October 15, 2017

# Q3 2017 Commentary: No doubts, winning streak continues…

The eerie calm in the stock market has extended into the Fall. In the week ending September 22, the total trading range of the S&P 500 was just 12.3 points, or 0.49%, the lowest weekly trading range since 1972. This absence of volatility has persisted all year. The S&P 500 has traded up or down by more than 1% on only 8 days in 2017. The last year the number of 1% trading days was lower at this point in the year was 1972. Furthermore, in our last letter we highlighted the extended period since the last 5% correction in the market. That streak continues and as of last week is now the longest on record having exceeded the previous record of 333 days. For the quarter the S&P 500 advanced 4.5% and it has now had positive returns for eight straight quarters. It really does not get much better than this.

But wait there's more. This business cycle has now moved into its 99th month of economic expansion, which is the 3rd longest expansion since 1902. Of course, the Federal Reserve has shepherded the economy along through massive monetary stimulus and artificially low interest rate policy. If one wants to quibble, one could argue the expansion has been marked by only moderate growth, but eight years on we would have to rate the Fed policy a success. Economies are growing in all corners of the world and global economic growth estimates are rising. Interest rates are still low and will remain low even after the Fed bumps the discount rate again in December.

At the beginning of the year we expressed that it would take a resumption of earnings growth to take stocks higher. At that time, we were on our fifth straight quarter in which aggregate quarterly earnings for the S&P 500 had been lower than the previous year's. Stock market momentum appeared to be flagging. Thus far, we have certainly gotten the earnings growth we were looking for in the first half of the year. Earnings advanced by more than 10% each quarter and the stock market has responded accordingly. Third quarter earnings are estimated to grow by 2.8%. However, if we exclude insurance company losses due to hurricane damage, earnings would be significantly higher. Our outlook for the stock market will continue to be favorable as long as we project earnings growth to continue.

We do need to keep an eye out for signposts of irrational activity in the market. Recently, Bioptix, a company that licenses fertility hormones for livestock, announced it was changing its name to Riot Blockchain and getting into the cryptocurrency business. Cryptocurrencies, like Bitcoin, are unregulated digital currencies. Bitcoin has appreciated more than 400% this year. In response to the Bioptix announcement, its stock surged higher. This reminds me of the sleepy little chain of book stores that added .com to its name in 1998. When Books a Million changed its name to Books a Million.com the stock price leapt from $3 to $38.94 within two days. This brand of lunacy has been largely absent in this bull market. If we start to see more of this kind of thing, our concerns will mount.

One thing that has been consistent in this extended bull market has been the skepticism with which investors have viewed it. Investor skepticism is healthy for the stock market. Market bubbles occur when investors lose all caution. We may be in the early stages of that skepticism waning. For now, however, we will stay on the same track we have been following. The ingredients that have gotten us this far are still firmly in place.