**Infomail**
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# Back to Even?

*“Investment based on genuine long-term expectations is so difficult today as to be scarcely practicable”*

Economist John Maynard Keynes in 1936

When the Dow Jones index closed above 20,000 for the first time on January 25th, 2017, there was much hoopla, but the indices mean little when drawing historical comparisons, mainly because the composition of these indices change over time. For example, since April 2004, the Dow Jones (30 names) has had eight changes since then. If those changes had not been made, the current Dow reading would be somewhere in the 13,000 range, not almost 21,000.

Also, as a price weighted index, a move in higher priced stocks (like Apple, Goldman Sachs, or Boeing) have an outsized impact on the index creating false impressions about the overall strength of the markets.

So as we stand here today, almost 5/12 of the way through 2017, the markets have basically traded sideways for the last three months.

The Trump rally seems to be losing some momentum, mainly over worries his pro-growth agenda keeps getting pushed out further into the future. Why does it matter the reader may ask? Because US GDP growth for 2016 (ie: pre Trump) came in at an anemic 1.6%, the lowest since 2011, and down sharply from 2015’s 2.60% average.

Last year marked the 11th consecutive year that the US economy failed to reach 3% growth, the longest period in history since the Bureau of Economic Analysis has reported GDP figures.

US Production numbers have declined on a year-over-year basis for 18 consecutive months now, and capacity utilization remains stalled in the 75% range. And remember folks, that's with the huge stimulus of eight years of zero interest rates, trillions of dollars of QE, global central bank stimulus, etc, etc…

So logically, one would have to come to the conclusion, that without all that central bank interference, stimulus and financial engineering, in general, the US economy (and the global economy) would actually have shrunk (ie: negative growth).

The most impressive aspect of this current bull market is that it survived the worst economic recovery in the last century, and survived eight years of US government policies that were overall hostile to pro-economic growth and markets in general. So even before Mr. Trump surprised the world and won the US election, markets were looking forward to a change….any kind of change, and the US stock markets 20% run right after the election reflected that optimism for change.

So now where are we? Economic data in general is improving, we are on track for a June rate hike by the US Federal Reserve (with at least one more, maybe two more for 2017), and US corporate earnings have bested even elevated expectations.

Hope for swift action out of politicians in Washington, however, is waning. Obamacare still is the law of the land, and the potential for tax reform is likely to be at earliest late 2017, or maybe early 2018.

Sure, there is no doubt that this current US economic cycle is getting long in the tooth, and we may be due for a pause sideways for a bit, or maybe even 5-10% on a pullback.

But human memory is short, and many investors forget how deep the last recession in 2008-09 was, so we had a lot to make-up in the US and global economies. After seven years of recovery, an argument can be made that we have just recovered <u>back</u> to the level the last cycle ended (ie: recovery stage) and now we still have to make up for lost time (ie: growth or expansion stage). If that is the case, this up cycle may still have years to run.

The Fed is just starting to raise rates. Corporations have cleaned up balance sheets, so leverage is not high. Interest rates remain low, and even negative in many parts of the globe. Inflation, so far, is tepid, and as mentioned earlier, manufacturing capacity is nowhere near full capacity.

I’ve learned economic cycles end when there is over-leverage, inflation is high, rates are much higher than where they are, defaults climb, jobless claims increase, and manufacturing capacity is bursting at the seams. PLUS investor psychology is in the euphoria (ie: greed) state. In my opinion, based on those factors, we are not even close to an overall cycle high.

If we are correct on that thesis, we are in the early days of a synchronized global economic expansion, not seen in over a decade, and equities should do very well, and Canada with the heavy overweighting of cyclicals and commodities, should do fine.

With the S&P 500 trading at 18 to 20X earnings, doesn’t mean we can’t see a pullback at any time in the 5-10% range, but any of those events would provide buying opportunities.

As explained earlier in this piece, markets have done well due to the outside influences, and margin improvements as companies paid down debt and cut costs. The next phase will be driven by earnings improving, and then the next stage after that via revenue growth from price increases as inflation kicks in.

Stay tuned,

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