MV CAPITAL MANAGEMENT

Weekly Market Flash

The Melt-Up Has Arrived

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We've seen this before. Well, not this, exactly. History doesn't repeat itself, but it does rhyme from time to time. Periodically, over the past while, we have floated the idea that the bull market we've been in since 2009 won't sing its swan song until we have had a good, old-fashioned melt-up. Here we are, in October of last year, musing over the possibility of a melt-up getting underway before the end of the year. We were premature, to say the least. But every dog has its day, and the evidence would now appear to be in that the melt-up has arrived.

Use That In a Sentence, Please

We will consider what this means for the rest of this year and, more significantly, what we might expect next year. First of all, though, definitions are in order. We consider a "melt-up" to be a spasm of mostly irrational giddiness in the course of a secular (multi-year) bull market, with money coming off the sidelines as investors late to the party try to grab a piece of the bull. A melt-up does not necessarily imply the end of a secular bull; the spasm may end with a technical correction and then a resumption of growth at a modest clip more in line with actual fundamentals. That happened to a certain extent in fall 2007, when indexes roared back to new records after a sharp late-summer fall, corrected again in early 2008, then sputtered along in a modest growth pattern prior to collapsing outright in September 2008. The Roaring Nineties, on the other hand, ended in a spectacular melt-up prior and right up to falling apart in early 2000.

Nice Words, and Magical Thinking

This year's melt-up is referred to in shorthand as the "Trump Bump," among other inane monikers. In fact, though, the good times started rolling a couple days before the election. The S&P 500 bottomed out the Friday before Election Week, then got a positive jolt the next Monday on word from FBI Director James Comey that there was no "there" there regarding that last twitch of the interminable Clinton email scandal. On Election Night, as we all know, overnight futures plummeted as the contours of a Trump victory took shape. Sentiment then turned sharply positive as a few nice words from the President-elect soothed nerves and it gradually dawned on investors that Washington would henceforth be a one-party town with a fondness for tax cuts and deregulation. Trump's infrastructure call-out in his speech was icing on the cake, though largely insubstantial as we discussed in some detail last week. Et voilà, the melt-up was underway in earnest.

The Shelf-Life of a Melt-Up

How long do melt-ups last? And is there reason to believe that the fundamentals will justify another growth phase once the sugar high wears off? These are the questions investors will want to consider as they make their portfolio allocation choices for the year ahead.

Timing these things, of course, is fraught with uncertainty. No two market environments are exactly alike. What we can say at this point is that the trend reversal has gained sea legs in a number of asset classes over the past couple weeks. Momentum can be its own tailwind – in fact, momentum feeding off itself is the basic essence of a melt-up (or its twin, the melt-down). So whether the run-up in industrial metals or bank stocks is overblown, as we suggested was the case in last week's post, may not make much difference in the coming weeks.

Add to this cocktail the holiday season that is now upon us, and the potential for some at least halfway decent early returns from the Black Friday – Cyber Monday retail continuum, and you may well have the makings of a go-go rally extending through year's end. Yes – there is a very high probability of a Fed rate hike next month, but that is already baked into the cake. Fed funds futures markets ascribe a near-100 percent likelihood to a 25 basis point hike, so its execution will be an unlikely trend-buster (in fact, it would likely be more unsettling if the Fed were to balk again).

Lurking Fundamentals

How far the good times continue into 2017 is another matter entirely. Even under one-party rule, Washington is in our opinion unlikely to serve up the kind of hyped-up fiscal policy investors seem to be banking on today. The ballyhooed infrastructure plan looks ever less like stimulative public works and ever more like a handful of tax credits for well-connected utilities and construction interests. After all is said and done, we believe, the relatively expensive market valuations of today will still make it hard to justify much fundamentals-related upside potential next year. That will be particularly true for large cap firms if they continue to face the headwinds of a strong dollar.

The market narrative has shifted. But not enough has changed to convince us that a new era of real, sustainable growth is back. There will be plenty of challenges on hand whenever this melt-up plays out.

We wish all our clients and friends a very happy and restful Thanksgiving.

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