

March 14 2016

# WILL EIGHT BE GREAT FOR THE BULL?

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## KEY TAKEAWAYS

The bull market celebrated its seventh birthday on Wednesday, March 9, 2016.

S&P 500 earnings have more than doubled and provided a good deal of support for this bull.

We do not see warning signs that would signal the end of the economic cycle, and the bull market.

**The bull market turns seven.** Last Wednesday, on March 9, 2016, the bull market officially celebrated its seventh birthday. During that seven-year period, the S&P 500 nearly tripled, gaining 194% in price and producing a total return of 241%. Although our expectations for the stock market in 2016 are for only modest S&P 500 gains, we do not see the warning signs that have signaled the end of past bull markets and would not be surprised at all if the current bull market celebrates its eighth birthday one year from now.

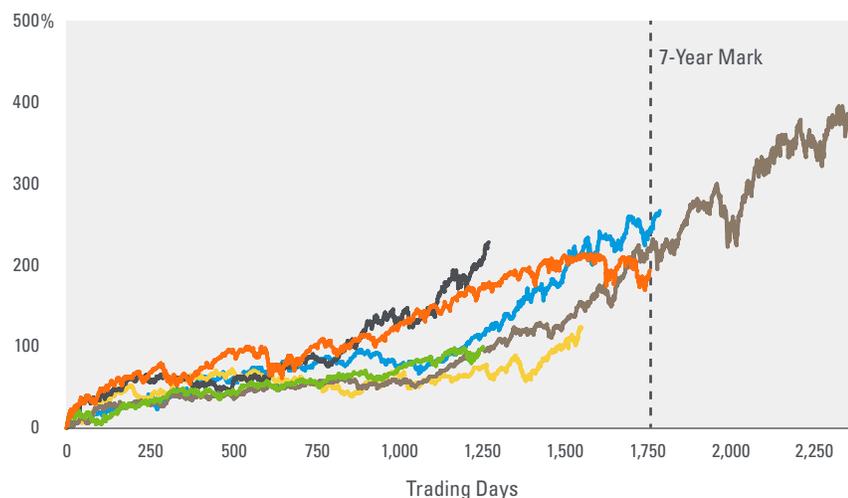
## QUICK HISTORY LESSON

Despite all of the time that has passed, memories of the stock market collapse in 2008 and 2009 remain vivid for all of us. Set up by the severe 2008–09 decline, this bull market has been one of the strongest in history. Going

### 1 CURRENT BULL IS THIRD MOST POWERFUL SINCE WWII AT YEAR SEVEN MARK

Longest Bull Markets Since WWII

- Jun '49–Aug '56
- Oct '74–Nov '80
- Aug '82–Aug '87
- Oct '90–Mar '00
- Oct '02–Oct '07
- Mar '09–Current



Source: LPL Research, FactSet 03/09/16

The S&P 500 is an unmanaged index and cannot be invested in directly. Past performance is no guarantee of future results.

back to World War II, only five bull markets have even made it five years, and only two of those celebrated their seventh birthday, making the current bull market the third longest over the past 70 years [Figure 1].

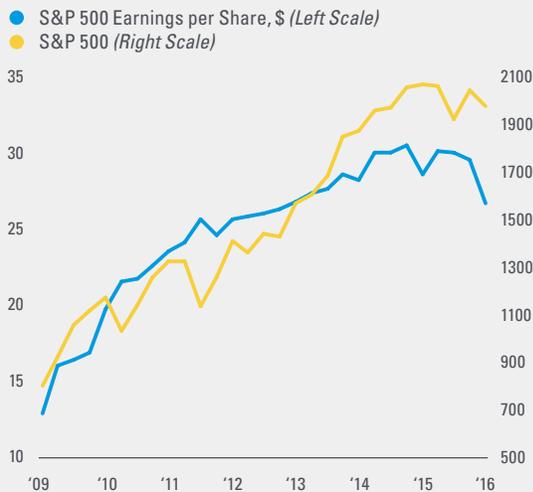
The previous two bulls to reach the seven-year milestone were June 1949 to August 1956 and October 1990 to March 2000. The rally in the 1950s lasted only one more month than the current bull, but the one in the 1990s lasted two more years. The current bull would have to stay intact until mid-2018 and propel the S&P 500 to over 3440 (up from 2022 on March 11, 2016) to match that epic bull market's duration and performance.

When asked what the biggest driver of these gains has been, many might respond with Federal Reserve (Fed) policy. Certainly, monetary policy stimulus—including quantitative easing (QE) and the so-called ZIRP (zero interest rate policy)—has played a role in powering this bull. But S&P 500

earnings have more than doubled during the past seven years, and thus provided a good deal of support for the market [Figure 2]. Corporate America's ability to drive profit margin expansion with efficiency gains during this decade is perhaps one of the most underrated pieces of the stock market's seven-year run.

Higher valuations have also played a big role, not surprising given the extreme amount of pessimism at the lows seven years ago. On a trailing four-quarter basis, price-to-earnings ratios (PE) bottomed between 8 and 9 during March 2009 before spiking to 17 later that year [Figure 3]. Interestingly, the S&P 500's PE is right around 17 today after peaking near 18 last year. Although a PE near 17 may seem high, it is roughly in-line with the average since 1980, and low interest rates are supportive of higher valuations. With some help from the possible resumption of earnings gains in the second half

## 2 EARNINGS HAVE PROVIDED A GOOD DEAL OF SUPPORT FOR THIS BULL



Source: LPL Research, FactSet 03/10/16

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Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

## 3 PRICE-TO-EARNINGS MULTIPLES HAVE COME A LONG WAY BUT ARE STILL REASONABLE



Source: LPL Research, FactSet 03/10/16

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The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Corporate America's ability to drive profit margin expansion with efficiency gains during this decade is perhaps one of the most underrated pieces of the stock market's seven-year run.

of 2016, we think valuations may be low enough to potentially keep this bull market going at least until its eighth birthday.

