

# DM Portfolio commentary

1st QUARTER 2019

## *Is this bull ready for pasture?*

Ten years ago, almost to the day, stocks began a prodigious ascent that has been unceremoniously dubbed “the most hated bull market of all time”. A sluggish and patchy economic recovery, expanded involvement of central banks in financial markets and, of course, the long shadow of the global financial crisis have all conspired to darken what should have been a glorious time for equity investors. If stocks climb a wall of worry, as investing lore would have it, then they’ve been forced to scale a rampart that even an ardent border blockader would have to admire.

Not surprisingly, calls for the bull market’s end have been frequent through the rise and have grown more impassioned with each leg higher. To be sure, in very narrow terms the S&P 500’s climb has been record-setting, with more than 3600 days having passed since its last official retreat of 20% or more. Failure to meet this adverse milestone, however, is more the product of an exceedingly precise view of things than of a flawless period for equities. In fact, US stocks *have* fallen by 20% from prior highs on two occasions over the past decade: from May to October 2011 the S&P fell by 21.6% and during the Christmas Eve washout that we just experienced, the index breached the negative 20% mark from its September high. Both of these lows, however, occurred in the midst of a trading day and because they weren’t booked as closing

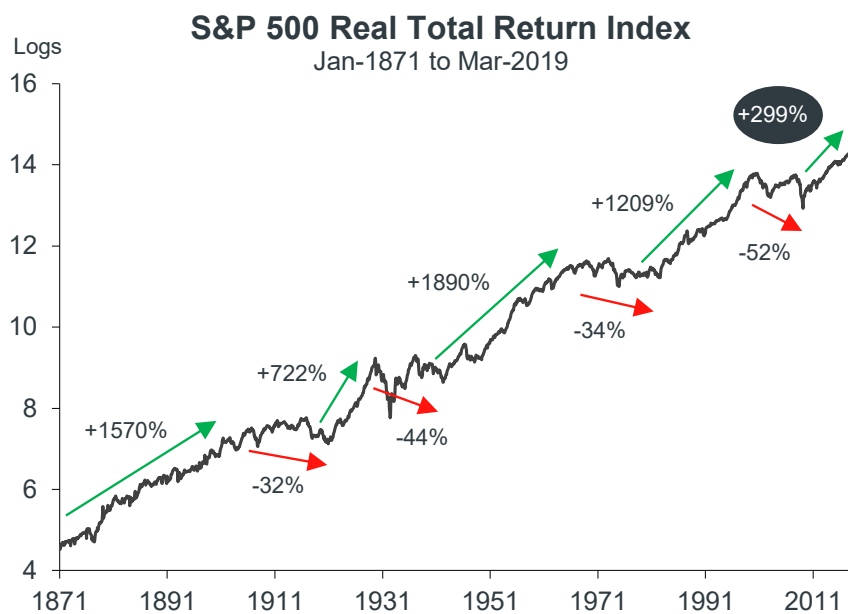
levels, doomsayers treat them as if they never occurred. While such analysis seems pointlessly arbitrary and entirely backward looking, the dialogue surrounding it combined with last quarter’s market plunge has undoubtedly lured many investors away from their long-term plans, or at least left them wondering if things have been too good for too long.

Though the equity analysis we do in support of our mandates is entirely focused on where individual companies are going and not where the broad market has been, the rising clatter suggesting that stocks will cease their climb because of some historical precedent has piqued our interest in the subject. With the help of a major investment research house, we gathered some long-term – *really long-term* – data on the US equity market to see where we might presently stand if, in fact, the investing past is prologue. The graph below charts the path of American stocks from 1871 all the way to the final trading day of the recently completed first quarter. We’ve made two adjustments to the data: we’ve plotted it in log terms to keep the compound growth from shooting off the page (*remember logarithms from grade 12 math??*) and we’ve used real returns, netting out inflation so that stock gains in periods such as the 1980s aren’t just a reflection of sharply rising prices for everything in the economy.

As you can see, when we pull back the lens much further than those who fixate on the next few months, a fairly discernible pattern emerges. Over the past century and a half, equities have tended to move up in very long waves, which are separated by shorter, punishing downturns. Technicians often call these extended moves “secular” bull and bear markets, or periods where even substantial interim fluctuations occur within, but do not disrupt, an overriding trend. A couple of points worth noting from the data:

- The two post-war secular bull markets prior to the one we might be in now generated massive returns for those who stuck with them;
- Each of the ascents shown included several detours along the way which didn't alter the dominant path, but which would have definitely tested investor mettle and staying power; the great 1982 to 2000 bull market, after all, included the crash of '87, which was as jarring as it was brief;
- Significant downturns have set the table for each long-term bull market and the “lost

decade” that began with the dot-com crash in 2000 was as severe as any of these declines. What's most notable about the graph, however,



Source: Macquarie Macro Strategy

isn't the grandeur of the current market upswing, but rather how short and insignificant it would be relative to its predecessors if it were to end today. In fact, stocks could triple from here and they'd still fall short of the previous secular

bull market on an after-inflation basis. Does this mean that we're necessarily going to enjoy another 300% or more before the next extended bear shows its claws? That's impossible to predict and a fool's errand to try. If one chooses to let history be the guide, though, the prudent course from here may be much different than what gut instincts or many talking heads are suggesting.

At the end of last year, we rolled our eyes as we listened to investment 'experts' claim to have known that stocks were due for a steep fall, with some even doubling down to forecast that the December difficulties would mark the end of the market's climb from its sub-prime abyss. What we didn't hear was any of these gurus forecasting that Q1-19 would be the best quarter for stocks in a decade ... which it was.

Over the past ten years, the principal thrust of our commentaries has been positive, drawing attention to attractive valuations, robust earnings growth, and accommodative credit conditions, while downplaying the hobgoblins of money printing, Grecian insolvency, Brexit, and countless other distractions that were being cited

as reasons not to invest. The underlying intent of this approach was to do all that we could to keep you invested and on plan, despite what was often an unsettling backdrop. This has been a winning strategy through the past decade, and we think it will be equally fruitful in the years to come.