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The Bull Market is Ten Years Old?

On March 9, 2009, the S&P 500 Index closed at 677. It marked the bear market low point and a 57% decline from its pre-financial crisis high; erasing all gains of the previous 13 years. The financial and economic news was dreadful and investors saw only gloom ahead. Then on March 10th, for no apparent reason, stocks began to rebound. For the next few years there were countless podcasts, articles and TV talking heads claiming that the rally was a "dead cat bounce" and that more disaster lay ahead. On March 9th, 2019, the S&P 500 stood at 2,743 - an average annualized return, including dividends, of just over 17% for the past decade. The tenth birthday of the current bull market was noted last week throughout the financial media and most reports included forecasts about how much longer it might last. The simple answer to that question is that nobody knows.

Short-term uncertainty is a fact of life for stock investors. Every day, the pessimist can cite bad news and the optimist can cite good news. Future stock market performance will be driven by corporate earnings. Outside factors, like the economy and political turmoil, influence prices because of their presumed impact on earnings. With the Fed putting a hold on interest rate increases, low inflation, low unemployment and an economy growing in the 2% - 3% range, the fundamentals are sound. But the unknown is always lurking in the shadows, out of sight to all the suspicious experts who are vain enough to pretend that they can see what lies ahead.

At ten years, the current bull market is the longest on record. But I'm not celebrating its 10th birthday. The generally accepted definition of a bear market is a 20% decline from a former all-time high. The S&P 500 fell 21.6% from May to October in 2011 and 20.2% from September 20th to December 24th last year. Both times the index managed to rally before the close of trading the day in which it reached its low point; finishing a decimal point or two away from an "official" bear market. If you focus only on the S&P 500's closing values instead of intra-day prices, then the bull market is ten years old. But in 2011 and 2018, the S&P 600 Small-Cap Index and the S&P 1500 Total Market Index fell more than 20%. I'm not buying the ten-year bull market narrative. To my way of thinking, we've had two bear markets since 2009.

There's no way to avoid the short-term volatility that accompanies stock ownership. Stocks are long-term investments and the benefit of owning stocks occurs over many years. Wise investors don't focus on short-term market movements. They understand that emotional responses to short-term market activity are likely to lead to imprudent investment decisions. Patience is a characteristic of all successful investors and it's easy to use 20/20 hindsight and proclaim the virtues of a buy and hold strategy. But even the staunchest advocate of staying the course had to overcome countless demoralizing headlines over the past decade. Here's a few you might recall -

The European sovereign debt crisis…10% unemployment in 2009….157 bank failures in 2010…Ongoing worries about a slowdown in U.S. economic growth…Ongoing worries about a slowdown in the Chinese economy…A strong dollar that hurts U.S. exports…The Japan earthquake/tsunami/nuclear disaster...The U.S. Treasury debt downgrade in 2011...The fiscal cliff...Obama gets re-elected - Oh No Mr. Bill!...What if Hillary gets elected?...Trump gets elected – Oh No Mr. Bill!...The Fed lowers interest rates – sure to lead to hyperinflation and gold spikes to $1,895/oz…Inflation is a no-show – deflation worries arise and gold crashes 40%…The "Taper Tantrum" in 2013 due to worries that the Fed might kill the recovery by raising interest rates...Ebola will kill us all in 2014…Oil prices collapse in 2015…Brexit and the potential breakup of the Eurozone in 2016…Oil prices rise too quickly in 2018...Russia invades Ukraine...North Korea...ISIS...Syria......Trade tensions...A dysfunctional federal government....and despite all this gloom and doom, the S&P 500 reached its all-time high of 2,931 on September 20, 2018.

Wise investors take only as much stock market risk as is necessary to reach their long-term financial goals. Your portfolio allocation should be determined by your long-term financial goals, not on what's happening in the market today or forecasts about what might happen tomorrow. Foolish investors do just the opposite. Their portfolios are based on what's already happened or what they think is going to happen. During the financial crisis many people fled stocks. It felt good in the short-term, but stocks are long-term financial assets and the opportunity cost paid by investors who spent most of the past decade in cash and bonds will be impossible to recoup.

Many do-it-yourself investors believe that by paying attention to the daily ups and downs of the market and "keeping an eye" on their investments they can improve their portfolio's performance. But just the opposite is true. Studies in behavioral finance indicate that investors who pay the most attention to their investments trade most frequently; to the detriment of their long-term returns. Trust me when I tell you that you're unlikely to increase your portfolio's long-term return by making short-term portfolio changes and you'll wind up paying more fees and taxes along the way.

From 1926 through 2018 the S&P 500 Index had a daily positive return 54% of the time. So, investors who peeked every day would have seen red numbers just about every other day; making it difficult to stay optimistic. However, investors who peeked on a quarterly basis would have seen a positive return 69% of the time. Annual peekers would have received good news 75% of the time. Over five-year rolling periods the S&P 500 Index was positive 88% of the time, 95% of the time over 10-year rolling periods and positive in all 20-year rolling periods. The increasing probability of achieving positive returns as the time horizon increases is the result of what is called the stock market's long-term "upward bias".

