Infomail

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HAPPY BIRTHDAY!

The Bull Market Turns Four, But Where's The Party?

"Bull markets are born on pessimism, grown on skepticism, mature on optimism, and die on euphoria. The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell"

Sir John Templeton, Legendary Investor

The world's markets hit a 12 year low on March 9^{th}, 2009, marking the bottom of the worst bear market since the Great Depression. The S&P 500, which is the generally accepted benchmark of the USA markets, hit 676 that day. As of last nights close it stands at 1553. The TSX in Toronto bottomed at 7506, and stands at 12800. Not as impressive, but up nicely nevertheless.

Four years later the economy is improving, corporate balance sheets are in the best shape in decades, corporate profits are booming, and markets are up. But none of that has been enough to rekindle investors' love of stocks.

With the US markets going into record territory (the TSX unfortunately is still 18% below 2007 levels), we are hearing plenty of folks suggest the market is overvalued. On a trailing basis of past year's earnings, the S&P 500's price to earnings ratio is still below 15, which is well under the 18.8x average since 1989. In fact, it is at the lowest valuation going back to 1989. Also keep in mind total corporate earnings for the S&P 500 are expected to hit $27.77 in Q4, compared to the $23.06 previous peak in Q2 2007. That's about 24% higher corporate earnings yet markets are at the same level. Trading volumes are way down, and until January 2013, investors were pulling dollars out of equity mutual funds every month since 2007 and for five straight years, the longest streak in data going back to 1984. Last year, withdrawals were $135 billion, the second highest total after 2008, even though markets continue to creep up.

One reason investors remain nervous and pessimistic is that 2011 and 2012 were two of the most volatile years on record. Ongoing Euro concerns, the slowing of China's growth, and persistently high US unemployment, on top of fiscal dysfunction in Washington, continue to weigh on investors' minds.

In 30 years of finance, it is continually reinforced upon me that fear is a stronger emotion than greed, and the ability to scare the heck out of people is much greater than the ability to attract them to equities.

While the latest rally has been impressive, it follows a particularly punishing period when the financial crisis of 2008-2009 saw all global markets plunge in the 50% range. It was the severity and quickness of the fall that added to anxiety, and I would argue the Obama administration policies have made the recovery weaker on most, in fact, one of the weakest on record.

The larger debate I hear among managers I respect is whether this is a rally within a secular (longer cycle) bear market that started in 2000, or is it the start of a new secular bull market?

According to data from Fidelity:

- The average secular Bull market lasts 21.2 years and produced a total return of 17.2% in nominal terms and 15.9% in real terms. The market's PE more or less doubled from 10.1 at the start to 20.5 at the end.
- The average secular bear market lasts 14.5 years and had a nominal return of 1% and a real return of -2.3%. The markets PE compressed an average of 9 points, from 20.5 at the start to 11.3 at the end.

So today, we start the 14th year of the secular bear market that began March 2000. On Main Street there is a general disinterest in equities. Ratings for financial television and other media are low. Interest in non stock investments – bonds, commodities (Gold), and real estate – have been strong.

The past decade plus is reminiscent of the 17 year span starting Dec 1964 when the Dow Jones ranged between 577 and 1051, ending at 875, just one point above where it began. After the 17 year stall that ended in 1982, the markets staged one of the biggest bulls in history through to 2000.

I remain positive for many reasons:

- Economic reports from around the globe are improving
- Corporate earnings have been excellent
- US housing market is definitely improving
- Cash on the sidelines is huge, and starting to come back to market
- There will be a big shift from bonds to equities in the near future

Shorter term, we've had a decent run, and we are due for some sort of pullback or pause. This is healthy and I believe will be shallow in magnitude and short in duration. Too much cash is now looking for an entry point. There's an old adage of Wall Street that says "bull markets never give you an opportunity to get in." This may be one of those times. Sure there are lots of concerns, but another old Wall Street axiom is "bull markets climb walls of worry."

Central banks extraordinary intervention measures have created an impression of inorganic gains. Without their actions, where would markets be? I'm not sure is the right answer.

But regardless where one stands on the debate, I think one fact is crystal clear. ***We are much closer to the end of this secular cycle than to the beginning.*** Markets are poised for a generational bull market, I just don't know if we are already in it or it starts in 2014 or 2015, but it's coming.

Stay tuned,

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