Infomail

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No Sugar High

"Mediocrity knows nothing higher than itself, but talent instantly recognizes genius"

Sir Arthur Conan Doyle

For all the talk of these markets resembling the tech-bubble days of 1999, how much media coverage did the S&P500 get this week after reaching a new all-time high? There were no party hats on the trading floor, or cocktail party chatter. No, the mountain of skeptics keep rising with every new high, and in reality, as Martha Stewart would say, "that's a good thing."

Sure, the markets need to take a break, and a pullback will happen at some point, but the sell on strength mentality and instinct which has been engrained like a Pavlov dog since 2000 is still in place. In short, there are a lot of investors who forget what a secular bull market looks and feels like.

Just a short five years ago this week, the Dow Jones stood at 6470. If I had a quarter for all the conversations we had in 2009 with people who said things like "it will take a long time to get back to 2007 levels" or it will "never get there in my lifetime" and so on. Here we are 10,000 Dow points later, and some would rather listen to the perma-bears who have been wrong for 5 years……and 10,000 points.

And while the last few years have been good in the equity markets, we still have not had the global economy in synch to get the really "feel good" type of markets. No, in fact, despite the recent run, and all the bear talk about overvaluations, here's how global markets have performed since 1999: (Annualized figures as of Feb 28, 2014).

Toronto TSX 6.2%
S&P 500 3.6% (USD terms)
S&P 500 1.7% (CAD terms)
MSCI World Index 2.7%
MSCI EAFE Index 1.9%
MSCI Europe 2.1%
MSCI Emerging Markets 5.3%
MSCI USA 3.2%
(Source: RBC Capital Markets, March 3, 2014)

Considering long term historical equity returns are in the 9-11% range, it's hard to say the numbers are anywhere near historical overvaluations. Nonetheless, few investors truly understand why things turned around so abruptly in 2009 and every time there is a market hiccup, there seems to be a mad rush to confirm the sky is really falling. Just look at January/February. After a 30% gain in 2013, just a 5-6% drop in the S&P 500 created panic.

There is a large and growing school of thought that the US bull market is uncommon in performance by historical standards. It actually currently stands as fifth in size, and there have been four other bull markets that were longer in term and better in performance. The bull that ended August 1982, lasted 5 years and rose 250% from its low. The bull that ended October 1990 lasted about 9 years and rose 380%. The other two were in August 1921 (9½ years, 495%) and June 1949 (12½ years, 350%). This bull market is "only" 5 years old and "only" up 150% from its lows.

There is a simple minded belief that the financial market world as we know it ended in 2008 and without Central Bank stimulus that it's simply a false recovery……a sugar high if you will. Well, TARP and QE began in October 2008 and stock markets promptly fell an additional 40%. The accounting rule which created a lot of the chaos in 2008-09, mark-to-market accounting, had a hearing by the US House Banking Committee on March 9th, 2009……that's right the exact day that markets bottomed. The rule was officially changed a month later in April but by then markets had already anticipated the accounting change. So TARP and QE didn't "save" the economy, and Fed tapering is probably neutral.

No, markets all around the world are going up for the same reason they always do: Things are simply getting better. In 30 years, I've learned markets only care if things are getting better, or getting worse. Global economies and corporate profits, and by extension stock prices, are going up because of "real" economic developments – an energy independent USA, technology productivity gains, new technology (like 3D printing), etc……which are driving growth. Sure, this has been the weakest economic recovery in history, but about a year and a half ago the bears were predicting a double dip recession. When it didn't happen, a slow but steady 2% GDP growth came out and the markets reacted accordingly.

And what of the bear's warnings of the massive increase in the Fed's balance sheet unleashing the inflation monster? Well the last time the Fed increased it to a similar degree was in the late 1940's, and for similar reasons the demon of inflation didn't raise its head:

- US energy revolution
- Uncompetitive Europe
- Capital poorly invested in the developing world
- Banking system deleveraging and tighter regulation
- Excessive developed world debt

These are all constraining on the velocity of money (and with it sharply higher inflation).

I've been saying for years now that America, fractured by an economic shock not seen since the 1970's, has focused on blame, rather than recovery. Considering the equity bull market is a young five years or so, the bond bull market is 30 years old; one would have thought they'd be tripping themselves to exit, but it hasn't happened yet. As the recovery gains traction, markets will rise, and so will interest rates. The real risk in my mind is the so called "safe" havens investors have fled to like bonds, preferred shares, utilities and high dividend names.

Many thought the markets would crash the day the Fed finally announced tapering. The same day the Dow rallied 300 points. There are many analysts who have been claiming "The End is Near" for five years now. They sell books and get lots of TV airtime. The markets are cyclical, always have been, always wills be. But those following their advice missed the 10,000 Dow points, and those ploughed into gold really took it on the chin.

The dilemma these days is that the market is breaking out to new all time highs in a cloud of doubt, with a background chorus of doom-and-gloom. Throughout history, markets have climbed "walls of worry," and these days there is a plethora of things to be worried about. The other side of the dilemma, there is the lingering issue of a long overdue correction.

I do not live for the crash, but I also know there will be down days. The next pullback/correction will create another buying opportunity, just like everyone before it.

Stay tuned,

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