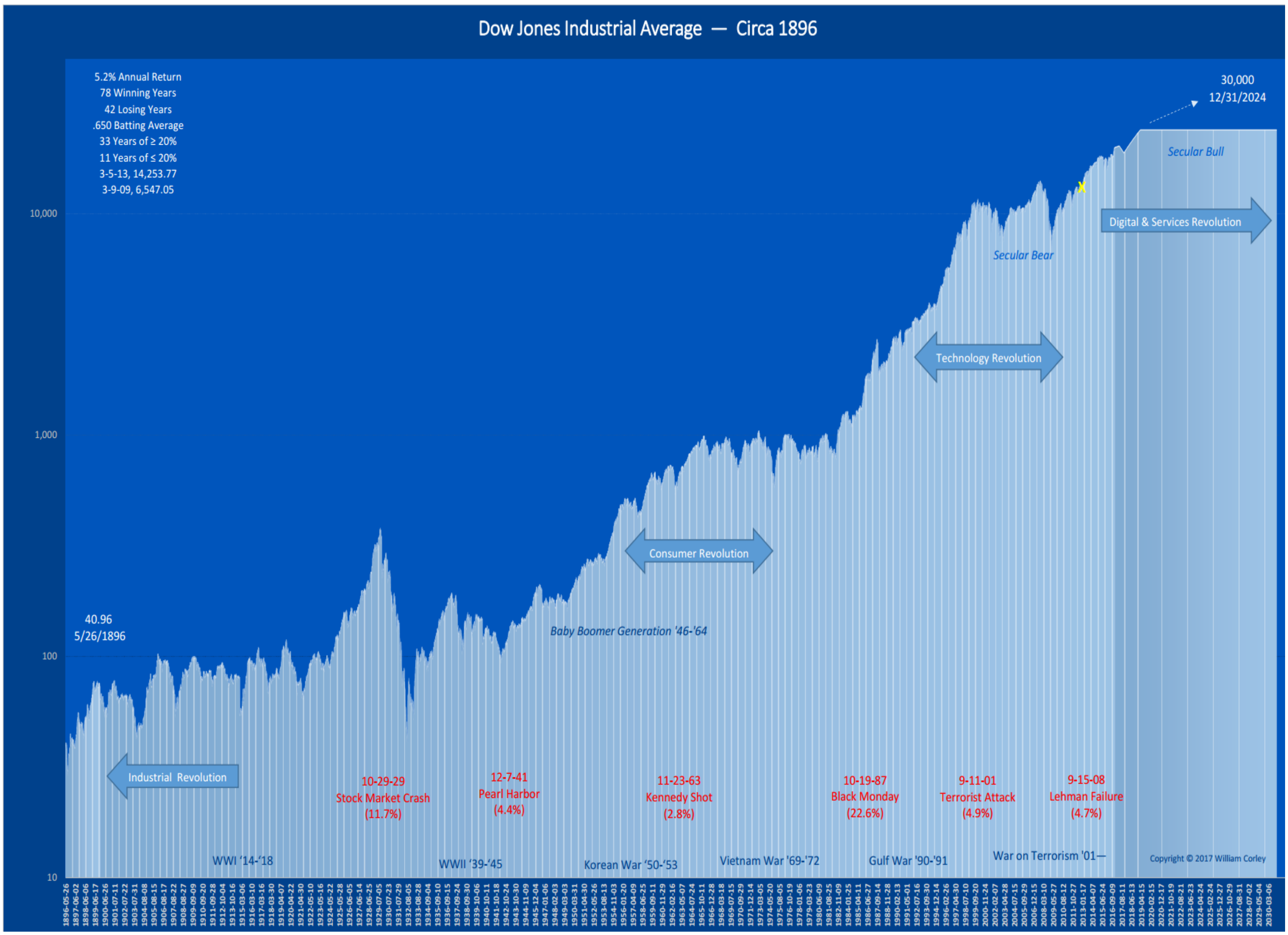
120 Years of Market Action

William "Chip" Corley ***2017 Letter to Investors*** ***January 9, 2017***

"Those who fail to learn from history are doomed to repeat it."
—Winston Churchill

The *January Barometer* is a theory that if the market posts positive results for the month, stocks are apt to be up for the year; since 1950 the indicator has been accurate over 80% of the time. According to the Stock Trader's Almanac, if the first five days of January are profitable, the likelihood of a money-making year is better than 80%. As of this writing, both the Dow Jones Industrial Average and Standard and Poor's 500 are heading in the right direction. Hopefully, these early green shoots will prove to be a meaningful harvest for the year ahead. In this letter I will address the market's current state of affairs and how we arrived to this point.