## SECTOR LEADERSHIP

It comes as no surprise that more economically sensitive sectors have led this bull market. Consumer discretionary has led the way with a 378% advance (434% total return), roughly doubling the performance of the S&P 500 and far outpacing financials, the next best sector on a price return basis [Figure 4]. Consumer discretionary benefited from the automotive sector coming back from the edge of the abyss during the financial crisis, from the rebound in consumer wealth (both housing and financial assets), and the meteoric rise of internet retail. Consumer discretionary has been a consistent winner, placing near the top of the sector leaderboard for the one-, three-, and five-year trailing periods.

What may come as a surprise is the fact that financials are so far behind consumer discretionary during this bull. Financials had the steepest decline into the March 2009 lows; at those lows, the sector was pricing in extremely onerous scenarios, such as nationalizing banks, which are unthinkable today. Financials did lead all sectors from those bear market lows through the end of 2009, but began to lose relative strength in 2010 due to low interest rates and new (and tough) regulations, pressures that have not let up since.

Technology and industrials also solidly outperformed during this period as the market priced in economic recovery coming out of the deep recession. Lagging over the past seven years were the more defensive, dividend-paying sectors that investors had turned to

on the way down during the crisis, i.e., telecom, up 90%, and utilities, up 113%. But no sector has done worse than energy, up only 45% and a victim to the sharp drop in oil and natural gas prices since the summer of 2014. Remarkably, the energy sector is flat since January 2010.

We continue to favor the technology and healthcare sectors and are waiting for opportunities to become more positive on energy and industrials. Our neutral view on consumer discretionary reflects its historical pattern of mixed performance during the latter stages of bull markets and economic cycles. Furthermore, the sector's gains from falling oil prices may be mostly behind it. Our recommended underweight sectors include financials, materials, and utilities.

### 4 CONSUMER DISCRETIONARY SITS ATOP BULL MARKET LEADERBOARD

	1 Year	3 Year	5 Year	7 Year
Consumer Discretionary	0%	44%	95%	378%
Financials	-10%	20%	31%	252%
Technology	-2%	44%	65%	249%
Industrials	-5%	28%	45%	248%
Healthcare	-7%	51%	103%	206%
Consumer Staples	6%	34%	74%	168%
Materials	-14%	9%	15%	150%
Utilities	11%	27%	46%	113%
Telecom	8%	7%	31%	90%
Energy	-19%	-22%	-21%	45%
S&P 500	-4%	28%	51%	194%

Source: LPL Research, FactSet 03/09/16

Data represents price returns for S&P 500 GICS sectors for periods ending March 9, 2016.

Top performers for each period are highlighted in green.

Because of its narrow focus, investing in a single sector, such as energy or manufacturing, will be subject to greater volatility than investing more broadly across many sectors and companies.

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## NO RECESSION, BUT SOME CONCERNS

The indicators we watch that could signal the potential end of the economic cycle and an oncoming recession are currently not showing worrisome signs. Collectively, our [Five Forecasters](#) are not showing any cause for concern. We do not see evidence of the excesses in borrowing, spending, or confidence that have ended economic expansions over the past several decades ([discussed here](#)). The majority of the indicators we use to assess where we are in the business cycle point to mid-cycle or mid-to-late, rather than late.

That said, although the S&P 500 is one good day away from breakeven for the year, we do have some concerns about this market and maintain a slightly cautious stance in the short term:

1. **China.** We continue to worry about the potential for China to devalue its currency and spark a currency crisis. A trade war is also a concern given the rhetoric coming from the U.S. presidential campaign trail. At the same time, China's recent support of the yuan and talk of financial reforms are encouraging.
2. **Oil.** Oil's recent resurgence has been a big part of the stock market rebound. Oil is up more than 40% since February 11, 2016 (just a month) and is back to near the \$40 level. We are concerned that the rally, based on little more than talk of a production freeze among Russia and OPEC members, lacks a strong enough foundation from production cuts to sustain itself.

3. **The Fed.** Stocks have historically done quite well after the Fed starts rising interest rates, which it did in December 2015. That said, there is a risk that the Fed hikes rates too aggressively and upsets financial markets and the U.S. economy. (See today's [Weekly Economic Commentary](#) for a Federal Open Market Committee [FOMC] meeting preview.)
4. **Earnings.** Fourth quarter 2015 earnings season was disappointing. The declining drag from the strong U.S. dollar and smaller energy declines are expected to help earnings growth improve throughout 2016, but the mid-single-digit earnings gains we had initially anticipated for this year may be delayed until 2017.

## CONCLUSION

Stocks may not produce scintillating gains in 2016, but we do expect the bull market to continue despite its age and the aforementioned risks. Bull markets don't die of old age, they die of excesses. We do not see warning signs that might signal the end of the economic cycle or the now seven-year-old bull market. ■

*Thank you to Ryan Detrick for his contributions to this report.*

#### IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market.

All investing involves risk including loss of principal.

Currency risk arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

#### INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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