

The stock market bounce off the December lows continued in February and into mid-March. The keys to the recovery have been a swing from extreme pessimism in the final months of 2018 to extreme optimism in regards to the Federal Reserve policy and the trade war. The swing in sentiment has led to considerable changes in investor's risk appetite and stock prices. The Fed's message of pivoting from several more rate hikes to now basically saying it's done raising rates for now, combined with an ease on the trade rhetoric provided the tonic the market was looking for to keep the rally going. The S&P 500 finished February with a 3.2% gain, while the Russell 2000 did even better up 5.2%, and international stocks were up 2.6%. As of the middle of March almost all major global stock indices are up double digits year to date.

"The swing in sentiment led to considerable changes in investor's risk appetite and stock prices"

Risk appetites carried over to the bond market, with high yield bonds up 1.7% in February while core bonds were basically flat. As of the middle of March, high-yield is up over 6% and core bonds are up 1.7% year to date. Real estate has also been a big winner as investors seek yield in a declining interest rate environment. REITs were up close to 13% in the first two months of the year.

In this month's commentary we discuss the 10 year anniversary of the current bull market and some of its unique aspects. We also discuss the rapid increase in the US national debt since the 2007 crisis and its implications for the financial markets.

Longest Bull Market

March 9th marked the 10th anniversary of the current equity bull market, making it the longest on record in the past 140 years! During this time the S&P 500 generated a total return of 401% or 17.5% annualized, according to Goldman Sachs that ranks in the 94th percentile of 10-year annualized returns since 1880, not too shabby. Here are a few other things of note about the current 10 year bull market:

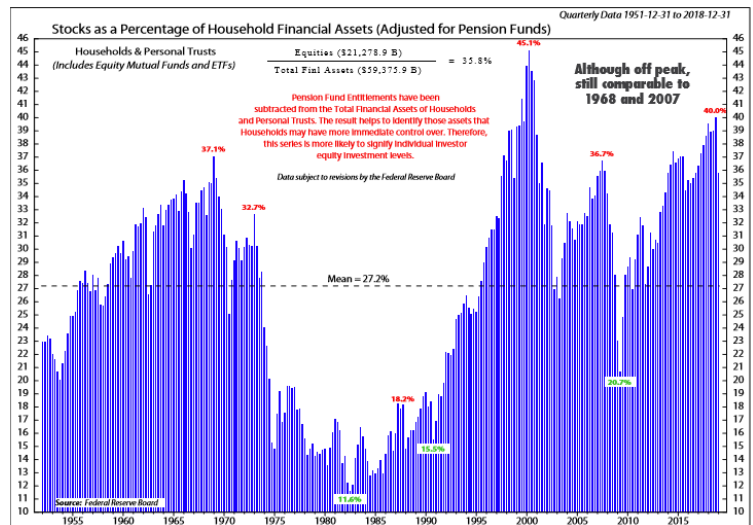
- The bull market nearly ended a couple of times if the arbitrary down 20% standard is used to mark the end of a bull market. In 2011 the S&P 500 dropped 19.4% and in the fourth quarter of 2018 it dropped 19.8%, but never quite made it to down 20%.
- Just 10 stocks were responsible for close to 25% of the total return in the S&P 500 over the 10-year period. And just two stocks (Apple and Microsoft) accounted for close to 10% of the returns! See the chart to the right.

10 stocks have accounted for 24% of S&P 500's 10-year return

| Top 10 contributors to S&P 500 return | | | | | | | |
|---------------------------------------|-----------------------|-------------|------|-------------|---------|-------------------|---------------------|
| Ticker | Company | Ann. growth | | Forward P/E | | Ann. total return | % of S&P 500 return |
| | | Sales | EPS | Mar '09 | Current | | |
| AAPL | Apple Inc. | 23 % | 32 % | 15.2 x | 14.3 x | 32 % | 5 % |
| MSFT | Microsoft Corporation | 7 | 9 | 8.0 | 23.0 | 25 | 5 |
| AMZN | Amazon.com, Inc. | 28 | 30 | 37.7 | 54.8 | 39 | 2 |
| JPM | JPMorgan Chase | 5 | 27 | 8.5 | 10.4 | 23 | 2 |
| JNJ | Johnson & Johnson | 2 | 2 | 10.1 | 15.9 | 15 | 2 |
| BA | Boeing Company | 5 | 17 | 5.9 | 20.4 | 33 | 2 |
| HD | Home Depot, Inc. | 4 | 22 | 13.8 | 17.9 | 29 | 2 |
| INTC | Intel Corporation | 7 | 17 | 23.9 | 11.6 | 19 | 2 |
| UNH | UnitedHealth Group | 11 | 18 | 5.8 | 15.8 | 31 | 1 |
| CSCO | Cisco Systems, Inc. | 3 | 8 | 10.9 | 15.7 | 17 | 1 |
| Top 10 contributors | | | | | | 23 % | 24 % |
| S&P 500 | | | | | | 17 | 100 |

