

When will the equity cycle end?

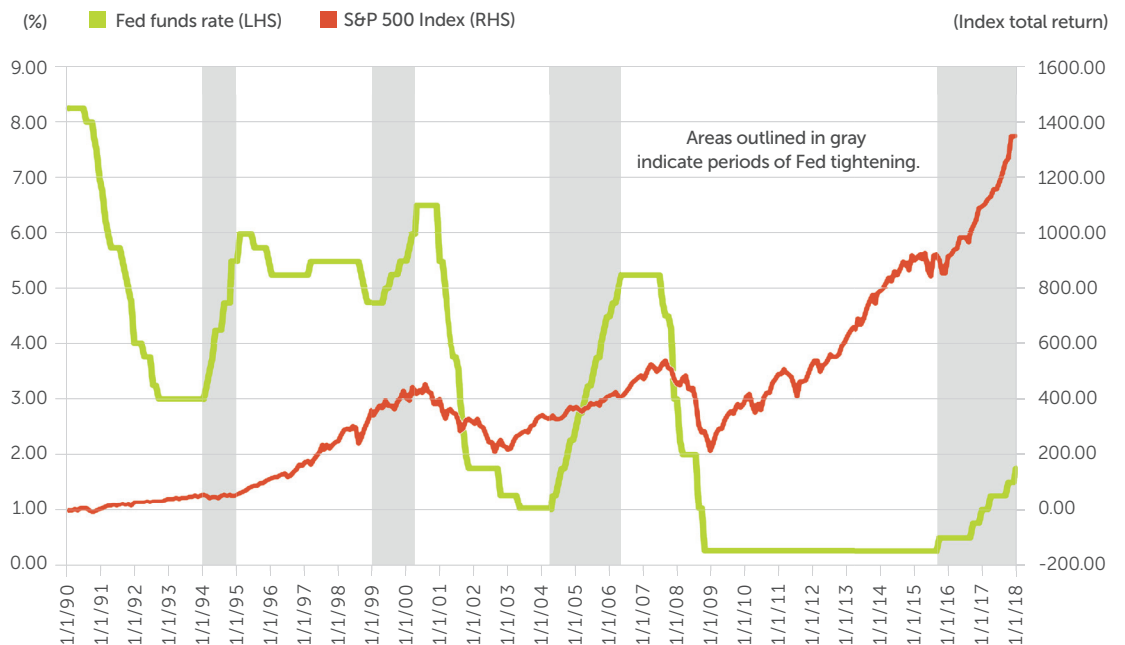
Key highlights:

- Second longest bull market in U.S. history will become the longest this year, barring a correction.
- Current economic expansion is in its ninth year and represents the second longest since World War II.
- Recent stock market volatility raises the question of when the current cycle might end.

Death by fed funds rate?

There is an old adage on Wall Street that bull markets don't die of old age, but rather they are killed off by the Federal Reserve (the Fed). As Exhibit 1 shows, the Fed is clearly in the midst of its latest tightening cycle, with the expectation of more rate hikes in the coming months. Such policy implementation may eventually end the expansion, but we believe that any Fed impact is likely to take some time before manifesting itself. Looking again at Exhibit 1, since 1990, the S&P 500 Index continued to show positive performance despite a series of four Fed tightening periods (including the current cycle).

Exhibit 1: Fed tightening cycles and stock market performance since 1990



Source: Morningstar, Federal Reserve Board of Governors, 3/30/18. S&P 500 Index returns are cumulative.

Hello, I must keep going?

