Infomail
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Is This The End of The Bull Market?

"Bull markets are born on pessimism, grown on scepticism, mature on optimism and die on euphoria"

Sir John Templeton

The year 2016 has started out with a "bang" to say the least. Through the first three weeks of the year the score is "3 up days, 12 down days, and the size of the relative moves being big. Last Wednesday, the Dow Jones was down 566 points mid-day, to finish down "only" about 290 points.

While many pundits are predicting a bear market, across the averages we are already there. The TSX is down 21% from its high, and the broadly based Russell 2000 is down 22% since last summer's high- the technical definition of a bear market. Only 40 of the S&P500 stocks are positive for 2016.

It's been the worst start to a year….ever…..and it's been humbling. While no answer can properly identify all the reasons, many factors are in play:

1) The ever worsening collapse in energy prices. At one point on Wednesday, a barrel of oil ($27.50) cost less than a bucket of Kentucky Fried Chicken.

2) Volatility in China. For years, many doubted the Chinese data and China's GDP has gone from 10% to closer to 6%. Chinese policy makers have also made some errors in that effort, which have created more volatility and more uncertainty. When the Japanese or the Europeans devalue their currency, everyone seems ok with it, but when the Chinese devalue their Yuan, its viewed as a big negative.

3) US Recession Risks. The ISM Manufacturing Index has recently dropped below the Magic 50 level, as well Q4 GDP will likely come in weak and its building a case that the US Economy is sliding into recession

4) Tepid Earnings. We are right in the middle of the US earnings reporting season and so far it's been mixed. The high US dollar is definitely having an impact on multinationals.

5) US Monetary Policy. The Federal Reserve raised in December and the threat of additional Fed interest rate hikes and its impact on the bond market and currencies continue to hang over markets as well.

6) US Presidential Election. We all know markets don't like uncertainty and when the two front runners (so far) for the respective parties are Donald Trump and Bernie Sanders, well, you don't get much more uncertain than that.

7) Despite the long list, whether the markets continue to leak or whether they rebound, depends on two main items right now: crude oil prices stabilizing (not necessarily rising a lot, but just stabilizing) and the Fed delaying further rate hikes (which in turn will weaken the US dollar).

There's a lot of talk and articles being written about a repeat of the 2008-09 cycle. I believe the odds of that occurring is slim to none for the following reasons:

1) The US Recession risks remain low. If the US does go into recession, it would be the first time in history with an economy creating 250,000+ non farm payroll jobs a month, rising consumer confidence and falling gas prices. The odds of the US going into recession heading into a US Presidential election are also slim.

2) Oil prices will stabilize. This energy "shock" has been more than about supply and demand. There is plenty of geopolitics at work, and to me it's no coincidence the Saudis allowed prices to collapse just as the USA and Iran become friendlier to one another, and Iran received the green light to export oil once again. Even last week, the Saudi oil minister said prices fell much more than they expected. Expect a rally in oil prices at some point in 2016.

3) The Fed will be cautious. Chair Yellen doesn't want to be the one who messed it up after seven years of efforts to right the ship. The Fed will not over tighten and will base anymore rate increases on the data. And if the data slows, it will pull back. I would even go on a limb and say if the Fed does tighten (ie: raise interest rates) 2 to 3 more times in 2016, it would mean things are pretty good, and I think the US market would actually rock.

4) The Yield Curve. Since I graduated from University, I've been through six recessions (1981-82, the late 1980s, 1991-92, 1997-98, 2001-02, and 2008-09). Let me be clear. We will have another recession one day. It's a fact and part of the economic cycles. But…one thing I know for certain 100%: Since

World War II (about 70 years folks), no recession has ever occurred in the USA until the yield curve went negative (inverted). That happens when short term overnight interest rates go into a "premium" over the 10 year interest rate. The curve (so far) is far from "inverted".

5) The US Consumer. There are too many reasons to list to be enormously bullish on the US Consumer, which comprises about 70% of US GDP. Auto sales remain strong, and housing is picking up momentum.