<Ctrl+click to enlarge image>

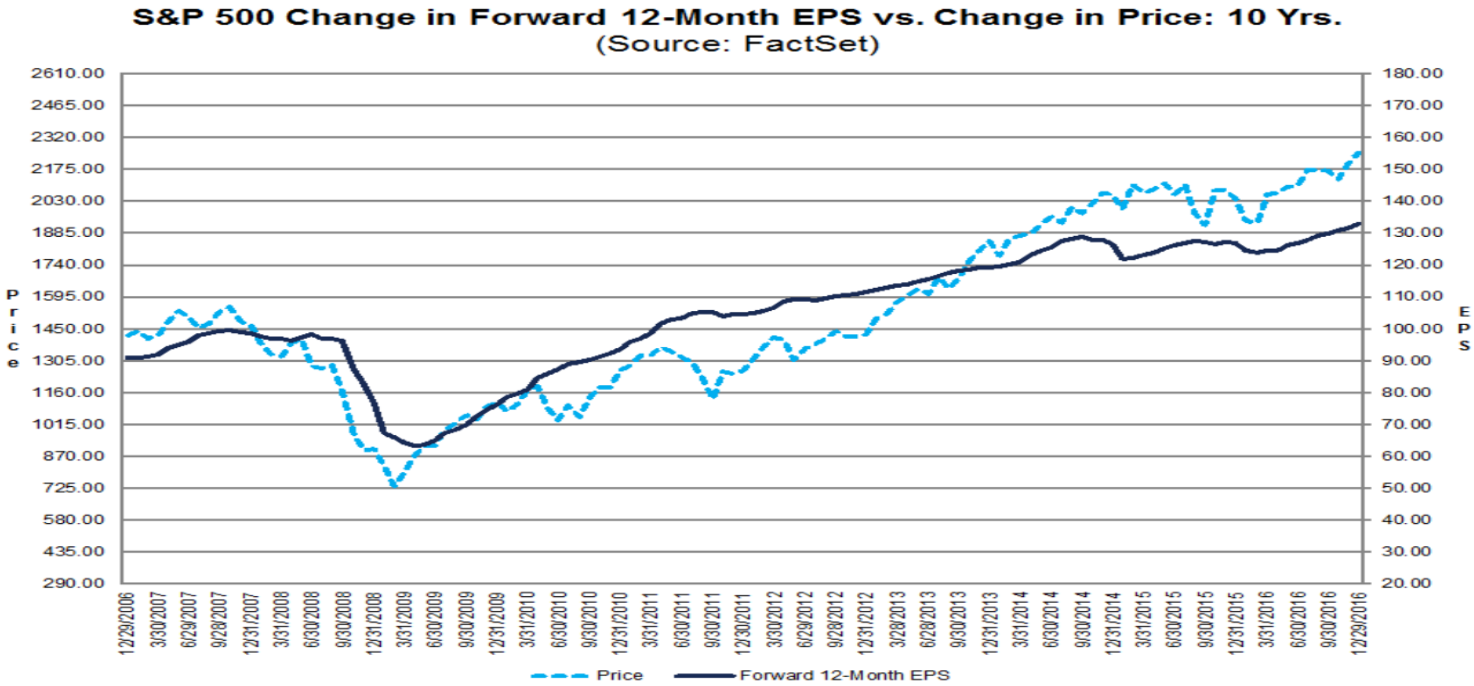
I find it beneficial to reflect back in history to gain insight into what may lie ahead in the future. I created the DJIA 120 year log chart below (which took longer than I expected) to assist in building a case for what's next. The Dow commenced trading on May 26, 1896 closing at 40.96. As the graph illustrates, the road to today had its ups and downs. In the first half of the 20th century, our world relished in the upshot of the Industrial Age, an era known as the Roaring Twenties. Stock prices during this time soared by over 500%, lifting American spirits and creating unheralded wealth. Unfortunately, on October 29, 1929 the stock market bubble burst, sending stock prices spiraling downward and investors into a panic. This proved to be the beginning of the end of those halcyon days, followed by the Great Depression, America's darkest days. By the summer of '32, the index erased 90% of its gains. It took until November 23, 1954 to return to the '29 high. Our nation witnessed multiple wars during this period, but the American spirit never waned.

After World War II ended, it brought with it a baby boom. From '46 to '64 there were 76.4 million babies born in America that would need love, food, shelter, clothing, medical care, transportation, education and entertainment, among countless other goods and services. It would take a ramp-up in output from American industry to satisfy the consumption requirement for this sizeable horde. Consumerism became the American way; it brought jobs, investment, style, individual expression and innovation. Baby boomers were next in line to make their mark in the world, led by Bill Gates and Paul Allen of Microsoft. Gates brought the personal computer to the masses, spawning a technological revolution that would prove to be uniquely American. Stocks had been quiescent for nearly a decade; tech became the primer for equity liftoff. This set the stage for what would become the next secular bull market. With the advent of the internet, everything tech had been the rage. Money from all over the world was thrown at this sector, sending tech stock prices and valuations through the stratosphere. Initial public offerings were offered to the public in droves at preposterous valuations; bankers couldn't package the stuff quick enough. It was a Wall Street California gold rush like no other. Consumer sentiment, as measured by the Michigan Survey, rose to decade highs and would set all-time records over the course of the next 20 years. Investors who bought and held stocks were richly rewarded; the DJIA posted a 14% compounded return. As Western society marched to its second millennium, *irrational exuberance* ruled-the-day. This too, would not last. It was all pretty much fool's gold with investors losing 90% of their hard earned savings. For the next decade, 2000 through 2010, investors that held blue chip stocks barely broke even; those that held tech lost money.

