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The Second Longest Bull Market Since WWII…When Will It End?

Executive Summary

- The S&P 500 is currently in its second longest bull market since WWII in terms of both magnitude and duration.
- Various historically-reliable measures of market valuation are indicating returns in U.S. stocks over the next decade may be less than half their historical averages.
- It's reasonable to expect about a 50% decline in U.S. stocks during the "bear" phase of this cycle just to bring valuations back to historical averages.

Second Longest Bull Market Since WWII...

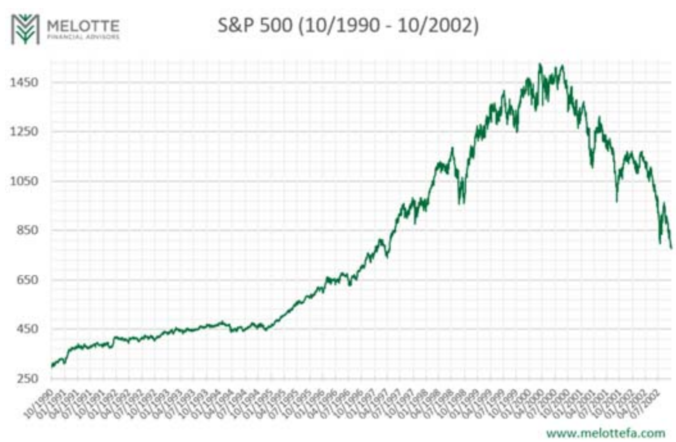
Commentary

The U.S. stock market is in its second longest bull market since WWII. As of March 27th, the bull market is aged over 8 years. The S&P 500 is now 246% higher than it was on its March 9th, 2009 closing low (not including dividends)!

When you include dividends (reinvested), the average annual return for the S&P 500 for the eight years from December of 2008 through December of 2016 has been ~15%, or over 50% higher than the long-term historical average.

Is it likely that pace will continue? No, it's not likely at all. It's far more likely returns will fall far below historical averages over the next eight years.

The longest bull market occurred between October 1990 and March 2000 (9 years and 5 months) when the S&P 500 climbed over 400% (excluding dividends). Below is a chart showing that full market cycle, which ended in October 2002. Notice that by the time the cycle ended in October of 2002 the S&P 500 was trading about 50% lower than its peak... That downturn wiped out over 5 1/2 years of gains!



You might also notice that during the bear phase there were moments of sharp reversals and strong returns, which fakes investors into thinking the correction is over before the market turns lower again. This is why market timing is impossible.

This is not abnormal for a bear phase. In fact, brief periods of positive returns are typical in bear markets just as corrections are common in bull markets.

So what does this all mean for the market going forward? Well, truthfully, not much on its own.
The longest bull market in history lasted over 9 years and experienced even more impressive returns while there have been much shorter bull markets as well.

Neither duration nor magnitude of a bull market tells us much about when it may end. What is far more telling, however, are market *valuations*.

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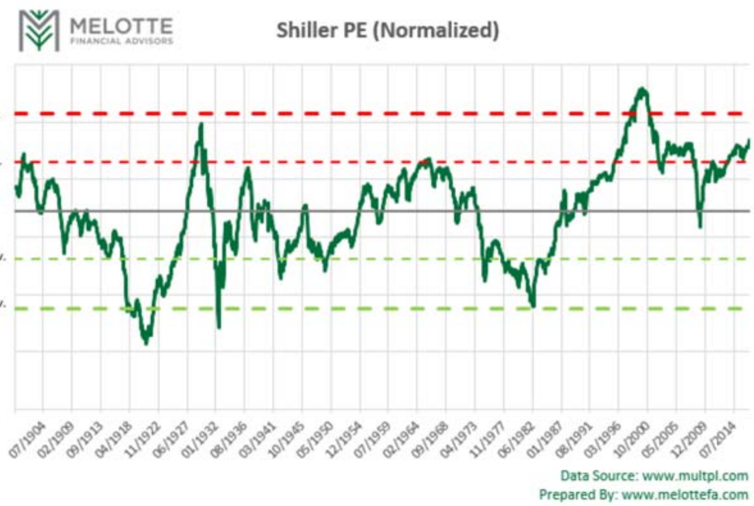
Valuation Metric #1: Shiller PE



The Shiller PE ratio has historically been a reliable indicator of subsequent ten-year market returns. This measure indicates **we are currently experiencing the third most extreme valuation going all the way back to 1900!**

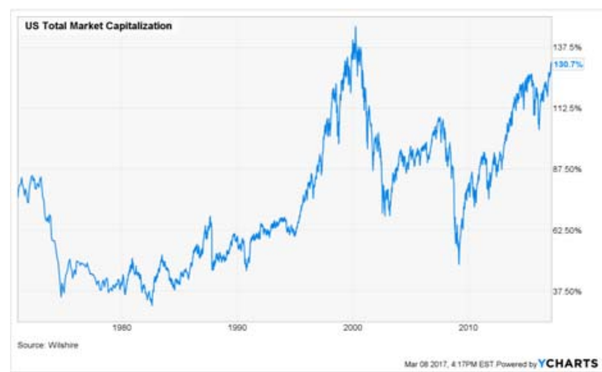
In other words, current valuations have been exceeded only by the Great Depression and the Dot-Com Bubble.

