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The Long Equity Cycle – Stock Market Conditions – Part 1

This month marks the sixth anniversary of the bottom in U.S. stock markets related to the secular Bear market of the 1999 – 2009 era. Since the S&P 500 intra-day low of 666 reached in March 2009, the S&P 500 has risen by a stunning 218 percent! Is this type of return unusual following the end of the secular Bear market? Hardly. In my opinion, ***it is a strong signal that the U.S. market is experiencing its fourth secular Bull market since 1920.***

The purpose of this piece (and the next two pieces) is to outline my thoughts as to the longer-term return potential of the U.S. stock market. As our regular readers are aware, I have been positively biased towards U.S. stock market exposure for quite some time. Frankly, the last time I was outright concerned about it was in 2011. Since then, I have remained positive (to varying degrees) for U.S. stock exposure. ***As we near the six-year anniversary of the market bottom, it's fitting we step back and take account of the U.S. equity market and think about where it may go from here.***

Should a balanced or growth oriented investor (not speculator) ever be completely void of U.S. equity participation? That is the question today's commentary revolves around.

Embrace This Market

This is a market to embrace, not a market from which to run. If the current secular Bull runs in a similar fashion to the three previous secular Bulls, the market's upside potential is not yet fully tapped out. ***That isn't to say a meaningful and possibly painful interim correction in stock prices won't occur; it will. We just don't know when the correction will occur and how deep it will be.***

Market Timing – You Have to Be in the Ball Park to Hit the Ball

Most people believe "market timing" doesn't work. Being fully "out" of a major, time-proven asset class isn't in the best interest of most long term investors. The cost of being wrong in market timing exercises can be extremely high***. Let's look back to December 31, 1979. The chart below details what your S&P 500 Index annual return was if you were invested at that time. In addition, it also details the ramifications if you were unfortunate enough to be out of the market for the best 50 days during that long period of roughly 9,190 trading days. According to our friends at Ned David Research, (NDR), the results an investor would have seen are as follows:***

	Average Annual Return	Growth of Initial $100,000 Investment
Buy/Hold Strategy	**11.66%**	**$4,862,880**
Without 50 Best Return Days	**4.23%**	**$429,740**
Without 50 Worst Return Days	**21.06%**	**$83,806,980**

The 50 best trading days highlighted above represent 0.54 percent of all trading days over that 35+ years. If an investor had been ***hapless enough to have been completely void of U.S. stock exposure during the 50 best days of market return over the past 35+ year period, that investor would have realized a return roughly in line with U.S. T-bill returns!***

In dollar terms, the mistake made would have been devastating. The hapless investor would have seen his investment increase by 4.3 times the initial investment, while the steady, buy and hold investor would have seen his investment rise by 48.2 times over the same period. Investing in the stock market is similar to hitting a baseball – to hit the ball a batter needs to be in the ballpark, at home plate, and willing to swing the bat. ***That is similar to having capital invested in the stock market – at times you may strike out, but you absolutely won't hit the ball unless you are in the ballpark.***

On the other hand, being out of the market during the 50 worst days and in the market during the remaining 9,100 trading days would have generated an average annual return of about 21 percent. The initial $100,000 investment made on December 31, 1979, would be worth almost $84 million today! It should be obvious to most serious investors that ***completely*** escaping the 0.5 percent of "bad" trading days, and ***at the same time, capturing*** the 0.5 percent of "good" trading days ***is a fool's errand***. An investor needs to be "in" the equity market to some degree at all times.

So, while timing of this magnitude is not wise for the investor to partake, it makes sense to allow for variance of asset allocation in an attempt to capture an increased share of the good days and miss some of the pain of the bad days. ***The exercise can be so valuable that some attempt, not at market "timing" per se, a disciplined exercise of exposing a portfolio to a slightly higher level of equity exposure when there is the probability of the good market days occurring vs. the bad market days.***

How can we tell when the probability of good market days exceeds the probability of bad days? We will attempt an answer to that question next week as we discuss our long-term equity market outlook. We will be back next week.

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