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Raging or Aging: How Much Longer Will the Bull Last?

The surging stock market appears to be making investors nervous. Is their concern justified? This month, we compare today's market to past bull markets, and examine current volatility and valuations. Evidence suggests that despite excessive global debt, the fragility of a few countries, and investor anxiety, this bull market may be merely middle aged rather than past its prime.

A recent lead article in The Wall Street Journal neatly encapsulated many investors' concern that equity markets, which have started the year in robust fashion (the S&P 500 was up more than 5% for the first four weeks of the year), are now so frothy that they invite comparisons to the memorable bubbles of the late 1990s. With valuations now well above 20th century averages, and the bull market entering its ninth year, increasing numbers of market participants appear to be getting nervous.

Those concerns may prove entirely warranted, but the logic is flawed, and for several reasons. The length of the current bull market is not particularly notable; volatility is not a threat to long-term gains unless it is an early warning sign of structural weakness, which is not evident at the moment; and valuations are high only if looked at in isolation. In addition, at almost no point in the past eight-plus years of equity strength have retail investors been much in evidence, and market participants have been chronically uneasy. Those have never been features of past bubbles.

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Long in the tooth? Hardly.

The cliché that this current equity bull market is looking old, or long in the tooth, has been a consistent refrain for years. Just Google it. But truly, nine years is not an "old" bull market. It is, at best, middle aged. Many in middle age do indeed succumb to sudden and unexpected demises—too much red meat, watching too much football in lazy chairs, you know the drill—but many live decades more, even as relatives and friends look on in wonder.

Take the last major US equity bull market, which lasted from about 1982 until early 2000. That was, by our calculation, 18 years, or more than double the length of the current market, which is said to have begun in March of 2009. During that earlier run, there was one down year (1990, when the S&P 500 fell about 3%), and a few single-digit years (1987, 1992, and 1994). The period 1995-2000 posted gains above 20% every year, and above 30% for two of those (Figure 1).

By comparison, the recent run in US stocks (and since about 2011, in global equities as well) is almost modest. It's been a good stretch for sure, but one that until 2016 also came with some wild and sharp swings of volatility that hit different sectors at different times. In the case of commodity stocks in 2015, or the fast sell-off in tech stocks that ushered in 2016, those volatile corrections often generated losses of 20%-30% in those companies' stocks.

In a related vein, from the early 1960s until 1982, stocks were in what we now identify as a relative bear market, even though there were years with substantial gains (in excess of 20%) followed by years that fell by equal amounts. That period of back-and-forth, neither feast nor famine, lasted nearly 20 years. Or take the bond market from 1982 until 2015, led by the U.S. 10-year Treasury Note. In 1982, sparked by then-Chairman of the Federal Reserve Paul Volker's aggressive moves to attack inflation, rates peaked above 14%. By 1988, they were down to 8%, and by the mid 1990s, below 7%. Starting in 2000, they fell below 6%, then below 5%, and then dropped below 2% by the beginning of 2015. That is a 33-year bull market in bonds, which appears to have ended at last.

A nine-year bull market, with much skepticism and precious little retail participation (as assessed by various on-line brokerages, trading commissions, and other inputs, such as Gallup surveys), is thus hardly long in the tooth. It is perhaps middle aged, and of course could end at any moment, but its length is not a cause for concern, no matter how many people say that over and over.

What of volatility?

Another frequent refrain these days is that we are due for a return to volatility. It is certainly true that market volatility, as measured by the VIX, has been remarkably low the past year plus (Figure 2). It feels even lower, given just how spikey and high volatility was during the great financial crisis and in the years after. Oodles of traders and quantitative funds designed strategies around volatility, and they saw flush times between 2010-2014. Since then, and in the last two years especially, it has been slimmer pickings for volatility.

