

Final Stages of a Bull

4/25/2018

Introduction

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Since 2018 marks the 20th year of my professional money management career, it seems fitting that this could prove to be the time frame that the market cycle comes full circle.

Anyone who follows my work knows that I believe the market has 3 distinct locations within a full cycle. Those locations are the Boom phase, the Bust phase, and the Consolidation phase. When I started managing money in the late 90s the markets were near the tail end of a Boom and now I think we have entered into that tail end phase again.

Before I get started with the body of the report I think it is important to state that when making a market call, I don't just randomly make a proclamation. Rather I have a very intricate way of looking at the markets. This process is elaborate and pieces together decades and decades of market data. In fact, the slogan on my website is based off of this idea and the concept that understanding the markets is vital to having long-term success. That slogan is:

“To be at peace with your position in the Capital Markets, you must put in constant and diligent effort to comprehend what makes the markets move.”



In fact, it is the countless hours of research that I have performed that has unlocked this understanding of the markets for me. Now, this doesn't mean that day by day or hour by hour, I know exactly what the market will do. But what it does mean is that I understand where the markets are likely to move to and what path they may take to towards that end.

This level of comprehension allows the anxiety regarding market movements to calm down and give way to a peaceful understanding of the path the markets are on.

With that, let's take a deeper dive into where we are in this market cycle.

Holy Grail Revisited

As was mentioned in the introduction, I have spent many years trying to understand the markets. In fact, close to 10 years ago I put my macro-outlook regarding the markets down on paper. The title of that report was “The Holy Grail” and in it I outlined what I look for in the Big Picture regarding the markets and how certain indicators line up to give us clues on how the market should perform. As I’ve shared with my readers many times those indicators are: Earnings Relative to Potential, Valuations, Consumer Sentiment, and the Level of Complacency in the market.

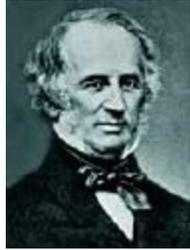
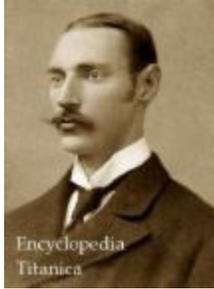
Tracking these metrics is important because they will tell you your location in the cycle, which has direct implications on the most effective way to invest. And, of course, the three cycle locations correlate to either Boom, Bust, or Consolidation Phase.



With that being said, all my indicators line up, and have lined up since February of 2009, with the Boom Phase of the market cycle. Here is a direct cut and paste from the aforementioned report, “The Holy Grail”, regarding the Boom Phase:

The Boom Cycle

The boom cycle is the fun cycle. Money is being made hand over fist. Business tycoons are born. And as time goes on, everyone joins the party.



In this section, I will discuss three examples of boom cycles beginning. World War I giving way to the Roaring 20's, The Great Depression and WW II transitioning to the boom of the 50's/60's, and the stagflation of the 70's leading to the huge boom of the 80's and 90's.

The Roaring 20's—

Once again, not all the statistics that are kept today were kept back during this period of time. Nevertheless, given that World War I raged on from 1914-1918 and The Spanish Flu pandemic took over from there and is estimated to have killed up to 100 million people worldwide from 1918-1920, I think it can be assumed that consumer sentiment was absolutely in the toilet. I think this is reflected in the fact that on 8/1921 the 10 year normalized p/e on the market was 6.13.

From there an overwhelming feeling swept through America and the Roaring 20's were born. I will reiterate my words from page 10 of this report.

The Roaring 20's was distinguished by several inventions and discoveries of far-reaching importance, unprecedented industrial growth and accelerated consumer demand and aspirations, and significant changes in lifestyle. Normalcy returned to politics in the wake of World War I, jazz music blossomed, and the flapper redefined modern womanhood. Everything seemed to be feasible through modern technology and these technologies, especially automobiles, movies and radio proliferated 'modernity' to a large part of the population. Amusement, fun and lightness were cultivated in jazz and dancing, in defiance of the horrors of World War I, which remained present in people's minds. The period is also often called "The Jazz Age".

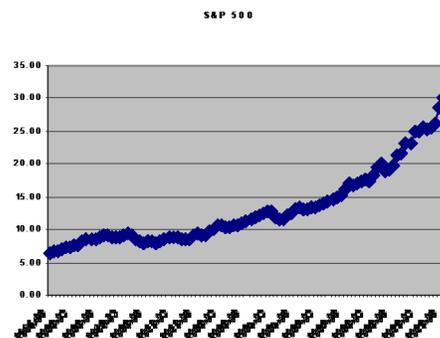
From the bottom of this market to the end of September of 1929, the normalized P/E ratio of the S&P 500 went from 6.13 to 26.60. A truly incredible jump. And I think it can be surmised that the sentiment from (sic) consumer went from extremely pessimistic to wildly optimistic.



Another interesting fact concerning this period of time is that during the time period in question (almost precisely 8 years), the market "pulled back" 16 times. If you would have bought more stock on those pullbacks, you would have had to wait a MAXIMUM of 4 months for the market to begin going back up. In fact, 11 of those 16 "pullbacks" lasted no more than one month.

So, what did this market teach investors? As soon as you see a chance to buy equities on the downswing...jump in fast and jump in hard and you will be rewarded. Your risk is being late to the party. It is precisely this type of "buy on the dips" mind frame that makes the inevitable bust cycle so painful.

Anyway, this wild bull run lasted only 8 years but the S&P 500 shot up 366% or an average of 21.2% per year on a price basis.



Post WWII America—

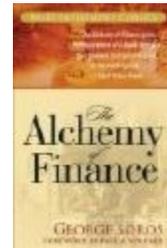
Following the bust cycle that came after the Roaring 20's was the Stock Market Crash of 1929, the Great Depression, and then WWII. As the consolidation phase that followed the bust was growing long in the tooth, the catalyst that kicked off the next boom phase was the momentum the Allies were building in WWII, their eventual victory, our boys returning home from the War, and the return to normalcy of the American way of life.

This boom may turn out to be the greatest boom in the history of America. As the tide turned in WWII, the S&P 500 stood at 7.84 at the end of April 1942. From there it shot up to 118.4 by January of 1973. That is a 1,405% gain over a little less than 31 years. The normalized P/E on the market went from 8.12 to 18.84 over that time frame as well.

