4th Quarter 2017

Euphoria? Is it a bubble?

The Stock Market did not miss a beat in the 4th Quarter. In fact, it rarely seemed to have a down day and set record high after record high almost universally across all major indexes. For the quarter the S & P 500 rose more than 6%.

With so little down side and frankly so few down days of note one wonders if we are back in the bubble years of the late 1990's. One thing is for sure, optimism is high right now and historically over optimism has not been a great thing for future returns. Our job is not to get caught up in the hype but to stay diligent to our process and continue to look for problems that may arise. So, let's take a quick look at some statistics.

The economy is firing on all cylinders. The LEI (Leading Economic Index) has made a new high in every month this past year. This bodes well for the six-month outlook on the economy. In addition, unemployment is at or near an historic low and manufacturing indexes are in expansionary territory across the board. In short, it will be difficult to have a recession over the next two quarters with statistics like these.

Technically the market is on solid footing. The advance Decline line (number of new stocks making new highs vs. new lows) is making new highs at the same time the major indexes are making new highs. This is a good sign of market strength. There are no real signs of distribution in the market (think institutional selling) and the s and p 500 (as well as other major indexes) is well above its 50, 100, And 200 day moving average. This is also a good sign of momentum and all of this points to likely gains ahead.

Let's not wind up here!

The one area of the market that continues to be a concern is valuation. The Shiller PE Ratio is now above 33. This level has only been achieved one other time and that was the bull market of the late 1990's that eventually ended in March of 2000 with the Shiller PE above 43. This bears watching, however as we have stated bull markets don't die on valuation alone, many other factors contribute to their demise, so we will continue to watch for possible events or data points that may prompt us to move to a more defensive position. Interest rates will likely play a key role in investment returns in 2018. If the economy gets too strong the Fed may need to increase rates at a faster pace than the forecasted 3 rate increases for this year and this would most likely have a slowing effect on the economy and possibly stocks. Stay Tuned!

As for the models that we manage, the only change that took place was in the sector model on 10/25 where we replaced Matthews Asia Fund with First Trust Developed Markets ETF. This change was made to use a lower cost more internationally diversified ETF. We will be doing our annual rebalance on 1/31. With the stock markets stellar performance over the past year portfolios have become stock heavy and carry more risk than a year ago so time to get them back in line with their original objectives. As always feel free to reach out with any comments or questions.

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