Weekly Market Flash

Marathon Bull

September 1, 2017

Talk of endurance is all the rage these days. Fall race season looms for runners and triathletes contemplating their next attempt at 26.2 or 140 or whatever mileage benchmarks await the end of the arduous training programs through which they (we!) have been slogging all these humid summer months. In markets, too, endurance is the word of the moment, and not just in stocks. Sure, we're into the ninth year of the equity bull market that began in March 2009, which counts by most calculations as the second-longest running bull on record. But that pales in comparison to the granddaddy of all distance runners. The bond market produced yields in the stratospheric heights of 20-odd percent in 1981, then rallied as the Fed broke the back of double-digit inflation. We've been in a bond bull ever since.

New Challengers Emerge

Alongside these elite harriers we have a couple other asset classes looking to break through more modest distance goals. The long-beleaguered euro limbered up back in January and started to chase its longstanding nemesis, the US dollar. The euro is up around 16 percent versus the dollar year-to-date, a surprising turn of events for those caught up in the hype of the so-called "Trump trade" that followed the election last November. In commodity-land, copper and other industrial metals have gained more than 20 percent. While the China demand-fueled "supercycle" for commodities is deemed long dead, the future for a select group of metals, including copper, may well be bright if forecasts about the demand for lithium ion batteries (key components of electricity-operated vehicles) prove to be accurate. For the moment, non-US currencies and industrial metals are still microtrends, unproven at longer distances, but it will be worth keeping an eye on their progress.

A Flat & Forgiving Course

Distance runners tend to do their best work on predictable, smooth courses with a minimum of steep hills or unexpectedly rough, slippery terrain. Which brings us back to stocks and the nine-year bull. There really haven't been too many Heartbreak Hills since the summer of 2011, when the simmering Eurozone crisis and the US debt ceiling fiasco took stocks into a vortex that stopped just short of a bear-level pullback of 20 percent. The tailwinds have come courtesy of the central banks and their monetary stimulus programs, along with an economy that has delivered steady, if modest, growth, an improved labor market and muted inflation. Corporate earnings have done well in this environment, so that even if stocks are expensive by most valuation standards (they are), they remain well below the bubble levels of the late dot-com era.

Now, anything can disrupt the equilibrium at any time. There are always risk factors lurking under the surface that, if actualized, would create havoc in asset markets. Think back to the longest bull on record: that of 1982-2000. Technicians would dispute our labeling this entire period a bull market, as it was punctured by the sudden cataclysm of Black Monday 1987, when the Dow and other major US indexes fell more than 20 percent in one day. We don't think of the 1987 pullback as a bear market in the classic sense, though, because (a) it was entirely unrelated to broader economic trends, and (b) it was over almost as soon as it began. The 1987 event looked nothing like the last real bear market, a long stretch of misery that endured from 1968 to 1982. We bring this up because, based on everything we see in the economic and corporate profits landscape today, any potential pullback in the immediate future would more likely arise from the sudden emergence of a hitherto dormant risk factor than from a structural change in conditions. The course, in other words, remains flat and forgiving, but runners should always be aware that lightning can strike.

Even Ultramarathoners Tire Out

And that, in turn, brings us back to that superstar distance runner, the bond market. Because if anything could potentially make that flat course hillier and more unpredictable, it would be an end to the “lower for longer” assumption about bond yields that is baked into every asset class with a risk premium. The risk premium for any asset starts with interest rates; namely, the prevailing risk-free rate layered with additional quanta of risks deemed pertinent to the asset in question. Upsetting the applecart of low rates would reverberate throughout the capital markets in a uniquely pervasive way.

For now, the bond market would appear to still be a ways away from its last legs. Both the Fed and the ECB will likely try to provide reassuring guidance over the course of this fall as to how they plan to move towards a more “normal” monetary policy environment with a minimum of disruptive surprises. We don’t expect much disruption to ensue from the upcoming September meetings of either central bank. But we have to pay close attention to any unusual wobbles or other signs of fatigue along the way.

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