During this boom cycle, the University of Michigan began to track consumer sentiment. And when the survey first came out in 1952 it quickly broke over 90, remained high for a VERY, VERY long time with only a few blips down, peaked in the mid 1960's with a string of 100 plus readings from 1964 through 1966. To avoid being redundant, I discussed this period of time on page 16 and 17 of this report. But I will say this to re-enforce a point, short bursts of pessimism usually are not enough to offset a long-term feeling of optimism and the upward movement in the markets will most likely continue after the dust settles.

This type of feeding frenzy mentality seems to appear over and over again in studies of human nature. Followers of behavioral finance theories call it Groupthink or herding behavior. The esteemed hedge fund manager, George Soros, referred to this concept as the Theory of Reflexivity in his classic investment book "The Alchemy of Finance."

Soros' concept of reflexivity states that the biases of individuals enter into market transactions, potentially changing the fundamentals of the economy. Soros argues that such transitions in the fundamentals of the economy are typically marked by disequilibrium rather than equilibrium, and that the conventional economic theory of the market (the 'the efficient market hypothesis) does not apply in these situations.



Reflexivity is based on three main ideas:

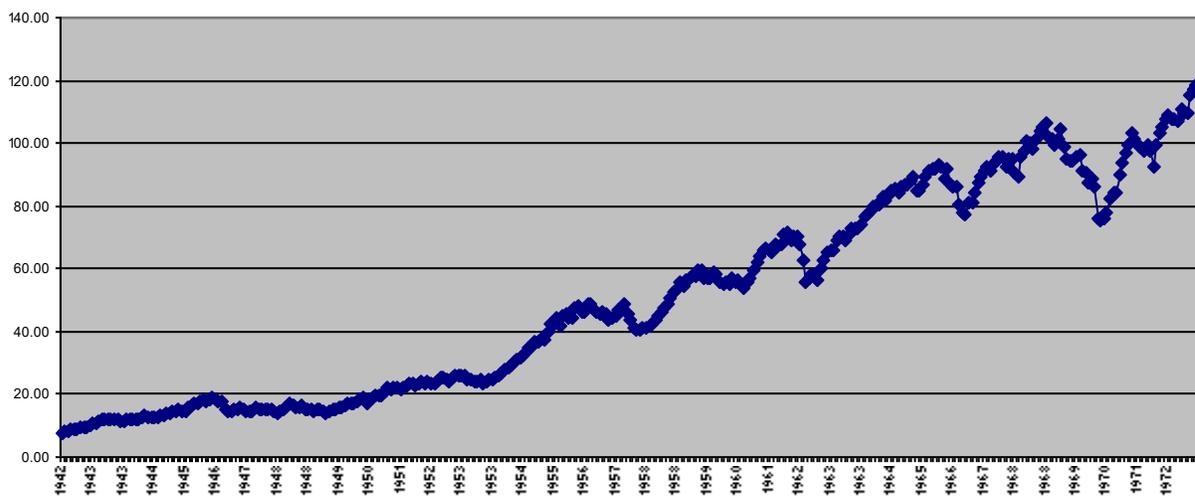
- 1) Reflexivity is best observed under special conditions where investor bias grows and spreads throughout the investment arena. Examples of factors that may give rise to this bias include (a) equity leveraging or (b) the trend-following habits of speculators.*
- 2) Reflexivity appears intermittently since it is most likely to be revealed under certain conditions; i.e., the equilibrium process's character is best considered in terms of probabilities.*
- 3) Investors' observation of and participation in the capital markets may at times influence valuations AND fundamental conditions or outcomes.*

Basically, what he is saying is that once a group of people start doing something and they have success...others will pile in. This piling in directly affects that market place. For instance, if everyone likes company X and they are buying up that stock at any price...then company X can get free capital buy issuing shares to the public to purchase at whatever price they want to pay. This makes it so much easier for them to operate their business than it normally would and, therefore, easier to meet the expectations of the market and their investors. HOWEVER, at some point the people/investors will realize what they are doing and see how ridiculous their behavior has been. Then the whole thing unravels. And, in fact, the exact opposite can happen...sending the specific stock and/or a marketplace into complete disarray and tanking it beyond the level of rationality until they realize that they have been stupid again. And the whole thing starts again, this time to the upside.

Excuse my digression, back to my original point...

The post WWII boom cycle saw a dramatic uptick in the P/E ratio on the market, a dramatic uptick in consumer sentiment, and I believe the Theory of Reflexivity kicked in and pushed this market up beyond what was reasonable and rational from 1965 to end of 1972. And as this market pressed on, the "buy on the dips" mentality most likely got more and more ingrained in investors minds.

1942-1972



Reaganomics and the Tech Boom—

As we've already read in this report, the post WWII boom met with a brutal bust in 1973-1974 then a consolidation period until 1982. The boom that followed was epic in many of its aspects, some of which we will discuss below.

Back in the early 80's to give a boost to the economy and end a period of stagnate economic growth Reagan introduced the largest across-the-board tax cuts in American history, attempted to reduce the size the government and bureaucratic regulation of the economy. Many of his policies were referred to as "Trickle-Down" as the benefits started at the top of the economic food chain and spread down to the bottom. The results of his policies were a reduction in the top U.S. tax bracket from 70% to 28%, a strong rebound in U.S. GDP, and a massive reduction in the unemployment rate. This appears to have worked as the market and the economy began its next boom in 1982.

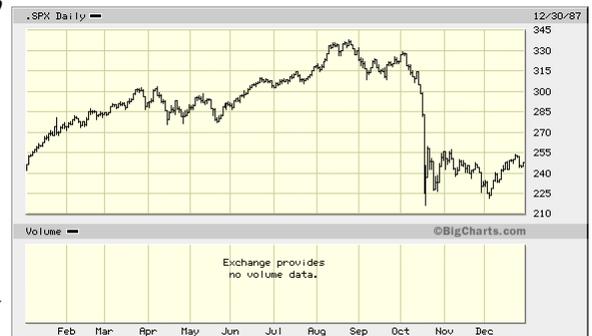
The 1980's was marked by a revival of capitalism and laissez-faire economics. Consumers became more sophisticated in their tastes and things such as European cars and designer clothing became fashionable. The financial world and the stock market were glamorized in a way they had not been since the 1920s, and figures like Donald Trump and Michael Milken were widely seen as symbols of the decade.

