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LOOKING AT THE DECADE AHEAD

Jeremy Nelson, Partner

In our 2020 Economic & Market Forecast we outlined the potential for a secular bear market to begin this decade. This was not stated to evoke fear and is not something we believe will begin in 2020. Rather, we wanted to give a historic perspective on longer-term market cycles, evaluate how we got to where we are today, and highlight themes that we believe will play out over the next decade. This article will break down the topic in further detail. First, we must define the a between a secular and cyclical cycle. A secular bull market is a period of above-average returns for stocks, with relatively short and generally mild declines. Think about 1982-2000. There was the Crash of 1987, the early 1990's recession and the blow up of the hedge fund Long-Term Capital Management in 1998. Each of these events led to a short-term, or cyclical, bear market. But over the entire period the Dow Jones Industrial Average (DJIA) gained 1409%, excluding dividends. Prior to that we had a secular bear market, or extended period of flat or declining stock prices, from 1966-1982. During that period the DJIA declined 22%, excluding dividends. Below is a table that illustrates all of the Ned Davis Research defined secular bull and bear markets since 1900.

Ned Davis Research Defined Secular Bull & Bear Markets

Beginning	DJIA Level	End	DJIA Level	Gain/Loss	# Days	
3/31/1900	38.8	1/19/1906	75.45	94.46%	1943	Secular Bull
1/19/1906	*75.45*	*8/24/1921*	*63.9*	*-15.31%*	*5549*	*Secular Bear*
8/24/1921	63.9	9/3/1929	381.17	496.51%	2932	Secular Bull
9/3/1929	*381.17*	*4/28/1942*	*92.92*	*-75.62%*	*4620*	*Secular Bear*
4/28/1942	92.92	2/9/1966	995.15	970.98%	8688	Secular Bull
2/9/1966	*995.15*	*8/12/1982*	*776.92*	*-21.93%*	*6028*	*Secular Bear*
8/12/1982	776.92	1/14/2000	11722.98	1408.90%	6364	Secular Bull
1/14/2000	*11722.98*	*3/9/2009*	*6547.05*	*-44.15%*	*3342*	*Secular Bear*
3/9/2009	6547.05	*1/17/2020	29348.1	348.26%	3966	Secular Bull

*Current

Source: Ned Davis Reseach

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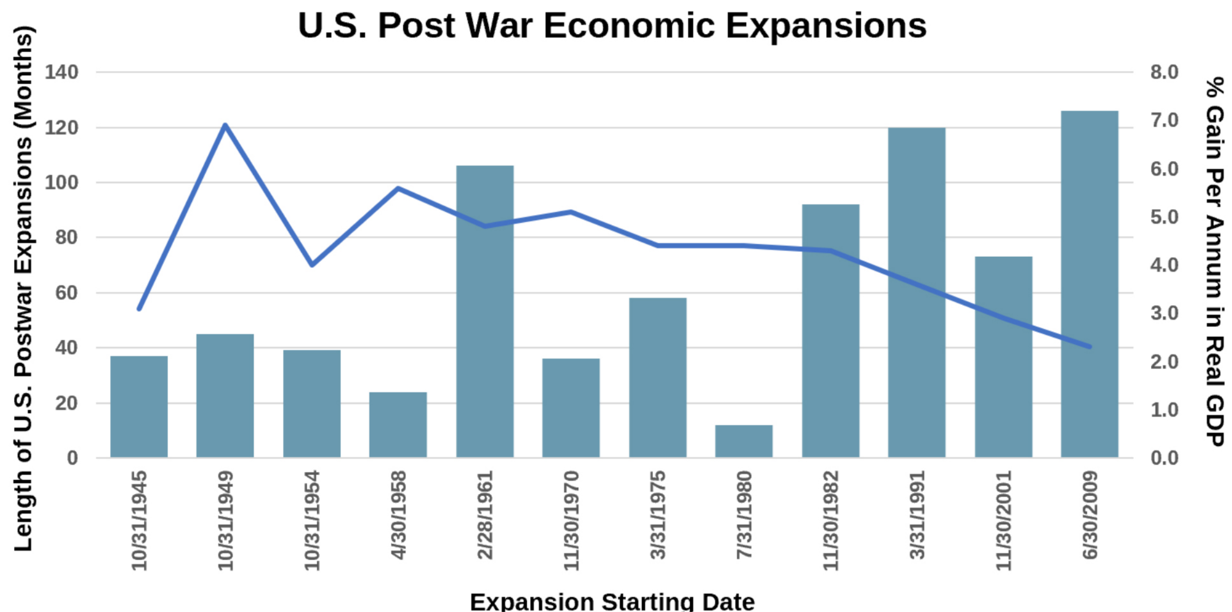
For every bull market there is a bear market and for every secular bull market there is a secular bear market. Secular bull markets generally end with excessive valuations and extreme optimism. Currently, we have been in a secular bull market for stocks since March 9, 2009, when stocks bottomed during the Financial Crisis.

