Registered Investment Advisor Firm

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Bull Market Continues?

Late in August, the S&P500 hit all-time highs and is now the longest bull market in history. General consensus is bull markets are rallies that exceed 20% and are never interrupted by a 20% fall. By this definition, the current trend started March 9, 2009.

The main drivers pushing share prices higher are a US economy powering along at its fastest clip since 2014, companies growing their profits at the best pace in eight years and the nation's jobless rate now at 18-year lows.

The boost from tax cuts for businesses and everyday Americans should persist at least into the middle of next year. That could offset obstacles and possible bull-market killers: trade disputes between the US and its trading partners and the Fed's ongoing push to lift interest rates back to normal levels after pegging them near 0 percent for seven years after the 2007-8 financial crises.

Remember the adage "Bull markets do not die of old age"? CNBC recently posted its "Wall of Worry" about the recent highs:

- Job Markets tightening leading to higher wages
- Higher wages leading to increased inflation
- Slow growth of the money supply
- Peak in Real Estate (homebuilder stocks peaked in January 2018)
- Peak in credit cycles

History reveals there are a variety of signals that flash before stocks start to plunge. Five of the most common and followed are below:

Extreme Optimism: Bull Market tops are always characterized by excessive optimism. We are not witnessing the public excitement in equities like in 1987 before the tech/internet debacle and before the financial crisis of 2007-8. In fact investors appear subdued and almost complacent about stocks despite the surging prices.

However, all financial markets are interconnected; meaning the public's hype about private equity and real estate could be signaling a top in the economy, therefore the stock market.

Ultra-High Valuations: Every market top has been superseded by high valuations in stocks. Metrics like Price-to-Book, Price-to–Earnings (P/E) and Price-to-Dividend are all signaling the market is trading at historical high valuations. Remember that stocks can stay overvalued for a long time.

Trouble in Financials: The financial sector often leads the overall stock market, with regional banks appearing to be a better signal of a top. The regional bank ETF peaked in June 2018 and is not underperforming the bank ETF and keeping close to the S&P500 Index.

Divergence: A divergence occurs in the stock market when a majority of stocks are moving in one direction, and the indexes are moving in another. Divergences are measured by the advance/decline (A/D) line. This technical tool compares the number of rising stocks to the number of falling ones. If most shares are falling, yet the indexes are rising, it signals the Bull Run is about to end. Currently that is not happening; both indexes and A/D lines are still climbing.

The VIX: The Volatility Index (VIX) is a measure of volatility in the stock market. Climbing VIX levels indicate that investors fear a correction and a falling or steady VIX level indicates bullishness or complacency in the equity markets. A recent high was hit in February 2018, and has been steadily falling since. Money appears to be secure in the bull market moving higher and avoiding a correction.

Based on the five signals, the current bull market can easily extend well into 2019. Of course a shock, whether economic or geo-political, can change this over a short period of time.

What could derail this rally? I list several of the obvious causes and a brief comment.

- Stock prices are hardly a bargain. Stocks have had a great run, but it’s not because buyers necessarily think there are good values out there. As the saying goes, “all good things come to an end”.
-Interest rate surge, earnings sag or inflation returns. Right now the Fed is on a slow, measured increase. A combination of higher rates and a tight labor market could push up wages and consumer prices. Earnings have been robust lately.
- Investor optimism could erode. Currently, we have low interest rates, lots of cash, strong earnings and little inflation. If this changes, so will investor attitudes.
- Watch for the wild card. Trade wars, foreign government selling of US Treasury debt or other geo-political issues can trip up the current trend.

If your financial time horizon is more than five years, save no matter what.

The more important concern isn’t when will the market go south, but how you reach your financial goals. How much do you need to save for retirement? That’s something you can do no matter where the market is going.

Let’s watch closely the next 2-4 quarters to see what happens.

If you need help or more information on this or any other financial matters, contact Bob Davis at (707) 648-2024.

FED Watch

No action at the August meeting, as expected, but the FED signaled they are likely to raise interest rates in September and expressed concern that the prolonged trade disputes could disrupt economic growth. Currently, the September meeting has a 99% probability for rates to rise and a 68% probability the December meeting will bring the next rate increase. Most officials have signaled they are keen to raise rates to at least a neutral setting, though there is some uncertainty as to what that setting is. The Fed will also continue the process of reversing quantitative easing by allowing assets to mature off their balance sheets, rather than re-investing them. They expect to be at $50 Billion quarterly by October 2018.

Next meeting:
September 25th and 26th

Castle Rock Wealth Management

Castle Rock Wealth Management is a Hybrid Advisory firm servicing the needs of clients across the United States.

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