This type of economic excitement continued into the 1990's. As the first decade following the effective end of the Cold War, a combination of factors including the mass mobilization of capital markets through neo-liberalism, the widespread proliferation of new media, and the dissolution of the Soviet Union led to a realignment and reconsolidation of economic and political power across the world. Living standards and democratic governance improved in many areas of the world. Major technological breakthroughs, like Microsoft Windows, Intel Pentium, cell phones, and the Internet, fueled this optimism. As earlier as 1992, Alan Greenspan coined the phrase "irrational exuberance", but no one listened and the boom drove higher.

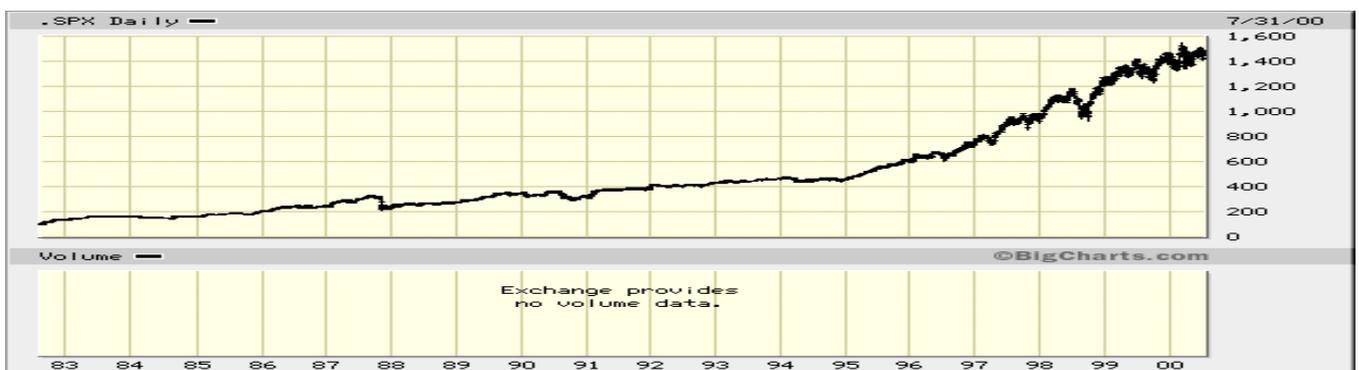


During this time, the S&P 500 went from 109 to approximately 1,500. The normalized P/E went from 8.25 to a record high of 40.4. Consumer sentiment was actually OVER 100 for almost 4 straight years from 1997 through 2001. And the VIX index stayed at a very tepid to low level for most of the 1990's. Earnings versus the trend initially broke above trend in 1995 and for the most part stayed above trend until 1998 and then broke out wildly above trend again in late 1999. However, the market pushed upward. Reflexivity/Irrational Exuberance? I think so...in fact this probably took hold in 1995!

Now, don't think this market didn't pullback. It did and it did often. In fact, the "pullback" or crash in 1987 is historic for many reasons. Historic in its level of one day decline. According to the Wall Street Journal from October 20, 1987 that I had hanging in my office, the Dow fell 22.6% on that fateful day in 1987. About 10% more than it fell on October 28th, 1929. It was also historic in the level of confidence investors showed. In fact, they dove back into the market in rapid fashion and actually ended up pushing the S&P index towards a gain for calendar year 1987. BUY ON THE DIPS...no matter how big the dip!!!!



Without question these booms make people money and lots of it. Checking our stats on the boom cycle reveals that on average they last for 18 years and provide investors a little less than 15% annual price appreciation on their stock investments. Furthermore, on average there are 5 cyclical bear markets, or pullbacks, within these boom phases. These short-term bears average a rate of decline of about (15%). However in the mist of these wild bull markets, they are simply dips that the investing public is trained to buy into to make big money.



When this boom turns into a bust, the market by definition must pullback. With the masses trained to buy on these dips, they generally pile in. This type of behavior is exactly what makes these bust cycles so brutally devastating. Instead of this being a profitable dip that should be bought into, it is a ride straight down which on average takes almost 60% of investors money.

So, we need to always be aware of where we are in a given cycle and what factors we need to look for in order to sense the transition from cycle to cycle.

Our Current Market

With that background regarding what to look for in terms of identifying market locations, specifically the Boom Phase in the markets, let's take a look at our current market cycle.

As is noted in the original "Holy Grail" report, the average Boom phase lasts 18 years. Our current Boom started in 2009, which puts the length of this expansion at 10 years.

Furthermore, the average price appreciation of the market in a Boom is 1,014%. Thus far our current Boom has grown by 325%

And finally, within the average long-term Boom phase there are 5 cyclical Bear Markets that average 15.4% in their drawdowns. Thus far, we have had 4 and they've only averaged declines of 11.96%. To be specific, those short-term Bear markets were the 10% pullback from April 2010 through August 2010, the 17% pullback in mid-2011, the 9% pullback in 2015 (but those gyrations lasted until early 2016), and our current pullback which seems to have bottomed out at 11.84%.

So, as you can see, this data would suggest the market does have a lot of room to run. However, over the next few pages we will be taking a deeper dive into this expansion and past expansions to get a better idea of how "average" this Boom will be.

To keep the length of this report manageable, I will only be looking at 3 past Booms and comparing them to our current one. Those 3 prior Boom Phases are the Roaring 20, the Post WWII expansion, and the 80/90s boom.

The Roaring 20s was the quickest of these 3 booms and lasted from August of 1921 through September of 1929. That timeframe saw Government Debt decline by 29%, GDP increase by 17%, CPI decline by 3.8%, and the 10 year yield fall by 1.25%. Meanwhile, the S&P 500 shot up 385% with earnings rising 237% and the P/E ratio expanding by 44%.

To be frank, this looks like one of the healthiest Boom Phases I've ever seen. It appears to have been led by a decline in Government Debt and rise in GDP and earnings.

Furthermore, it is vital to understand that my definition of a Boom doesn't move lock-step with the Bureau of Economic Analysis' definition of an expansion. In fact, the Boom of the 20s lasted through 3 recessions that averaged 11 months each. You see, the Boom phase is more powerful than any singular Economic Cycle. It is the shifting of an entire community's mind frame.



The next one we will look at is the Post-World War II Boom. In this one, The S&P 500 rose by 1,399% over a 30 year period. This phase endured 6 recessions that averaged 10 months each. GDP grew by 882%, CPI declined by 6.5%, the 10 year rose by 3.82%, while earnings grew 529% and the P/E expanded by 138%.

HOWEVER, the key to this expansion was debt. Government debt rose by 493%, but Consumer Debt rose by 2,484%!!!!!! You see, this was the timeframe that the credit card was invented and the world found out how powerful buying things with borrowed money could be.