Defining when a secular trend begins and ends is subjective and can only be done in hindsight. It is also important to remember that past performance is not a guarantee of future results. However, we saw valuations on stocks rise dramatically over the past decade. Per Standard & Poor's, the trailing four quarter GAAP price to earnings ratio for the S&P 500 bottomed in September 2011 at 13.01x. As of December 31, 2019, it was 23.18x based on most recent earnings estimates. On January 31, 2000, the same valuation measurement was at 28.95x. Using a longer-term valuation metric for the S&P 500, the 10-year average cyclically adjusted price to earnings ratio (CAPE) was at 30.89x as of December 31, 2019. This is above 2007 levels of around 27x but below the dot.com bubble, above 45x (source: Ned Davis Research).

Looking back, the story of how we got here is remarkable. In 2009, and the years following the Financial Crisis, there was great fear that our economy would slip back into recession and the secular bear would continue. Instead, we were in the early innings of the longest economic expansion in U.S. history. Some point out that it has been the weakest expansion in U.S. history as well. The chart below illustrates that since WWII, the strength of our economic expansions has been weakening, specifically, since the 1980s. This intuitively makes sense as our debt has piled up making it harder to grow. Also, the economy has matured, becoming heavily weighted towards the consumer rather than manufacturing. This has led to slower growth but longer expansions.



The recovery in the economy and the bull market in stocks has been underpinned by low interest rates, aggressive central bank intervention, and massive government deficit spending. Consumers, businesses and the government have refinanced debt to lower interest rates, making debt service less of a burden, but overall debt levels are high. In 2018, the 10-year treasury rate went above 3%. The stock market had a sharp sell-off in the 4th quarter and recession concerns rose. The Federal Reserve reacted and cut interest rates three times in 2019. Since then, recession fears have subsided, and the stock market has reached new record highs.

As we move forward, we still have the lowest unemployment rate since the early 1950s and the economy continues to grow. Will low unemployment lead to wage inflation? Will wage inflation lead to inflation? If that becomes the

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case interest rates will rise again and threaten stock market valuations. What if the economy stalls and we face a stagnation, or worse deflation? Only time will tell what is going to happen. But with elevated stock market valuations and investors being heavily invested in stocks, downside risks are mounting.

Our outlook for the short-term remains constructive. The economy is not showing signs of slowing and the employment picture remains strong. Stock market trends are still positive, and corrections will likely become buying opportunities, until we reach the peak. Unfortunately, we won't know it's the peak until after it has happened.

So, what does one do? That depends on your age and tolerance for risk. If you are in the early accumulation phase of retirement savings, keep saving and dollar-cost averaging. Over the long-term stocks still offer much better return potential than bonds, especially with the 10-year treasury below 2%. But if you are at or nearing retirement, or are extremely risk averse, it is critical to have a plan. Ultimately, it is important to have risk controls built into your portfolio and plan. Retirement planning is about finding your unique mix of income, growth and guarantees. This framework can help build a plan to address the numerous risks that each individual will face in retirement. If you'd like help figuring out your plan, we are here to serve.

