

The Aging Bull Market Is Raging Anew

U.S. stocks are back at record peaks, but how long can the high last?

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Photo: Chris Ratcliffe/Bloomberg

And we're back, after a long break, to a stock market that once again is making serial new highs! Until this latest marketable triumph, the Standard & Poor's 500 index had gone nearly 14 months since its last record peak in May 2015—a dry spell

longer than the 410 days it took to build the Empire State Building, three of Elizabeth Taylor's marriages, and my spiritual vegan phase. Is our aging bull market raging anew?

Brokers groping for good news quickly embraced the new oomph in our 7½-year-old bull run, already the second longest ever. Historical data suggest investors can expect some forward momentum when the S&P ekes out a record high more than a year after its last, with gains averaging 8% six months later. But, please, curb your enthusiasm.

In the short term, there are signs stocks' frantic 8% bounce off the late-June Brexit lows is peaking. Nine out of 10 S&P stocks are already straining above their 50-day averages. Investors last week plowed \$11 billion into stock funds, the most in nine months, after snubbing them all year. Even notorious laggards like Apple (ticker: AAPL) are starting to perk up and attract buyers.

Today, investing feels like an exercise in choosing the least loathsome asset, and we trudge to U.S. stocks because, quite frankly, what else is there? Treasury yields are sagging near all-time lows, and last week investors actually paid to lend money to Berlin—*danke!*—when they bought 10-year German Bunds at a negative yield. Roughly 30% of global bonds, or \$13 trillion worth, now sport negative yields, up from none just two years ago, notes Bank of America Merrill Lynch. A conventionally balanced portfolio of 60% U.S. stocks and 40% Treasuries yields just 1.9%, the lowest ever. All this forces investors looking for bond substitutes to go further out on a limb—into stocks, real estate, emerging markets. Is it any surprise that 2016's hottest sectors are yield-pimping telecoms (up 22%) and utilities (up 20%), while financials is the only group in the red?

Money managers who must justify their fees face even more pressure to chase performance. In the first half, only 18% of large-cap funds outperformed the Russell 1000, making this “the worst year for active managers” since at least 2003, notes BofA

Merrill Lynch strategist Savita Subramanian. When stocks snap back violently from serial setbacks like Brexit and China, the impulse is to cover the shorts and join the herd. This makes our embrace of stocks precarious at best—and about as desperate and as convincing as Donald Trump’s comb-over.

It would be one thing if rising valuations were accompanied by rising profits. But second-quarter earnings are projected to wilt 5% for a fifth straight quarterly decline. And the S&P already trades at 18.5 times what companies earned. Record buybacks support stocks, but how long can companies keep buying back shares at these multiples?

THE LUNGE AT DEFENSIVE STOCKS might seem like a contrarian signal that buying power isn’t yet exhausted, but Doug Ramsey isn’t so sure. If such investors are bearish, “then they are, at a minimum, fully invested bears,” notes the Leuthold Group chief investment officer. “Remember, that particular breed of bear was plentiful at the market top of March 2000, but their underlying ‘pessimism’ did little to cushion against the ensuing 50% market drop.”

Meanwhile, the expansion keeps getting longer in the tooth. Michael Darda, MKM Partners’ chief economist and market strategist, points to two signs that are evident in aging cycles: 18 of the last 19 recessions have seen some form of Federal Reserve tightening, no matter how slight, and profit margins peak and recede. While stocks could still climb—the median gain in a cycle’s last year is 7%—the median decline from a subsequent downturn is 27.8%.

Do low or negative rates really stimulate growth? Conventional wisdom says low borrowing costs help us all, but it’s important to examine both sides of the balance sheet. U.S. households have \$14 trillion in debt, but they have seven times more in assets, including \$26 trillion in cash and fixed-income assets, note Deutsche Bank’s strategists. Depressed rates can be “a sizable net tax, not a subsidy,” they write.

Yet they clearly benefit governments, often developed nations' biggest debtors. Between 2008 and 2015, U.S. public debt swelled from \$5.8 trillion to \$13.1 trillion, yet Uncle Sam's interest payments actually shrank over that time, from \$253 billion to \$223 billion, note Laurence Siegel of the CFA Institute Research Foundation and Stephen Sexauer of the San Diego County Employees Retirement Association. Yes, controlling a central bank can prove very convenient.

While depressed rates let corporations borrow freely, individuals may feel compelled to save more just to afford the same retirement, notes Deutsche. Low rates boost housing, but they do so at the expense of other sectors, like banking, where weak profits weaken the resolve to lend. Then there's that old saw that low rates are good for market confidence. Well, look around you now: Stocks are at record highs and rates are lower for longer. How confident do you feel?