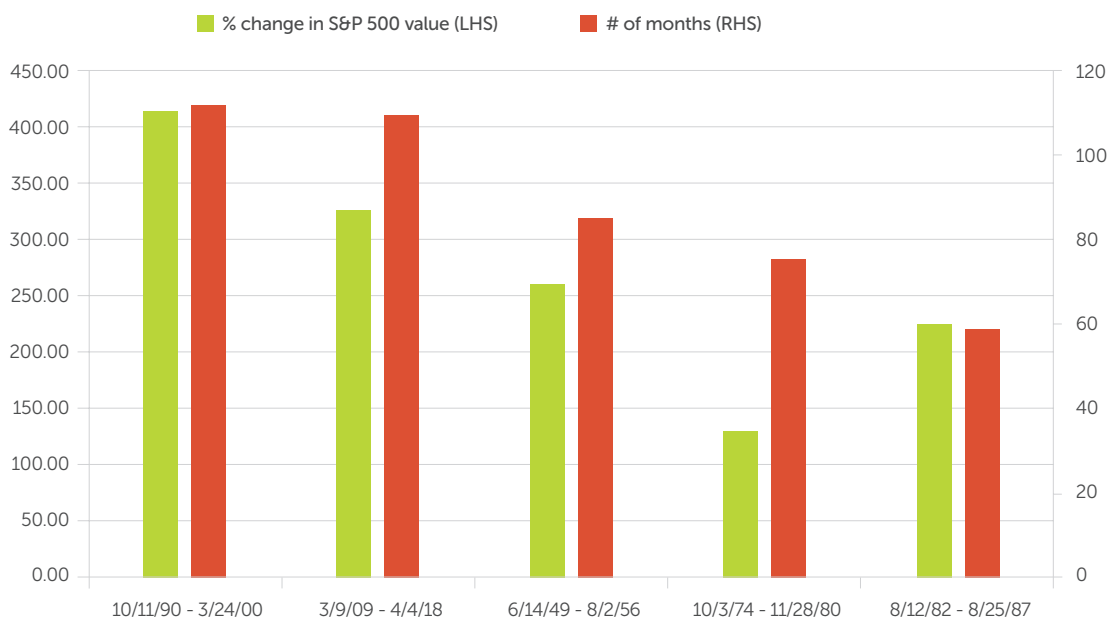
Some market observers have suggested that the most recent run up in equities is getting a bit long in the tooth, noting that the current bull market is the second longest in history. In fact, if the market continues to rally, it would actually eclipse the "go-go" 1990s in about three months (see Exhibit 2).



Clark D. Wagner

Chief Investment Officer,
Foresters Financial

Exhibit 2: Current equity market rally is nearly the longest on record



Source: S&P Dow Jones Indices, FRED, Federal Reserve Bank of St. Louis, 4/4/18.

As highlighted in last month's *Market insights*¹, there are certainly red flags popping up in the economy. In addition to the rise of trade protectionism, prospects of rising interest rates and an increasing federal deficit, to name a few, the S&P 500 Index scored its first quarterly loss since 2015, returning -0.76% for the period ending 3/31/18.² The underperformance seemed to result from questions surrounding global trade and the regulation of technology companies (a leading sector in the Index) looming over the market—but does this mean that investors are now heading into a bear market? In our opinion, reports of this market cycle's death may be a tad premature. We would point out that, since 2009, investors have endured five corrections—meaning instances in which the S&P 500 Index fell at least 10% from its prior highs—while overall maintaining an upward momentum in equities. With inflation remaining largely contained, monetary policy still easy, an almost historic low in unemployment, strong corporate earnings and tax cuts, there are still plenty of positives in this economic cycle to give comfort to market bulls.

Central bankers talking the same talk

Turning to a more global perspective, central bankers in the developed world have been increasingly moving down the same monetary path, namely, tightening policy. In the U.S., as mentioned earlier, with the Fed embarking on a rate tightening path, the end of so-called "easy money" is at hand. Overseas, the European Central Bank, by all accounts, will be terminating its asset purchase program. The Bank of Japan may raise its yield target on Japanese government bonds, while the Bank of England has already started to raise interest rates. These actions indicate a potential growing synchronization of central bank policy may lie ahead.

What does it all mean?

For investors within a diversified portfolio, this is likely to mean stocks are relatively less attractive as interest rates rise and that some consideration of other asset classes is warranted. With cash now providing a higher yield than the S&P 500 dividend yield (2.09% vs 1.96%)³, and longer-term interest rates higher as well, "there is no alternative" is no longer an argument for only holding stocks. Nonetheless, while expectations for returns should be tempered, it seems like the U.S. equity market still has a bit more room to run. The patient still has a pulse.

¹ "A market in transition", March 2018, Foresters Financial.

² Source: Bloomberg.

³ Source: S&P, U.S. Department of the Treasury, 3/29/18. Cash rate shown is the discounted 1-year U.S. Treasury yield.

Glossary

The **Standard & Poor's 500 Index (S&P 500)** is a capitalization-weighted index of 500 stocks. The Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Investors cannot directly invest in any index.

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