Housing, i.e. extravagant leverage, became the amateur investor's next junket. The fix was on, led once again by Wall Street's finest, who were in cahoots with Washington's elite, our elected officials. It was an asset buying binge for the ages. Stocks had been a loser's game and real estate had been going higher by the month. Banks, finance companies and brokerage houses were leveraging their balance sheets, enabling ordinary folks to do the same. Housing prices skyrocketed, until they didn't. Housing had become a bubble with prices artificially pumped up by egregious lending practices. The carnage was irreparable for over 7 million people that lost their homes. The housing crisis wiped out 8.8 million jobs and over $16 trillion of net worth. It was the worst of times for many; it was the best of times for few.

The few who enjoyed abundance were in rarefied air. Stock prices were cut in half, doubling dividend yields; residential housing in certain markets was down similarly, offering high capitalization rates; REITs offered favorable total returns; municipal bonds were discounted, and high yield bonds were on fire sale. It was the time to buy, if you had funds to invest. March 9, 2009 was the bottom of the stock market sell-off. By June, the recession was over. Professional investors, the Warren Buffett's of the world, along with the Federal Reserve, righted the ship. Stocks have since been in a seven year bull cycle. Housing and real estate are on solid ground. Personal debt is within reason. And America is working. Will it last?

Since the November election, stock prices lifted sharply on the euphoria of President-elect Trump's vision for America. Can Trump's team of credentialed cabinet and economic advisors accelerate the nation's growth rate, increase job expansion with better pay, and raise standards of living for U.S. citizens at large? Market prices are said to precede fundamentals, meaning that stock prices foretell or forewarn what's to come. As illustrated in the chart below, earnings trajectory for the broad market has lagged price performance since late 2013. How wide can the gap deviate from its historical norm? According to the Fed Bank of Cleveland, the S&P 500 has traded at 16.5x forward earnings since 1990; it stands at 17x year's end.



Sam Stovall, CFRA Chief Investment Strategist and renowned market historian, informs investors that since 1945 under first term Republican presidents, the S&P 500 has performed poorly. During this period the index averaged a negative 2.7% return and has shown yearly losses 80% of the time. Will the first year of the new administration represent the past? Only time will tell, but as Sam often quotes, “History is a guide, but never gospel.” The obstacles that could curtail market advancement for the year ahead are: interest rates hikes by the Federal Reserve, skilled labor shortages to expedite infrastructure building, continued strengthening of the U.S. dollar, and potential Washington hindrance to Trump’s fiscal stimulus agenda. Additional drags to economic advancement could stem from restrictive trade policy and inflationary concerns.

Trump campaigned for less regulation, corporate tax cuts, dividend tax breaks, friendly capital investment treatment and fiscal stimulus. If President Trump is able to fulfill his campaign promises, the tailwinds of fiscal reform alone look promising. There are concerns about what’s to come in the digital age, in which artificial intelligence and robots are poised to replace human beings in the workplace. The digital economy is creatively disrupting enterprise at breakneck speed. Fast food restaurants are using robots for placing orders; vending machines are baking individualized fresh hot pizzas; self-driving cars are set to transform transportation and society. Accompanying creative destruction is the aging of America, as 10,000 boomers hit retirement age daily. How will our government be able to pay for its entitlement commitments of Medicare and Social Security with millions leaving the jobs market? Will the next generation of workers be sufficient to meet these obligations? Pessimists see the situation dire; is it?

America is a melting pot of people from all walks of life. It is the land of the free; everyone is able to make their own choices. Some folks are prudent in their dealings, others are not. Eighty percent of the jobs in the U.S. are from the service-providing sector. Services are projected to be the growth engine of the future, led by education, medical, and social services. As boomers retire, their wants and needs may diminish somewhat, yet in ways they may increase. The affluent will spend on leisure, entertainment, hospitality, recreation and wellness. Many retirees will continue working to supplement their income. Others will remain employed because they love working or are bored and living much longer. A majority of service producing jobs are here to stay, since they cannot easily be supplanted by tech innovation. This brings up the point that a considerable sum of baby boomers reaching retirement age will not be departing the labor force as soon as anticipated, and that entitlement obligations may be kicked down the road.

Returning to the 120 year chart, the *yellow X* designates the current level of the market. The DJIA is near 20,000; it started 120 years ago at 40. The index has provided a 5.2% annual price gain for more than a century. If the Dow remains on its historical path, it will reach 30,000 seven years from now. Secular bull markets are prone to last 15 to 20 years; if we are living in a secular bull then there is more upside to come. There will continue to be ups and downs, even cyclical bears and bulls (20% movements in either direction), but during a secular bull market, selloffs are frequently tempered and present buying opportunities. If a 5.2% price return afforded shareowners over the past century isn’t good enough for investors, how about topping it off with dividends, currently yielding 2.25%? I’m optimistic.

All the best in 2017!
—Chip