Market Note

July 2018

"The reports of my death have been exaggerated."
— **Mark Twain**

Bull markets are born in crisis, mature in confidence, and end in complacency. Though the beginning and the end of a cycle can be identified with some confidence in hindsight, the transition from one stage to the next can be problematic at best while in the midst of it. However, prudent investors will focus on eventual outcomes and will not assume that what happened yesterday will happen today or tomorrow or the day after that.

As evidenced by the number of investors who have predicted the end of the current bull market and were wrong, where we are exactly in the cycle is unknown, but we can at a minimum be aware of our surroundings and prepare accordingly.

- The duration of the current bull market has been exceeded only once prior during the period extending from 1987 to 2000. Time is not necessarily a factor in determining the end of a bull cycle, but the probability does increase the longer the duration.

- Theoretically stock prices are based on profits and the price investors are willing to pay for profits in the future. For valuations to hold, it is assumed that profits will hold steady or increase unless there is further multiple expansion. There is a consensus building among firms such as Goldman, Morgan Stanley, and Deutsche Bank as well as others that profits are in the process of peaking and growth rates will begin to decline.

    - All of this is occurring at a time that equity valuations are approaching the high end of their historical range and begs the question how much higher can stock prices go and how vulnerable are they to falling?

- The current bull market was built on the back of extraordinary monetary policy and monetary policy is now reversing in a measured fashion as evidenced by rising interest rates and a shrinking of the Federal Reserve's balance sheet. The consequences of this policy reversal are unknown and partially responsible for the volatility in the markets this year.

- If the yield curve has any predictive qualities in reference to recessions, the current flattening of the yield curve could indicate an economic slowdown by 2020 according to JP Morgan. The spread between the Two Year and the Ten Year is now thirty basis points. Markets by their very nature are anticipatory and recessions are usually identified after the fact. In short, markets have a tendency to correct before a recession not at the onset of one.

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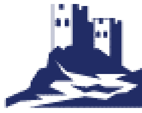

As you can see there are a number of moving pieces to the markets all occurring at a time that the threat of trade wars and political uncertainty globally is increasing. However, this is not a new dynamic nor does it mean that the end of the current bull market is nigh, rather it supports the rational for being prudent in regard to risk and proactive in managing it. We would argue that this may be a time to recognize the cycles within the cycles.

To that end we would direct you to a recent piece written by Jeff Kleintop of Charles Schwab. Jeff is someone I have had the privilege of knowing for more years than I would care to admit and his take on cycles is well worth reading. You may find it here: https://www.schwab.com/resource-center/insights/content/how-to-avoid-shark-attack

Best regards,

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