During the 80s and 90s Boom, the S&P 500 grew by 1,253% with earnings growing 286% and the P/E expanding by 251%. CPI declined by 5.5% as the stagflation of the 70s was broken, which led to the 10 year yield falling 7.9%. Furthermore, Consumer Debt grew by 343%, Government Debt grew by 400% and GDP showed a 209% gain.

This Boom followed through on the idea that debt was a good way to get growth and was bolstered by falling interest rates. However, this was the first Boom, that we are discussing, that saw the market being driven higher in, almost, equal amounts by rising earnings and rising P/E ratios. In the other Booms, earnings growth outpaced P/E expansion by about 5 to 1.



Our current Boom has seen earnings grow by 1,509% and the P/E ratio decline by 82%. However these numbers are a bit skewed because of the MASSIVE banking write down in 2008, which had the effect of drastically reducing “as reported” earnings. Nevertheless, from the bottom the S&P 500 has risen by over 300% in this Boom.

Also during this timeframe, CPI has risen by 2% and the 10 year yield has risen 0.22%. Debt has continued its upward trend as Consumer Debt has increased by 46% and Government Debt has, essentially doubled, with its 96% gain. But GDP has shown some decent gains with its 33% increase.

In all honesty, **our current Boom Phase appears to be the weakest on record.** We have solid market growth, but it appears to be built on the back on massive Government deficit spending with little GDP growth to coincide.

The one positive sign for continued growth is that the numbers show that Consumers do have more room to borrow and if GDP can ramp up, then we might get to see more out of this expansion. Nevertheless, I do expect below average results from this Boom due to the apparent constraints on available room for increased Government Spending.

Data Update

One item of utmost importance is to take what we just learned, which is that we are in a Bull Market that does have more room to run, and try to stay a step ahead of the curve.

With that in mind, as the cycle progresses the next step is the Bust Phase. That is the phase where the market falls apart. And as is outlined in the original “Holy Grail” report, the four metrics that I track have distinct characteristics right before the Bust Phase starts.

The first metric is Earnings Relative to Potential. The key point in tracking this metric in our attempt to see when the Boom might change to a Bust, is how far above Potential are the Actual Reported Earnings of S&P 500 companies. To gauge this, let’s take a look at the chart below, which show Earnings Relative to Potential.

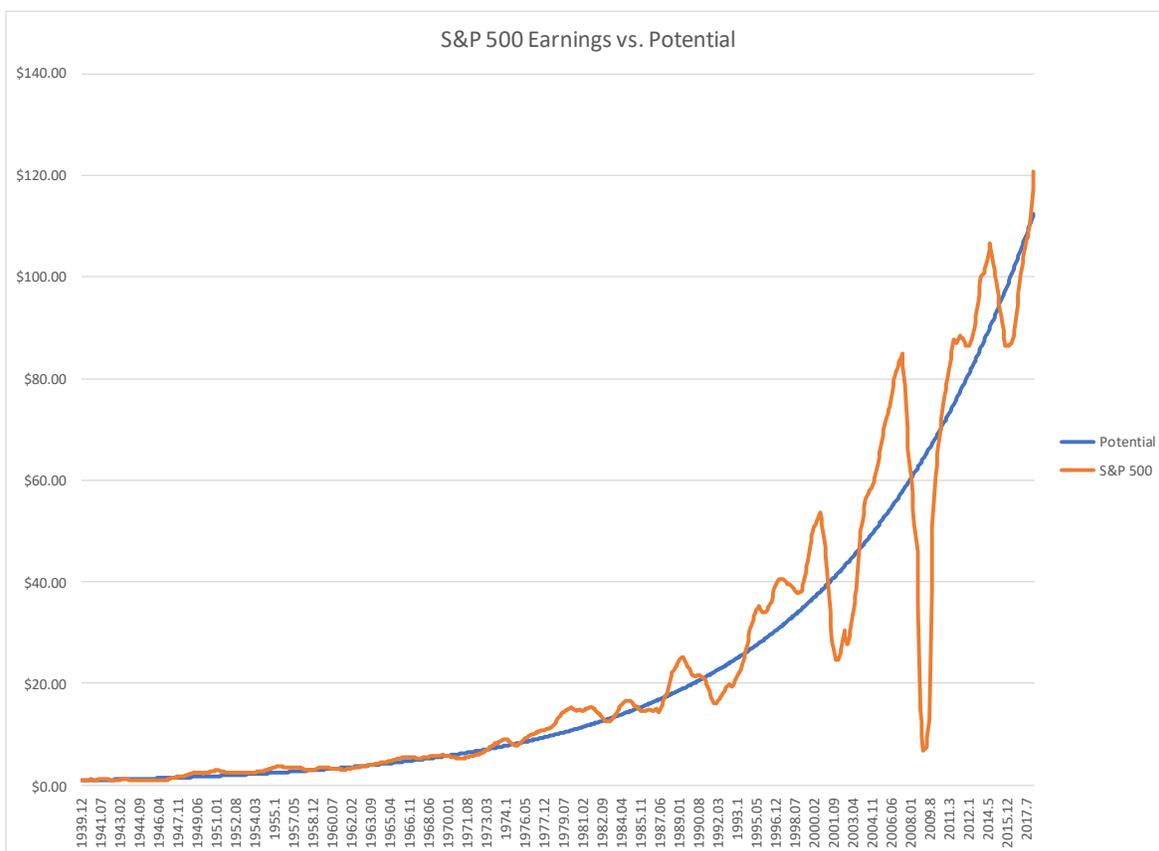


Chart provided by the MRPCI Database

As you can see from the chart, Actual Reported Earnings have risen above Potential earnings in the last quarter. Later in the report, we will detail what impact that will have on future stock market moves.

The next metric we track is the Valuation of the Market. We do this in two ways; one is a raw 10 Year Average P/E and the other is Stock Valuations compared to Bond Alternatives.

This first chart the 10 yr. Price to Earnings Ratio.

