As The Tax Bill Goes, So Goes The Market

Given the rich valuation of the U.S. market, the best explanation for the current optimism being shown by investors is their expectation that the tax bills now under consideration by the House and the Senate will become law. The major beneficiary of that legislation will be corporations, which may well enjoy substantial increases in their net income. Thanks to those prospective increases, what we view as rich valuations today may not really be that stretched and perhaps, taking a more encouraging view, future gains may be greater than what most observers now look forward to.

With that said, however, the hurdles that need to be crossed are quite formidable. On the House side, the main resistance will be coming from representatives in high-tax states such as New York and California, where discussions about the possible end of the deduction for state and local taxes is meeting considerable resistance.

On the Senate side . . . well, that's another story. Unlike the substantial Republican majority in the House, the Senate plurality for the GOP is relatively thin. Senator Ron Johnson of Wisconsin has already said that he will not support the bill and it's entirely likely that a half dozen or so others on his side of the aisle may join in turning it down.

The upshot is that one day there's widespread optimism that what's billed as a massive tax cut for the middle class is moving along well, but the next day it seems to stutter. All of which would help to explain why there's been an increasing level of volatility lately and quite possibly will be even more in the weeks ahead.

From the standpoint of prudence, it's a good idea to plan more conservatively and hope that you'll be pleasantly surprised. That, however, is not the way things are going at the moment. With the exception of more recent trading days, stock prices have continued to crawl upward at a leisurely pace. Indeed, the year-to-date volatility has been well below the pace of most prior years.

Now, we've begun to see the reemergence of triple-digit daily price changes in the Dow as well as a narrowing of range of stock price advances. Stocks that are still on the rise are increasingly those of the larger companies. And, no surprise, small caps are largely in the doldrums.

This kind of contrast is a distant cousin of the Nifty Fifty of the early 1970s. At that time, the biggest of the name brand companies continued to climb while the rest of the market languished. And, as some folks will recall, it all ended at the start of 1973, when stocks began a brutal nine-year drop that continued until late summer of 1982.

From that point, the great bull market of the 1980s began. Since then, stock prices have advanced more than tenfold.

The moral of the story is that there will be ups and downs along the way, but the long-term path of least resistance is up. Sometimes, such as now, patience may be required to see past the bumps.