Valuation Metric #2: Market Capitalization / GDP

Market Cap / GDP is Warren Buffett's favorite valuation measure according to a comment he made in a 2001 Fortune interview.

It's currently the second highest it has ever been and almost exceeds the dot-com record.

Dr. John Hussman has been performing extensive valuation work over the last couple decades, and he has also found Market Cap / GDP to be one of the most reliable predictors of market returns. In Dr. Hussman's December 19th commentary, "Red Flags Waving," he says,



"...valuations are consistent with expectations of S&P 500 nominal total returns averaging scarcely 1% annually over the coming 12-year horizon."

Given the fact that 10-year Treasuries are yielding around 2.4%, his expectation is that even low-yielding U.S. Treasuries may actually outperform U.S. stocks over the next twelve years on both an absolute and risk-adjusted basis...interesting.

So combining Shiller PE and Market Cap / GDP we're looking at a potential return range on the S&P 500 of 1%-4% annualized.

The question is how high will the market rise before the bear market begins? It's an impossible question to answer as we've seen valuations soar much higher than even current levels before topping out. All the valuation measures discussed here are reliable for forecasting 10-year returns but no measure reliably predicts short-term returns so we can't use this data for making short-term investment decisions. Always consult a professional advisor who intimately understands your goals, resources, risk tolerance and unique circumstances before making significant investment decisions.

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Second Longest Bull Market Since WWII...

One Way The Current Bubble is Worse Than The Dot-Com Bubble

The dot-com bubble was characterized by extremely high valuations, but the really ludicrous valuations were concentrated in tech. This impact the overall average.

Today's extreme valuations are far more widely-disbursed across the entire market. We know this because the *median* stock valuation is higher than it has ever been.

Conclusion

It’s safe to say that these historically-reliable valuation metrics are predicting returns that fall far short of historical averages over the next decade.

It's also reasonable to assume that we'll experience another severe contraction in asset prices, which could wipe out many years of gains as indicated by the chart below.

S&P 500 Closing Value on March 21, 2017: $2,344.02

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Hypothetical Decline	S&P 500 Close	First Time S&P 500 Breached This Level	Days Since	Approx. Years
10%	$2,109.62	February 20, 2015	760	2.1
20%	$1,875.22	March 6, 2014	1,111	3.0
30%	$1,640.81	May 14, 2013	1,407	3.9
40%	$1,406.41	March 19, 2012	1,828	5.0
50%	$1,172.01	July 14, 1998	6,825	18.7
60%	$937.61	July 24, 1997	7,180	19.7

Applying This Knowledge

WITH VOLATILITY COMES OPPORTUNITY, but only if you have some dry powder available to deploy in the downturns and remain disciplined enough to jump in when everyone else is bailing out.

"Be fearful when others are greedy and only greedy when others are fearful." - Warren Buffett

This means going against the herd by being a little more conservative as the bubble matures and then getting more aggressive when it feels like the world is ending. Going against the herd is very difficult. It requires patience, discipline and confidence in your analysis.

Risk management and disciplined rebalancing will be the key to preserving and growing wealth over the next decade. It may also be important to incorporate other assets in addition to traditional U.S. stocks and bonds.

Investors should review their investment strategy within the context of their financial goals and tolerance for market volatility. Weigh the potential upside with the potential downside inherent in your current strategy. If you can't do this on your own, let me help me you. I have all the tools and expertise.

Disclosures

Please keep in mind the point here is not to motivate you to start timing the markets. My goal is to educate and set realistic expectations so that you can revisit your long-term investment strategy armed with knowledge and a realistic outlook. As with all my commentaries, this is meant as an educational tool not investment advice. If you want to know how you should be applying this information to your situation, please reach out to me. I'm happy to help. It's why I am here.

All the valuation measures discussed here are reliable for forecasting 10-year returns but no measure reliably predicts short-term returns so we can't use this data for making short-term investment decisions. Always consult a professional advisor who intimately understands your goals, resources, risk tolerance and unique circumstances before making significant investment decisions.

There are many other factors not discussed here that influence market outcomes! No one or two datasets can tell the whole story. Past performance is no guarantee of future results. Data from third-party sources is believed to be reliable but accuracy cannot be guaranteed.