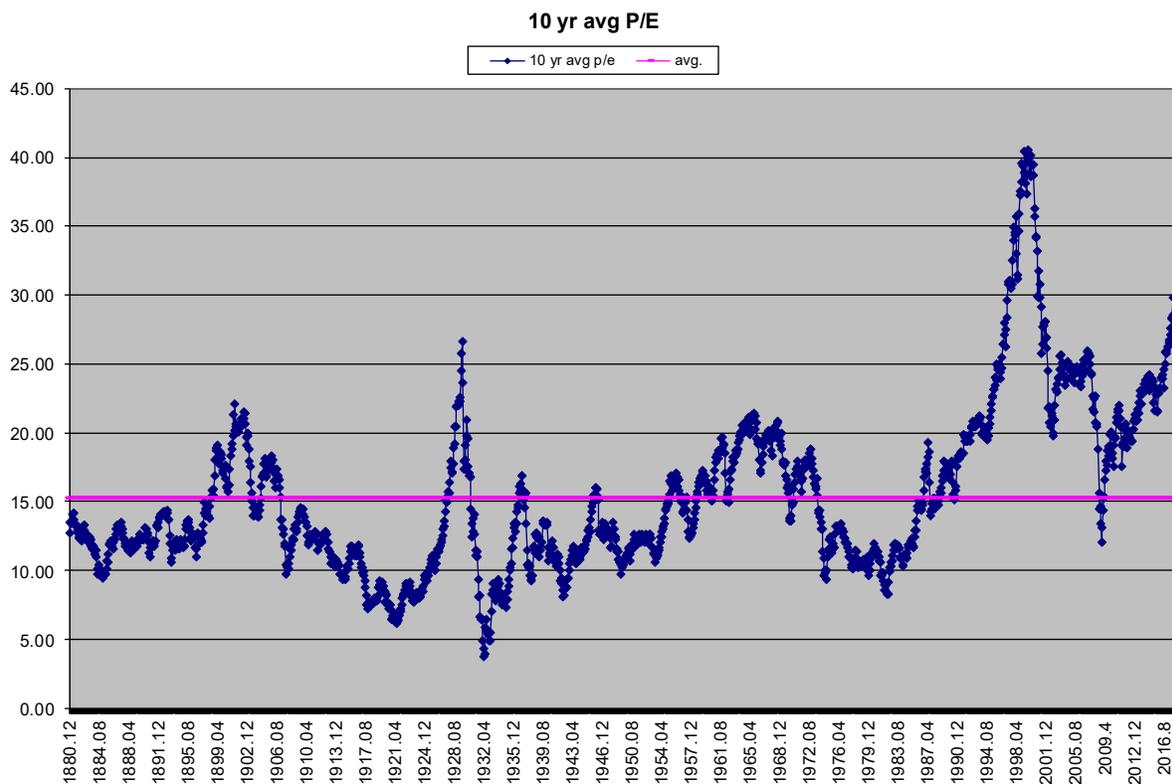


Chart provided by the MRPCI Database

By looking at this chart, you can see that P/E's are elevated.

The next valuation chart we want to look at is Stock Valuations in relation to Bond Alternatives. The Bond Alternative we use in this chart is the U.S. 10 year Treasury.

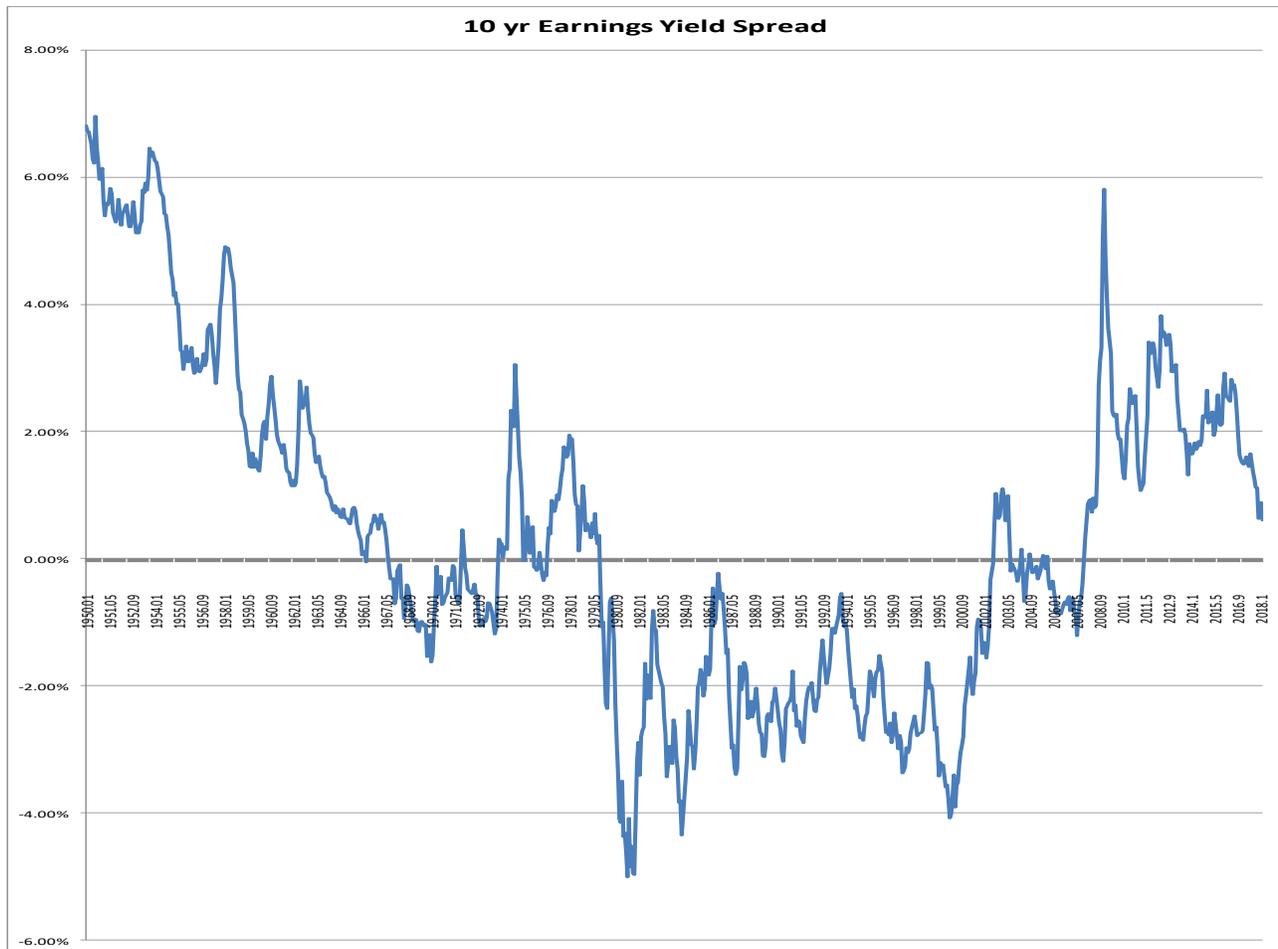
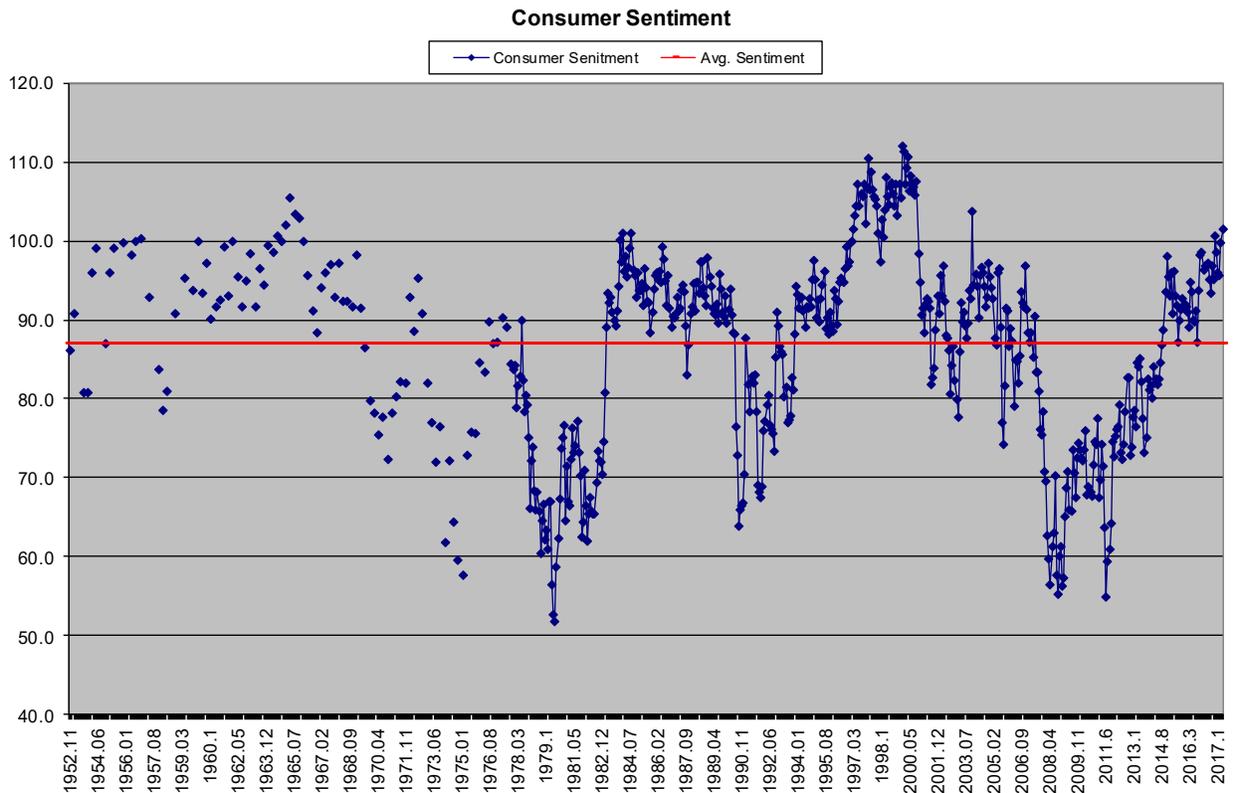