I looked back at the March 2009 issue of this newsletter to see what I was saying during those grim days -

The present economic downturn has been steep, significant, and unexpected. But when pessimism overcomes us -- as it surely has now -- we lose the ability to put events into their historical context. We are not on the precipice of Great Depression 2, but we are in the worst economic downturn since the 1980 - 1982 recession. I remember that recession, since I was an active participant. I was furloughed and the phrase "nothing to do in '82" was often on my lips. It was a time of high inflation, high unemployment and high interest rates. The "misery index" -- the sum of the inflation and unemployment rates -- exceeded 20%. The economic outlook was bleak. I remember leaving the unemployment office that year and reading a newspaper headline announcing that the unemployment rate had surpassed 10%...Today, those days are long forgotten by most and just a dim memory to me.

Looking into the future, we have the same two choices we had in 1982. The first is to have a pessimistic attitude, one that is all too common today -- that this time it's different and it's all downhill from here. I don't subscribe to this belief because it cannot be supported by history or my life experience.

The second choice is to have an optimistic attitude, one that isn't so common today, and believing that this time it isn't different. Just like recessions and stock market declines in the past, the most flexible, dynamic, productive, entrepreneurial, job creating economy that the world has ever known will somehow pull through and continue its long-term growth trend. Along the way, it will provide a growing population a better quality of life. This is my belief. If you ask me to prove that all will be OK, I can't. I wouldn't even try. But let me use a baseball analogy. We're at bat and 2008 threw us a wicked curveball. Swing and a miss – Strike One! But we're still at bat and the game's not over.

Unfortunately, along the way, the forces of "creative destruction" will be in play. New ideas, technologies and innovations will supersede old ones. This will lead to the disappearance of some household names whose product line or business model has become obsolescent. Upstarts will enter the marketplace and challenge incumbents with new products, better technology and a leaner business model. This process is painful for employees and investors in those legacy companies. But creative destruction has always played a key role in America's out-performance of other major economies. When terminally ill companies die and marginal players are absorbed by stronger survivors, consumers are better off, and the economic system becomes stronger.

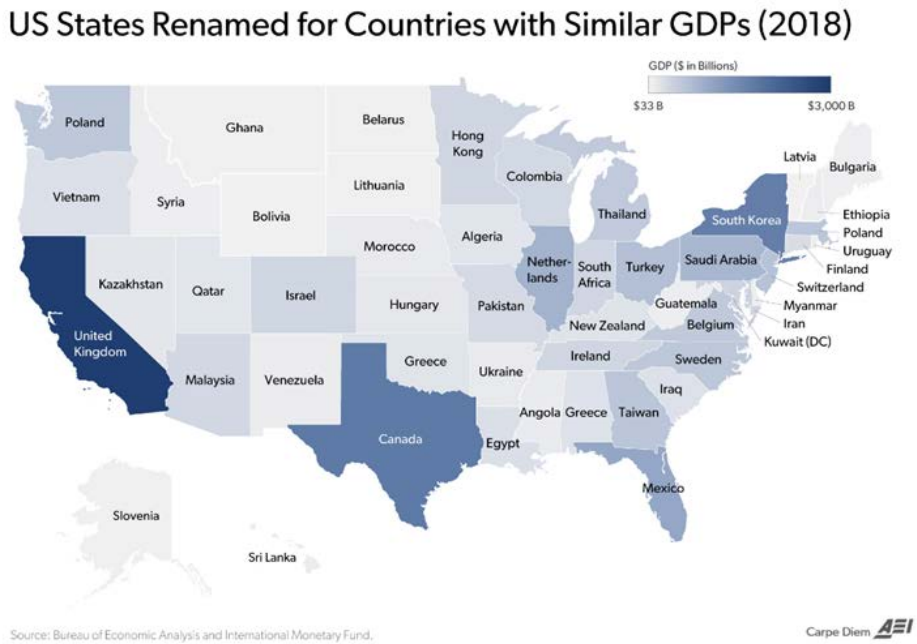
I'm just a susceptible to the pessimism of the day as anyone else, so let me walk you through my own thinking process. My portfolio losses have been disappointing but tolerable. The decline in the value of my home has also been disappointing but I've never entertained the thought of putting it up for sale...Likewise, I have stayed with my portfolio allocation and my investment strategy. I don't have a dollar invested in stocks that I will need to touch for 15 years. My short-term needs will be financed by fixed income assets…I'm never going to beat myself up with "woulda, coulda, shoulda" because I won't criticize myself for not knowing what I couldn't have known in advance.

Not too bad, if I do say so myself. There are two kinds of people in this world. People with too much class to say, "I told you so" and people like me.

