Key Questions:
Does “Late Cycle” Mean “End of Cycle"?

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2018’s flat market may point to a pause in, rather than an end of, the equity bull market.

Many investors were unnerved by the sudden 10% correction US equity markets experienced in February, a sentiment magnified by the optimism that still prevailed after 2017’s strong returns. Since then, stocks have been range-bound. Year over year earnings have swelled approximately 25% in the first and second quarters, decade-high confidence among consumers has persisted, manufacturing and service sectors have remained strong and GDP expanded by over 3%. Yet the S&P 500 only fully recovered from the correction on July 26th – a 115-day slog surpassed only twice in post-war US history (1978 and 1984).

To explain this disconnect, some analysts cite the longevity of a bull market that began in March 2009, now the second-longest on record. They infer that economic growth may be entering its final innings, with potential signs of a recession emerging: low unemployment, increasing inflation, rising rates and elevated asset prices, among others. Many also highlight the Trump Administration’s trade strategy and the 2017 fiscal stimulus, both of which may increase inflationary pressures as the Federal Reserve raises rates after a decade of quantitative easing. On top of that, mid-year elections tend to elevate market volatility, and this year’s promises to be unusually intense.

How should investors interpret these observations? We believe data from 2015 and 2016 provide a counterpoint to, or at least complicate, the “late in the cycle” thesis. Taken together, they suggest that 2018’s flat market may point to a pause in, rather than an end of, the equity bull market.

During 2015 and 2016 markets experienced significant periods of volatility, including three events historically indicative of an imminent recession, yet one did not occur. In December 2015, US Industrial Production declined by 3.98%, the only time in postwar history that a decline of that magnitude was not accompanied by recession. Then, the MSCI All-Country World Index declined 20.18% on February 11, 2016, a technical global bear market highly correlated with recession. Finally, Q1 2016 aggregate operating earnings of the S&P 500 dropped by 11.56% year over year. The only other non-recessionary instance of negative earnings growth that large occurred in 1985-1986.

Collapsing oil prices were a major driver of these events. But even under such stressful conditions, the US not only avoided recession, the economy gradually improved and equity markets rebounded to new highs in 2017 – all while the Federal Reserve steadily raised rates.

So, as investors survey the horizon, we would recall that this bull market has been challenged many times, all during moments when the economy was palpably weaker than at present. Economic growth continues to accelerate, despite adjustments to policy changes in Washington D.C., and we believe these positive trends should persist into 2019. That strong support should provide investors with some reassurance that “late cycle” does not necessarily mean “end of the cycle” – nor the end of the bull market.

For more information, please contact your Key Private Bank Advisor.

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