Chart provided by the MRPCI Database

This chart is, most likely, not one many of you have seen. It's an MRPCI developed chart that compares valuations of stocks to the 10 year Treasury. If the reading is positive, stocks are a better buy than bonds (based on valuation). And, conversely, if the reading is negative, bonds are a better value than stocks.

Currently, stocks are a better bet than bonds. **HOWEVER**, the valuation gap is getting tighter and tighter as interest rates rise.

The next metric I track very closely is Consumer Sentiment. I use the University of Michigan Consumer Sentiment Index to track this data point. I find this information to be important because it lets investors know the “mood of the market.” Are investors pessimistic, euphoric, or rational? Below is the latest update, March 2018, of the Index and for reference, the red line is the average reading since the Index was created.

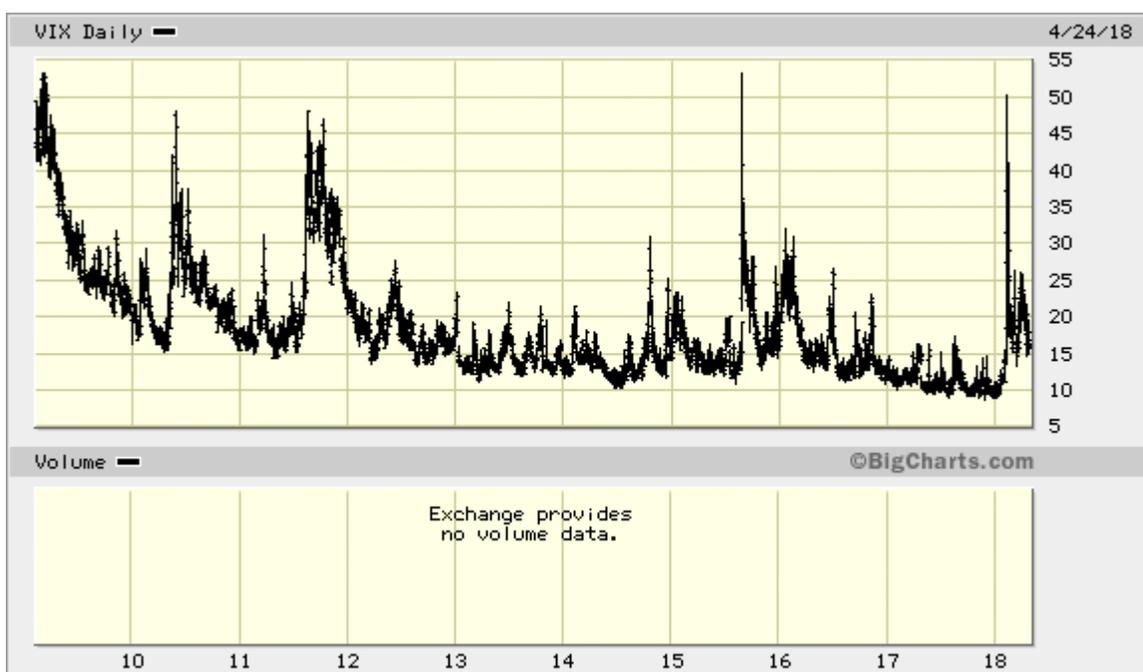


Clearly, the “mood” of the U.S. citizen is quite optimistic about their financial situation. In fact, their mood has been improving steadily since the Financial Crisis of 2008. And now, they have just entered into a Euphoric stage.