Jeremy

TALKING US INTO A RECESSION

Danny Williams, Partner

We have been hearing about the likelihood of our country having a recession at some time in the near future. I would say that you can count on it, but no one really knows how to predict one. A recession is pretty much a given at some point and is part of the business cycle. As I'm writing this article, it appears that most economists believe the chances of the U.S. economy going into a recession in the near term is low. Nobel prize winner Robert Shiller said in a recent interview that the odds of a recession in 2020 are less than 50%.

A recession is a period of temporary economic decline during which trade and industrial activity are reduced. They are generally identified by negative economic growth, and visible in gross domestic product (GDP), real income, employment, industrial production and wholesale-retail sales, in two successive quarters.

Depending on the source you reference, there have been more than 45 recessions in the U.S., dating back to when our country was formed. The length of recessions in recent years is difficult to compare to recessions of the past. According to Wikipedia, the average duration of the 11 recessions between 1945 and 2001 is 10 months, compared to 18 months for recessions between 1919 and 1945, and 22 months for recessions from 1854 to 1919.

The National Bureau of Economic Research (NBER) is the authority on recessions, as to when they started and ended, not so much on predicting them. As I look back over some past recessions, their causes are varied, including increasing budget deficits, rising oil prices, the Federal Reserve raising interest rates, a tight monetary policy, collapse of the speculative dot-com bubble, the September 11th attacks, the housing bubble tied to subprime mortgages, just to name a few.

I was listening to Leon Cooperman, an American billionaire investor, hedge fund manager and philanthropist, recently, and he said there may be one more leg to the current secular bull market. He went on to remind us that there are both good and bad things that come from a recession. He said the seeds for the next recovery are sewn during a recession and vice versa. According to Cooperman, there are two likely main contributors to the

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next recession: the possible war with Iran, which could lead to higher oil prices and a continuation of increased tariffs with China. Time will tell if either of these turn out to be the cause of the next downturn in the economy.

There seems to be an increasing number of stories by the media that we are going into a recession soon. This steady drum beat of recession fear may eventually cause consumer sentiment to weaken. Strong consumer sentiment has been a major contributing factor to this long-running bull market we are presently enjoying. It was reported in a recent Forbes article (Sept. 7, 2019 by Steve Hanke), that the current Chairman of President Trump's Council of Economic Advisers, Thomas Philipson, was worried about how the steady negative comments would weigh on consumer sentiment, which feeds into consumer purchases and investments.

There are some good things that can come from an economic decline, but you need to understand your financial condition. I believe we would all agree that we are in the latter stages of one of the longest bull markets in history. One thing we are discussing with our clients is the downside risk of their investments, and if they are truly aligned with how much of a decline in value the are willing to experience and stay the course. This conversation and any needed adjustments can be made more objectively when the market is at record high levels, as opposed to a discussion after the market has gone through a 20-25% correction. If it has been a while since you have reviewed the potential risk in your portfolio, this may be a good time to understand how your investments will likely perform when the next market decline comes our way. Our technology can help us see how your current portfolio may perform during different market environments.

	1 Year Prior	Recession	+1 Year	+3 Years	+5 Years
Aug 1957 - Apr 1958	0.8%	-6.4%	37.2%	66.1%	89.3%
Apr 1960 - Feb 1961	3.1%	18.3%	13.5%	34.8%	67.7%
Dec 1969 - Nov 1970	-10.7%	-3.4%	11.3%	20.4%	24.8%
Nov 1973 - Mar 1975	-0.1%	-18.2%	28.3%	21.6%	54.8%
Jan 1980 - July 1980	18.5%	16.4%	13.0%	56.0%	100.0%
July 1981 - Nov 1982	20.7%	14.4%	25.5%	66.4%	102.4%
July 1990 - Mar 1991	16.5%	7.6%	11.1%	29.9%	98.3%
Mar 2001-Nov 2001	-8.2%	-7.2%	-16.5%	8.4%	34.2%
Dec 2007-June 2009	7.7%	-35.5%	14.4%	57.7%	136.9%
Averages	**5.4%**	**-1.5%**	**15.3%**	**40.1%**	**78.7%**

"The man who views the world at 50 the same as he did at 20 has wasted 30 years of his life."
—Muhammad Ali

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