Partner Talk®

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What We Know Halfway through 2017

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With great speed, we are past the half-year mark of June 30th. Whatever the goal post - whether it's a birthday, an anniversary, a graduation, or the end of a decade – it's a very human tendency to take stock of things and reflect on what has unfolded during a specific period of time.

So what has 2017 delivered to us through June 30th? U.S stocks are up 9.3%, European stocks are up 13.8%; inflation is low and volatility is low; corporate earnings are strong; employment numbers are not great but good enough. But that's over 6 months, and the shorter the time period, the less its relevance, and the more meaningless it is with regards to the future.

If we extend the time period back to 2009, we find that we are in the ninth year of an economic expansion (though by historical standards it has often been a weak one). The S&P 500 has not had a negative year since 2008 and though it has seen a few corrections of 10% or more it has not seen a bear market drop of 20%. It is up over 200% since the beginning of 2009, meaning that investors in this index saw their money triple during the past 8 and ½ years. Inflation and interest rates have remained low. Employment has improved, though slowly.

If it's a human tendency to reflect on the passage of time, it's also a very human tendency to get nervous when things are going so well. When you reach a certain age, you begin to notice that life is not a series of endless triumphs but an unexpected and disjointed series of starts and retreats, successes and failures, both large and small. Too much unmitigated success and uninterrupted happiness and a little voice creeps into our head – this can't last forever.

On Thursday, July 6th, we read Greg Ip in the Wall Street Journal, who says: "When everyone acts as if steady growth and low volatility will last forever, it guarantees they won't". One day later, in the same paper, James Mackintosh writes: “It’s easy to explain…why so many people are worried that everything’s just too perfect.”

So which is it? If everyone is acting as if steady growth and low volatility will last forever, how can it also be that so many people are worried that everything’s just too perfect? And if that is the case, should we be reassured that so many people are worried?

It’s easy to pick on financial journalists, who by necessity have to resort to simplifications and questionable generalities. But this example does point to the difficulty of really knowing precisely what is going on in the market at any one point in time, and to the even greater difficulty of knowing what the implications are for the future.

At PMA we are culturally incapable of making predictions. However, we can give definitive answers to these questions:

Will this period of rising equity markets stop? Yes.
Will there be another recession? Yes.
Will there be another market correction of 10%? Yes.
Will there be another bear market of 20%? Yes.

Answering these questions with such certainty does not mean we are “boldly going where no man has gone before” (with apologies to Star Trek fans).

Instead, what would be charting a reckless course is basing an investment strategy on answers to these more pointed questions:

When will the markets turn?
When they do, how steeply will they fall, and over what period of time?
When it does occur, how deep and long will be the next recession?
What will be the response of central banks and governments world-wide?
When will the markets and the economy rebound, and when they do, how swiftly and dramatically will this happen?

Be suspicious of anyone who answers these questions with certainty or recommends bets based on their supposed knowledge of the answers.

No one thinks equities are cheap; but there is plenty of debate as to whether they are appropriately valued or wildly expensive. Oil prices are low – but does this reflect weak demand or greater supply? Interest rates will go up – but is this an ominous sign of lower equity prices in the future, or a positive reflection of a growing economy and increased consumer confidence?

The world is complex. It’s difficult to answer these questions. And this doesn’t even take into account the domestic and global political picture.

It’s hard to know where we are in an economic cycle, and whether we should be complacent or worried, bullish or bearish.

Don’t waste your energy trying to know the unknowable. Instead, follow this simple advice: know yourself, diversify, don’t market time, and call PMA.