In the next section of this report, we will dive deeper into what impact a Euphoric consumer/investor can have on the market.

The final metric I track as part of this analysis is, how Complacent (or Fearful) are market participants? As a general rule the longer that market participants are complacent about the risks in the market, the more dangerous the market is.

I use the CBOE Volatility Index (VIX) as a measure of Fear/Complacency. The lower the overall reading, the more complacent the market participants are. The higher the reading, the more fearful. Below is the a chart of the VIX, supplied by BigCharts.com, from the beginning of this Boom (February 2009) through were we are now (April 25th).



As you can see, we have had patches of time where the market felt like the coast was clear. But that was quickly met with very large spikes in Fear (volatility). Based on this chart, I think it is pretty evident that investors are nowhere near being complacent about the risks in the market.

Timeframes and Expectations

Now that we've outlined how our current market looks compared to other Boom Phases (Below Average) and we've seen how the four main metrics we track are looking, let's take the analysis a step further and try to apply some timeframes and expectations to the timing of the end of the Boom Phase.

To get this ball rolling, I want to do add another cut and paste section from the original "Holy Grail" report that detailed what to look for as the Boom transitions into a Bust.

To provide a quick summary of the information I have just shared, I have laid out the cycles and the characteristics within each stage of that cycle that will help us determine when the cycles are about to transition.

The Boom Cycle...

Begins when, normalized P/E ratio is below 10; there has been a long-period of time of below average consumer sentiment (4 years or so); earnings are off their lows, but still below trend; and the consolidation cycle yields one final pullback in the markets (historically 20%ish).

Signs the end of the boom is near...high normalized p/e ratio (20 plus), high consumer sentiment (high 90's-100 plus), earnings near peak, low to normal level of fear in the market place.

Investment Style that works best...anything and everything. Buy and hold. Throw darts at the Wall Street Journal.



Stats...Average length: 18 years

Average annual return: 14.33%

*# of cyclical bears and average return during those times:
(15.4%)*

5,

The Bust Cycle...

Begins when, normalized p/e ratio are high(20 plus), consumer sentiment is high (high 90's-100 plus), earnings are near their peak, and a low to normal level of fear exists in the market place.

Signs the bust is over...the market experiences a huge bounce, 39% plus is a reasonable number to market the end of the bust.

Investment Style that works best...Cash. Money buried in your back yard or under your mattress. Maybe gold.

Stats...Average length: 2.5 years

Average annual return: (57.22%)

of cyclical bulls and average return during those times: 2, 9.12%



As is detailed in the cut and paste from the old research piece, the Boom Phase ends (and the Bust Phase begins) when: valuations are high, Consumer Sentiment is high, earnings are peaking, and fear is low. Interestingly enough, my research shows that ALL FOUR of these metrics must be triggered before the Boom ends. We will take the time to go over each, and every one, in detail to see if they are triggered yet or not. And we will take the time to try to figure out how much time is left before any untriggered metrics might get tripped.

Frankly, the best place to start as we begin to assess timeframes is looking at our current Boom Phase in relation to the historical averages. As we've already discussed, it would appear that our current Boom Phase will be below average due to the already elevated level of Government Debt. I believe this will reduce both the timeframe of the expansion and the upside move of the market because one major lever that could be used to boost the economy has already been pulled.

With that in mind, the average duration of the Boom Phase is 18 years and our current Boom is in its 10th year. Furthermore, the average upside move in the market is average 14.33% and our average gain for this Boom has been 16%. We will circle back to these numbers at the end of this section, but for now that is our foundation for the analysis.

Earnings—As we've seen, earnings are already above Potential. The key here is, on average, how high do earnings go above Potential in the Boom Phase before the Bust happens. Happily, I've already done that analysis. If you refer back to the 7/21/2017 report entitled "A Brave New World", I detailed my work that showed, on average, "As Reported" Earnings peak out at 22.04% above Potential Earnings.

If the current pace of earnings continues, the "As Reported" first quarter 2018 earnings will end up being 7.3% above Potential Earnings. So, as you can see, **strong earnings can continue to drive this market higher.**



Valuations—There is no question that normalized P/E ratios are high. And that is, without question, a negative. However, there is one interesting twist in the data. The normalized P/E ratio uses an average of the market's earnings over the last 10 years and our current reading on normalized earnings includes the collapse in earnings in 2008/2009. For example, "As Reported" earnings in March of 2009 for the entire S&P 500 index was \$6.86!!! For context, in January of 2008 that number was \$64.25 and now is expected to be \$127.99 at the end of this quarter. Nevertheless, the current reading of the market's normalized Price to Earning's ratio is high.

Furthermore, the valuation of stocks as compared to bonds still favors stocks. But the valuation metrics are quickly narrowing as interest rates rise.

Putting all of this together, **I do not see the market being able to be pushed much higher, if at all, by a rising P/E ratio.**



Consumer Sentiment—In my opinion, one of the most powerful forces at work on the market is the “mood” of the investors within that market. After recording near all-time low readings during the Financial Crisis of 2008, the University of Michigan Consumer Sentiment Index (my proxy for the “mood of the market”) has been posting very high readings since November of 2016.

From an investment standpoint, this metric is an indicator of the market’s momentum and is a contrarian indicator at major market turning points. Continuing with the same example cited above, the low reading for Consumer Sentiment during the Financial Crisis was in February 2009 and the S&P 500 bottomed out on March 6th, 2009.

When analyzing market tops, it appears that Sentiment needs to be high enough for LONG ENOUGH to pull all the potential investors into the market before it becomes a contrarian indicator. For example during the run of the market in the late 50s and into the 1960s, the metric consistently posted readings over 90 (optimistic readings) for over 7 years, before the market pullback in late 1966. Furthermore, the Tech Bubble burst in 2000 after the University of Michigan Consumer Sentiment Index posted readings over 90 for over 4 years.