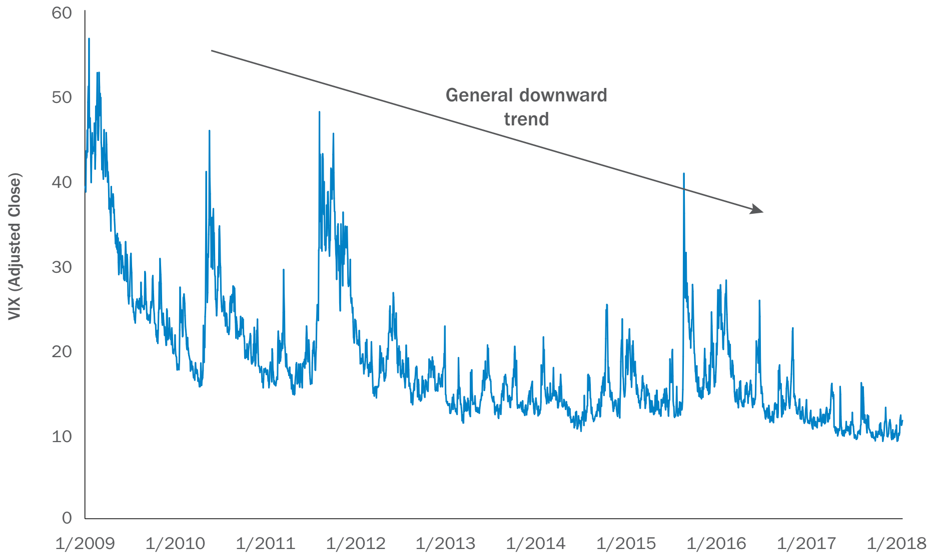
That has led to a widespread belief in investing land that we are due for a return. Here again, the answer is, perhaps, and then, so what? It is always wise to position portfolios with the full expectation that volatility could erupt at any moment, triggered by political crises (North Korea anyone?) or rogue trading programs (remember the flash crash?) or sudden rotations out of one group (commodities in 2015, for instance). But volatility in today's

Figure 1:
Extended Upward Trends in US Equities
S&P 500 Annual Total Returns

1970s			1980s			1990s			2000s			2010s		
1970	3.56%	UP	1980	31.74%	UP	1990	-3.10%	DOWN	2000	-9.10%	DOWN	2010	15.06%	UP
1971	14.22%	UP	1981	-4.70%	DOWN	1991	30.47%	UP	2001	-11.89%	DOWN	2011	2.11%	UP
1972	18.76%	UP	1982	20.42%	UP	1992	7.62%	UP	2002	-22.10%	DOWN	2012	16.00%	UP
1973	-14.31%	DOWN	1983	22.34%	UP	1993	10.08%	UP	2003	28.68%	UP	2013	32.39%	UP
1974	-25.90%	DOWN	1984	6.15%	UP	1994	1.32%	UP	2004	10.88%	UP	2014	13.69%	UP
1975	37.00%	UP	1985	31.24%	UP	1995	37.58%	UP	2005	4.91%	UP	2015	1.38%	UP
1976	23.83%	UP	1986	18.49%	UP	1996	22.96%	UP	2006	15.79%	UP	2016	11.96%	UP
1977	-6.98%	DOWN	1987	5.81%	UP	1997	33.36%	UP	2007	5.49%	UP	2017	21.83%	UP
1978	6.51%	UP	1988	16.61%	UP	1998	28.58%	UP	2008	-37.00%	DOWN			
1979	18.52%	UP	1989	31.69%	UP	1999	21.04%	UP	2009	26.46%	UP			

Sources: Seeking Alpha, Standard & Poors

Figure 2:
Volatility (VIX), 2009 to present



Source: Yahoo Finance. Data is from 1/1/2009 to 1/25/2017.

Figure 3:
Price-Earnings Ratio (P/E) and Yields on Major Indexes

	P/E Ratio			DIV Yield	
	As of 1/29/18[1]	1 year ago[1]	Estimate[2]	As of 1/29/18[1]	1 year ago[1]
Dow Industrial	28.15	20.23	19.09	1.98	2.4
Dow Transportation	15.19	17.07	17.63	1.28	1.3
Dow Utility	28.6	26.68	17.68	3.44	3.45
Russell 2000	145.15	Nil	26.75	1.31	1.46
Nasdaq 100	27.82	20.1	21.25	0.98	1.16
S&P 500	23.34	24.74	18.67	1.79	2.12

[1] Trailing 12 months
[2] Forward 12 months
Source: The Wall Street Journal, January 30, 2018.

machine-enhanced trading environment can be both magnified in intensity and shortened in duration, as various puts, calls, and more complicated derivatives get triggered. Unless investors are in the business of trading volatility (and good luck with that), trying to trade, reposition, and protect themselves during bouts of volatility is probably a bad idea, both emotionally and financially. The goal is to be positioned for some volatility, not to position during it.