Source: Compustat, Goldman Sachs Investment Research. As of Mar 7, 2019

- The valuation of the S&P 500 (using forward P/E) increased by 58%, accounting for a large part of the market's gain over the 10 year period.
- Robust stock market gains have greatly increased the allocation to stocks in household balance sheets. The chart on the right from Ned Davis Research, shows the current household allocation to stocks is 35.8% down from its recent peak of 40% back in September. Of note, even though the allocation is come down a little to 35.8% and not as high as 1999, it remains at levels that have signaled major market tops in the past (2007 and 1968). Something to keep an eye on!



Does the Amount of National Debt Matter?

In early March, the official debt of the US government exceeded \$22.0 trillion, the largest amount on record! According to the website justfacts.com, as of March 5, 2019 the national debt amounts to:

- \$67,057 for every person living in the US
- \$172,656 for every household in the US
- 105% of the US economy (GDP)
- Over 600% of annual federal revenues

The chart on the right helps put the current level of national debt in perspective, showing the national debt as a percentage of GDP from the period 1790-2018. The debt peaks created during World War II and today clearly jump off the page, with the current level reaching 105% of GDP. Begging the question does the level of national debt matter to financial markets?

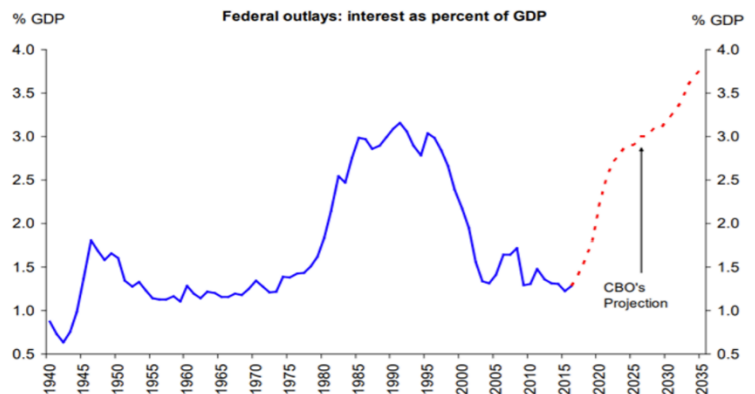


The short and smart-alecky answer is... it doesn't matter until it does! As we've seen throughout financial history, the markets are often willing to overlook the level of debt for a nation, sector or individual security for an extended period of time. However, at some point it inevitably becomes an issue. However the challenge, as always, is knowing when that is likely to happen and what will be the catalyst that will cause financial markets to start focusing on the issue. At this time we don't know the answer to

those questions (nor does anybody else!). However, we know that low interest rates have kept the massive level of debt affordable, but that can change. In fact, the forecast below from the CBO shows the projected level of interest expense as a percent of GDP for the U.S. government spiking upwards in the years ahead, from under 1.5% today to close to 4% by 2025. Needless to say, if this happens financial markets will start to pay attention.

Keep in mind, that debt grew about \$1.5 trillion the past year in the midst of a relatively strong economy. According to Jeffrey Gundlach of DoubleLine, the problem is the level of taxation as a percent of GDP is at its lowest since 1950, yet spending as a percentage of GDP is growing rapidly. If the US economy were to experience a recession the next few years, a reasonable expectation, the level of debt and interest expense could explode to the upside, making the above CBO estimates seem conservative. We don't anticipate any imminent changes to the financial markets, these trends can take a

while to play out, although we do believe long-term investors should start considering the implications high debt levels will have on financial markets. We suggest staying underweight duration in your bond strategy as long-term interest rates are likely to increase in the years ahead. Stick with higher quality balance sheets for both the bond and equity parts of your portfolio. Consider the long-term implications to the US dollar (not great), and start gradually increasing your exposure to assets that may benefit from a lower dollar such as foreign and real return securities. It's a good time to reflect on what's happened in the financial markets over the past 10 years, but more importantly to start thinking about what's likely to happen over the next 10 years. It will be different, be prepared!



Source: St. Louis Fed, CBO, DB Global Research
GDP: Gross Domestic Product is the measure of goods and services within a given country. Quarterly data. CBO: Congressional Budget Office. You cannot invest directly in an index.

- AWM Investments (March 2019)