Buffett's Letter

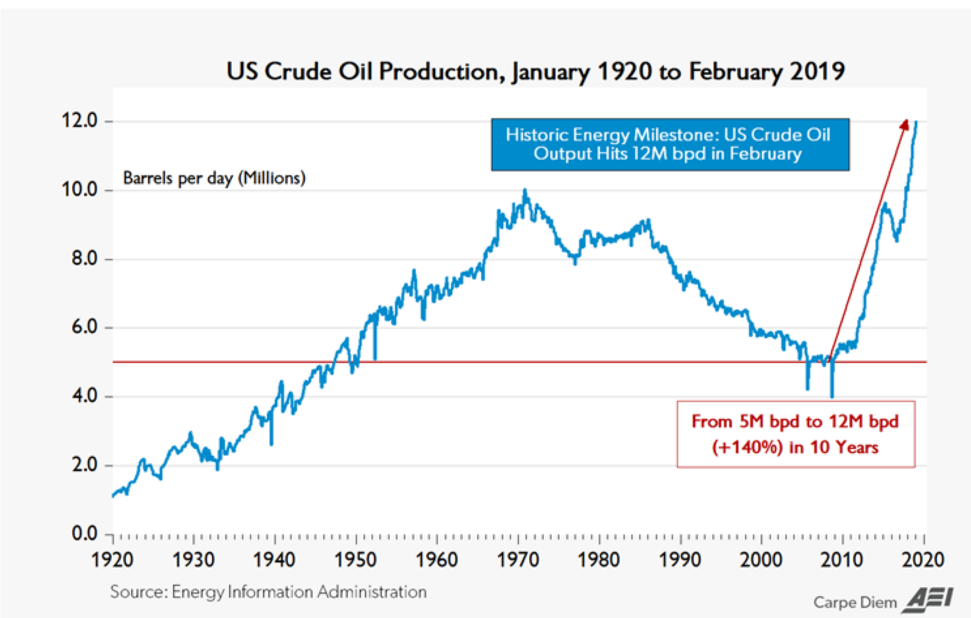
Warren Buffett's annual letter to Berkshire Hathaway shareholders always gets wide media attention. His annual letter focuses on the investments and operating performance of Berkshire Hathaway, but also includes many sound investing principles as well as his thoughts about the U.S. economy.

Buffett concludes this year's annual letter with some observations about what he calls "The American Tailwind". He made his first stock purchase in 1942, investing $114.75 in three shares of Cities Service preferred stock. Had he invested his $114.75 into a no-fee S&P 500 Index fund, and all dividends had been reinvested, his $114.75 would have grown to $607,000 by the end of January 2019. But what if he knew that over the ensuing 77 years, the federal deficit would grow 400-fold (40,000%) and as a hedge against economic disaster he avoided stocks and bought 3¼ ounces of gold instead. "Y*ou would now have an asset worth about $4,200, less than 1% of what would have been realized from a simple* *unmanaged investment in American business…The magical metal was no match for the American mettle…Today, the Federal Reserve estimates our household worth at $108 trillion, an amount almost impossible to comprehend…There are also many other countries around the world that have bright futures. About that, we should rejoice: Americans will be both more prosperous and safer if all nations thrive…Over the next 77 years, the major source of our gains will almost certainly be provided by The American Tailwind. We are lucky–gloriously lucky–to have that force at our back."* Warren Buffett's message has been consistent. Don't bet against America. The following images, Courtesy of Mark J Perry's Carpe Diem blog on the American Enterprise Institute's website, show the results of that American Tailwind.



This map puts America's $20.5 trillion economy into a global perspective. The U.S. produces about one-fourth of the world's Gross Domestic Product with slightly more than 4% of the world's population. The map compares the economic output of each state with the 2018 Gross Domestic Product of other countries. Today, the U.S. is the wealthiest nation on the earth and it didn't happen by accident. To quote from the blog –*"This comparison is also a reminder that it was largely free markets, free trade, and capitalism that propelled the US from a minor British colony in the 1700s into a global economic superpower and the world's largest economy, with individual US states producing the equivalent economic output of entire countries."*

If you buy shares of a total stock market index fund, you're investing in our $20.5 trillion economy. Why anyone would choose instead to own just a few individual stocks or an actively managed stock fund with just a few dozen holdings in an attempt to outperform the American Tailwind remains a mystery to me.



Domestic daily crude oil output reached an all-time high of 12 million barrels in February. Ten years ago, there was universal lamenting that domestic oil production had peaked in the early 1970s and that an ongoing decline in domestic production was a future certainty. Then, came fracking and horizontal drilling – a technological game changer unanticipated by the peak oil advocates. Texas' oil production recently surpassed Canada's oil output and Texas now produces more oil than all other countries except Russia, Saudi Arabia and Iraq. So, today we find the U.S. less dependent on oil imports while OPEC tries to figure out how much its members must cut production to prop up oil prices.