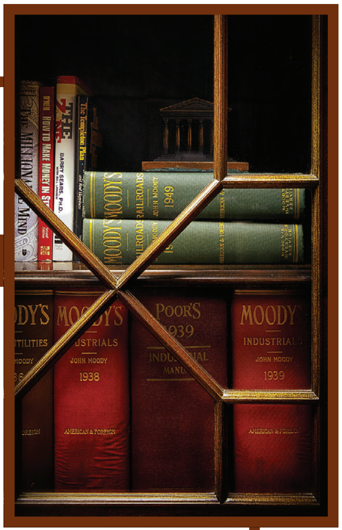
The INVESTMENT LETTER

Volume 89, No. 1 January 2018



How long can this bull market last?

This is the question weighing most heavily on investors' minds. As with everything, our perspective influences the conclusions we reach. If we start with the trough of the 2009 Financial Crisis, this bull market has advanced 400% as it enters its eighth year. This is the measure that the media reports. A more traditional view pins the start of this bull market at the point where we fully recovered from the losses of the prior bear market, or in 2013. In the four years since, we have advanced 100%.

In the past 120 years, secular bull markets have lasted an average of 17 years and have enjoyed advances surpassing 500%. This does not negate that, even during strong secular bull markets, we may experience material and painful corrections of 10% or more. Our current secular bull market may have years of life left and may even be in its early stages. The key to analyzing any bull market is to evaluate the market, and your options, with a clear head, and not let fear drive your decision to sell, thus costing you the next leg of the advance.

Examining this Bull Market: Its Causes and its Sustainability

When we identify and consider the major economic challenges that we faced during our last bear market, we start to name the conditions that gave rise to our current bull:

- Banks, during the Great Recession, were overleveraged, with loan-to-deposit ratios reaching 100%. Today, banks are much better capitalized, with LDR ratios closer to 70%.
- Oil prices peaked near $150/bbl. in 2008, when the US was the world's largest oil importer. Today, oil prices have fallen by more than half as the US is on the brink of becoming the world's largest oil producer.
- We are seeing a reversal in the trend that sent some 4 million US manufacturing jobs to lower cost of labor countries. In 2016, the Reshoring Initiative, an Illinois-based non-profit, reported that a net 27,000 manufacturing jobs were reshored to the US and that a total of 338,000 jobs had been reshored between 2010 and 2016.
- Today's low inventories in the housing market have replaced the housing glut of the Great Recession.
- Recent tax reform has brought relief to companies and individuals in the form of lowered taxes.

These economic shifts, and still others, helped the general economy rebound to a 2.3% GDP growth rate in 2017, which is projected to continue at the 2%-3% level into 2018. Perhaps equally impressive, this recovery has taken place with inflation rates ranging around 2%.

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Confronting Fear: What Could Go Wrong?

We will always have unforeseen short-term political or traumatic world events – like 9/11, Watergate, or natural disasters – that will temporarily impact the markets. However, these painful events do not normally end bull markets.

Given the relative youth of this bull market, the fact that this advance still has room to run, and that the economy is doing well and perhaps even better than most believe, are there any logical reasons to be concerned?

The concern that looms largest over us right now is whether recent progress represents an artificial high, created by unsustainably low interest rates. We worry about the impact of an interest rate increase. What would be the impact of this hike on corporate spending and investment, on consumer housing and spending, on government deficits? Should rates increase from their current levels of 1% to 2.5% to a more justifiable 3.5% to 4%, would this mean the end of the bull market?

In a World of Rising Rates

First, we need to understand what would cause rates to rise. Like any other commodity, money, or capital, as measured by the rate of interest, is subject to supply and demand. Globally, central banks have been targeting lower interest rates to bolster a weak global economy since 9/11. Most economies, including ours in the US, have now recovered and exceed pre-crisis benchmarks. As a result, the demand for capital is rising. Simultaneously, the 'easy money' accommodative policies of recent years are being unwound. This should lead to lower supply and a higher price of money, i.e., interest rates. However, due to the below-average recovery and sluggish changes to monetary policy, interest rates have remained historically low. What's now unclear is whether this gentle balance of supply and demand will be kept in equilibrium in order to avoid a more dramatic rise in rates. If equilibrium is maintained, the bull market should continue. But, if not, what could happen?

Although higher rates would impact housing, consumers, overall, have deleveraged to the point where modest increases in rates should not materially impact consumer spending. Corporate spending mostly tracks consumer demand and should remain strong so long as consumers continue spending. The more problematic sector is government. Approximately a third of all government spending covers interest on government debt. Should rates double to 5%, the dramatic impact on the federal government would imperil government spending, the current policy toward lower taxes, and even the continued health of the bull market.

How to Embrace this Bull

Can this bull keep running? At this point, the answer appears to be yes. However, we must prepare for and be vigilant against unforeseen risks by maintaining appropriate asset allocations.

Until now, most nations, including the US, have strategically avoided raising rates too quickly and putting themselves at a competitive disadvantage. We must watch carefully as the US Federal Reserve and its central bank counterparts unwind their current interest rate policies. We must also watch to ensure that the delicate equilibrium between supply and demand in the price of money is maintained.

Now is the time for neither fear nor greed. In any market, bull or bear, investing is never simple, but strong investment fundamentals and a patient, disciplined approach will go far. We will continue to manage portfolios at a risk-appropriate stock allocation as we prepare for a profitable yet more volatile ride in 2018. ■