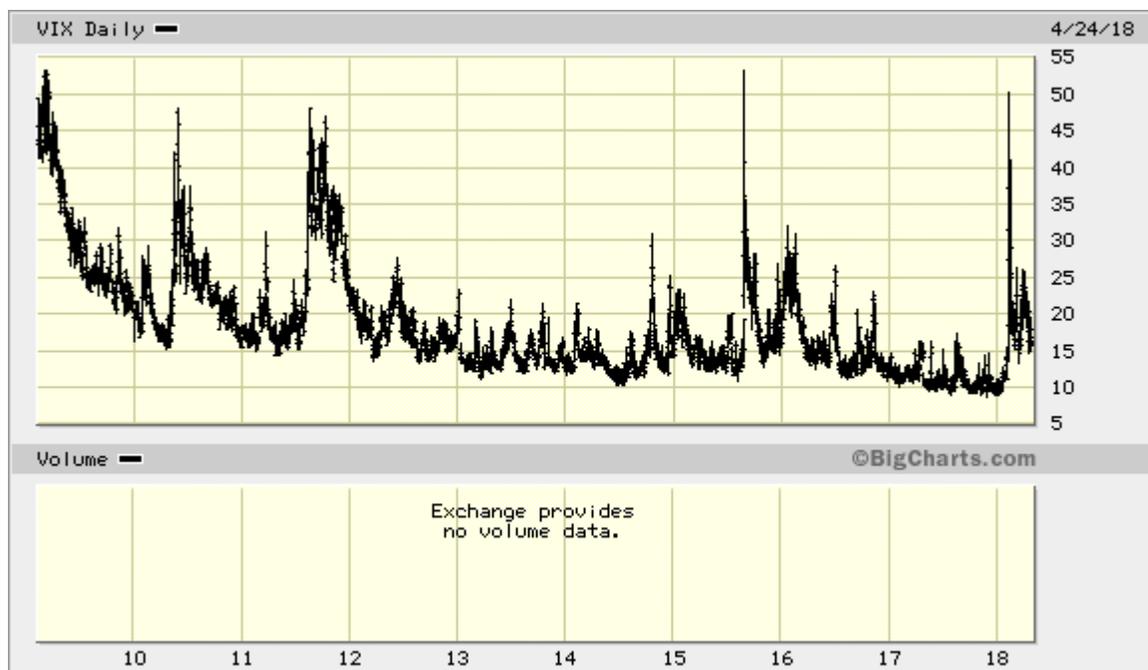
What this should show us is that our current optimistic readings, which have been going on for about 1.5 years, have quite a bit of time left to run. And this should continue to pull investors into the market.

All in all, it appears that **continued high readings on Consumer Sentiment can provide a continued boost to the markets.**



Complacency—One big warning sign that the Boom is about to roll over is when investors become complacent about the risks that are in the market place. As we previously mentioned, the best way to check the market's current level of complacency is to look at the VIX Index. The lower the VIX reading the more comfortable investors are; and that is fine. There are plenty of times when the “all clear” sign is out and the horizon is clear. Frankly, 2017 was one of those years. Things were good and the market behaved accordingly.

However, there are times when shocks hit the market. In fact, recently we've had some; North Korea firing rockets over Japan, Trade War rhetoric out of the U.S. and China, a rapid rise in interest rates. A complacent market would blow that off and volatility wouldn't rise too much on that news. The good news is that DID NOT happen this time around. As you can see from the chart below, the VIX has been elevated for most of 2018 and at times the volatility has been very intense.



This is a good sign for the markets and shows that investors are not over-exuberant and they are, in fact, making rational investment decisions based on the facts at hand. **This highlights that the markets are not irrationally priced, which suggests further gains can be made.**

Conclusion

To put all of that data into a quick summary, we have:

Earnings above potential but below the average Boom Phase peak by about 15%.

Valuations are high and it doesn't appear that further gains can come from multiple expansion.

Consumer Sentiment is high, but has only been that way for 1.5 years. The low-end of "optimistic investors" timeframes is 4 years as Bull Markets age.

Investors are not **complacent** at all! In fact, they are still skittish concerning this Bull Market.

And all of this needs to be looked at in the context of the following facts:

Boom Phases last, on average, 18 years and our current Boom is 10 years old.

Boom Phases, on average, generate gains of 14.33% annually and our current Boom's gains have been averaging 16% annually.

Given that it would appear our current Boom Phase will be below average, I would expect this Bull Run to last at least another 2.5 years and for the S&P 500 to break 3,000. This is consistent with the historical studies of Boom Phases and puts the time from trough to peak below average AND the returns of the market below average.

To add more specifics to the “I would expect...the S&P 500 to break 3,000”, I would refer you to prior reports where I fleshed out the mathematics behind my market valuation forecasts.

-In the 2017 report entitled “A Brave New World” on page 8, I said by 2020 I could see a “rational” S&P 500 hitting 3,030.80.

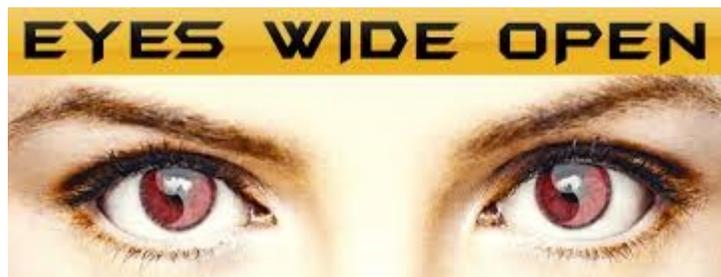
-In the 2016 report entitled “Earnings Recession” on page 7, I said by 2020 I could see the S&P 500 hitting 3,231.64.

-In the 1st Quarter 2016 Newsletter, I did an analysis that showed if the economy were to start clicking on all cylinders, the S&P 500 could hit 3,604 over a longer time period.

Frankly, each of these projections came at the valuation analysis from slightly different angles and with different assumptions. The most conservative used a below average earnings peak and got us to 3,030.80 by 2020 using a “rational” Price to Earnings ratio. The most aggressive projection assumed a “Nirvana Economy” and that got us to 3,604 over a longer-time horizon.

Of course, near market tops irrational exuberance can take over or, as we’ve called it previously, the market can turn into a Reflexive Bull Market and irrational behaviors can feed off of each other and push the markets into La La Land. And we will be looking for signs of that, but in the meantime logical market participants can make a solid case for a continued run higher in the medium term and 3,000 certainly appears to be a barrier the market could breach.

But anything can happen in the markets and we will be watching with our eyes wide open and will be at the ready to make adjustments as necessary.



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