6) General "Stuff"- There are lots of examples when the stock markets can be down double digits without a recession (1939-40, 1941, 1943, 1947, 1961-62, 1967-8, 1971, 1978, 1983-4, 1986, 1998, 2002, 2010, 2012, 2015). The Citi panic/euphoria index is in the panic zone (market has <u>always</u> been higher 12 months later). There isn't one asset class that is up on a one-year basis. Percentage of TSX stocks below 50 day moving average reflects oversold conditions. Insiders are bullish. The CNN fear/greed index is in panic territory. RBS (Royal Bank of Scotland, who went bankrupt by the way) came out with a "sell everything" call. Dividend yields are attractive. Valuations are decent.

   And last but not least, after being in finance 33+ years now:

7) Recency Bias. Once of the biggest challenges investors (and advisors!) face is believing that what has happened recently will necessarily happen again. 2008-09 scared the heck out of everyone, we all lived through it, felt the incredible pain and the fear it inflicted and the scars that came with it. We now reflectively conclude that each crisis we face is going to be a financial crisis all over again- it is possible that 2008-09 could occur all over again but very few of the components which caused it are in place now.

No, more than likely, the epicenter of the recent crisis has its cause emanating from the currency markets. An abundance of QE was infused in the European and Japanese markets driving down their currencies which ultimately affected the Chinese markets the most. Add in a Fed rate increase (and subsequent high US dollar) and some geopolitics in the energy sector, which prompted Sovereign wealth funds to liquidate, and you have what we've had fifteen trading days into 2016.

Energy prices will rebound, and China will figure it out (with over 750 million internet users now, expect technology and e-commerce to be a big area of growth), and for the first time in a while, the Canadian market looks like pretty good value.

Volatility will remain in coming months, and there's a good chance central banks everywhere ramp up stimulus again. Expectations are <u>extremely</u> low for market returns going forward, and usually that's when you get the largest upside surprises.

All concerns investors have are legitimate: terror, energy, geopolitics, China, Trump, high rates, global warming, name your boogey man- but the number one reason I read that returns will be muted is that markets are already up big over the last five years. That reasoning is dead wrong as party cycles show there can be a lot more upside.

Chart 2.) DJI Cyclical Bull Markets Since 1900

Dow Jones Industrial - cyclical bull markets since 1900			
Bear low	Decline into low	Following bull gain	Length (months)
1903	-47%	145%	26
1907	-49%	90%	23
1914	-29%	111%	27
1917	-44%	82%	23
1921	-47%	497%	98
1932	-90%	94%	2
1933	-38%	121%	12
1934	-23%	128%	35
1942	-53%	129%	53
1949	-24%	223%	89
1957	-20%	75%	50
1962	-27%	86%	44
1966	-26%	33%	27
1970	-36%	67%	32
1974	-46%	76%	21
1978	-27%	38%	40
1982	-25%	251%	63
1987	-37%	73%	34
1990	-22%	295%	94
1998	-22%	56%	17
2002	-38%	95%	61
2009	-49%	220%	81*
AVG	**-37%**	**136%**	

* Bull Cycle 2009 - December 2015

Source: UBS Technical Research

What many investors forget is that from the turn of the millennium in the year 2000, to pretty well 2010, the S&P500 was basically flat, so there is time to make up. Check out these figures:

- The S&P500 compounded at 7.5% for the ten years ending Nov 2015, growing 105% in that 10years. The average ten year compound return is 10.4%, making it 676th best period out of 959 total 10 year period, <u>or lower than 70% of all periods</u>

- The S&P 500 compounded at 5.1% for the 15 years ending Nov 2015, growing 112%. The average 15 year compounded is 10.7%. This was the 792nd best period out of 899 total fifteen year periods, <u>making it lower than 88% of all periods</u>

(Source: Ritholtz Wealth Management 12-17-15)

So, I believe we remain in a longer-term secular bull market which has some ways to go, but again, that doesn't mean we can get hiccups along that journey to higher markets. If Sir John Templeton's adage holds true, we have a long way to go to get to the euphoria level.

As always, if you would like to discuss your portfolio or holdings, please do not hesitate to contact us.

Stay tuned,

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