S&P 500 since 1950[1] and is the top-performing month over the past decade. When the first two months of the year post gains (like 2017), March has closed in the green 73.1% of the time since 1950. Also, when there is a four month or longer win streak heading into March (as in 2017), the month closes higher 84.6% of the time.

Trump Speaks, but light on details as expected.

President Trump's address to a Joint Session of Congress was light on details, as expected, and we heard nothing to change our expectations for the four key areas we have been watching: tax reform, healthcare, infrastructure, and defense. The stock market's strong reaction, at least in part, reflected the president's call for unity and a conciliatory tone, which on the margin may increase the odds that pro-growth policies get through Congress. On tax reform, a possible "border tax" remains a hurdle to implementation after Trump reiterated his call for fairer trade. Trump stated his desire to maintain access to healthcare for those on exchanges and those with pre-existing conditions, generally good things for the sector, although high drug prices also got a mention and remain a challenge for drug makers. Finally, he reiterated his lofty-and probably unattainable-goal of $1 trillion in infrastructure spending and his commitment to increased defense spending.

With all of the momentum in equity markets and the improving economic data, I am still mindful of policy risks that remain. A policy mistake by a government or central bank, uncertainty associated with the new presidential administration, Brexit, China's debt problems, and above-average stock valuations may present challenges to the relatively smooth ride we've seen so far in 2017. We certainly expect volatility to increase over the course of the year. That said, the obvious question: How long can this last?

As always if you have any questions, I encourage you to contact me.

Sincerely,

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