But then there is the larger so what? When stocks and sectors plummet sharply, pessimists have a field day, declaring that this is the beginning of the long-anticipated end. Well, maybe. Often, however, it is just a bout, without deep structural or fundamental roots, that passes like a hurricane and just as quickly. Unless the volatility is a sign of structural defects, it will burn out.

There is no shortage of candidates for defects in today's markets, ranging from excessive global debt to a conviction that the financial system remains frailer than it might look. Even here, it is hard to find evidence of deep structural flaws, either globally or locally, other than a few countries here and there that could possibly implode the way Asian economies did in 1997. Even that event passed more quickly than most remember, though it did count as a real structural implosion.

Et tu P/E?

Every major US index is trading above its long-term average (Figure 3). There is some debate about what the actual forward price-earnings ratio (P/E) for the S&P 500 is, depending on who is doing the forward estimating of earnings, but it is certainly in the neighborhood of 20x. Global indices are less "stretched," given that they only began to rally more recently (after 2014), but are still historically high.

That is often taken as a warning sign, but valuation concerns have been part of the mix for the past three years at least, and will remain there so long as valuations stay above a historical average that some take as a market absolute. It is not. Equities trade as part of a lattice of available investments, which includes liquid markets (such as bonds), and illiquid ones for those who have the means. Worldwide, almost all asset classes are outside of historical price ranges. On the negative side, that might mean that everything is ready for a major correction, which means no asset class anywhere will be safe. On the positive side, it means that the current levels of valuation are relatively supportable, even if they are historically deviating from some imagined mean.

Underlying all of this are the increasingly strong fundamentals of the bulk of national and international companies, with increasing earnings driven by revenue growth, aided by the recent US corporate tax cut, and bolstered by the synchronous expansion at the end of 2017 and into 2018 of all of the world's major economies. This benign economic environment must be factored in.

And so…

The next time investors hear the plaint about the bull market's length, the lack of volatility, and pricey valuations, they should stop and ask if we are truly so out of sync, either with the past or with the world as we currently can gauge it. It is always, always possible that we are on the brink of something bad. But it is also possible that we are in the midst of a long equity bull market, like the one that lasted from 1982-2000, and at the end of a bond bull market that endured more than three decades. Any volatility or valuations concerns in the midst of that larger trend will likely be shorter-lived than the trend itself. That may prove incorrect, but it is a perspective that should help guide decisions if investors are to take advantage of the period we find ourselves in. ■

January Takeaway:

Investors appear concerned that the nine-year bull market may be aging, citing an inevitable return to volatility coupled with high valuations as rationalization for their fears. Volatility is indeed low, and of course could surge again. But absent structural defects, volatility tends to subside. Although valuations appear high only when viewed in isolation, prices must be considered in relationship to all available investments, which are outside historical ranges worldwide. Past bull markets had some down years, but they quickly recovered to surge even higher. And even bear markets had years that posted gains in excess of 20%. Most global and domestic companies have strong fundamentals, and those in the US are underpinned by strong revenue growth and the corporate tax cut. The bull market could be ending—anything is possible. But that perspective works both ways, and the bull market could continue to charge forward just as readily. With historical evidence suggesting it could, advisors should be prepared to position clients' portfolios to take advantage of it.

INDEX DEFINITIONS: The **S&P 500 Index** is an unmanaged index comprised of 500 widely held securities considered to be representative of the stock market in general. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index. The **Dow Jones Industrial Average** (DOW or DJIA) is an unmanaged index of 30 common stocks comprised of 30 actively traded blue chip stocks, primarily industrials and assumes reinvestment of dividends. The **Dow Transportation Average** (DJTA) is a price-weighted average of 20 transportation stocks traded in the United States. The **Dow Jones Utility Average** (DJU) is a stock index from Dow Jones Indexes that keeps track of the performance of 15 prominent utility companies. The **Russell 2000 Index** is an unmanaged index considered representative of small-cap stocks. The **Nasdaq Composite Index** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market.

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