Is The Correction Finally Here?

In the wake of the latest round of nationwide elections, there are early signs of discontent among the voters. The turnout was well above expectations and the results suggest a significant shift in attitude from what propelled the current administration into office. All of which adds up to an increasing probability that the latest efforts to enact major modifications to the U.S. tax code may come to naught.

One of the problems facing the Senate is that to pass this tax bill the increased burden on the national debt cannot exceed $1.5 trillion. So long as the bottom line is under this limit, only a major of senators will be needed for passing. Should the number be greater, a total of 60 votes would be required.

As things stand, given the rumblings of Senators Flake, McCain, Collins, Murkowski, and Paul, among others, it's not even certain that keeping under the debt limit addition would be sufficient to gain approval. And as various interest groups stiffen their resistance to provisions of the legislation to which they object, it looks like it's going to be even hard to move it along.

Yet in recent months, the stock market has moved steadily higher, without missing a beat. This is highly unusual. Looking back over several decades of market history, it is clear that in almost every year there has been an interim pullback of 10% sometime during the year. But nothing of the sort has happened this year . . . yet.

2017's exception to correction tradition seems to have its roots in the fact that corporate earnings are rising steadily and interest rates remain at unusually low levels. In addition, the possibility, albeit not assured, of a substantial corporate tax cut has lulled investors into thinking that there will be a significant bump up in the bottom line for many companies.

That may not happen. If it doesn't, support for currently rich stock valuations would weaken considerably. The recent multiple on the Standard & Poor's 500 Index is about 20 times estimated earnings for the current year. That's way up there. If a big tax cut comes through and interest rates remain low, it might be sustainable. But the odds of both of these happening are getting long.

The Federal Reserve is almost certainly going to raise rates again next month, and more hikes may be on tap for 2018. That’s not a good thing.

Although the first and fourth calendar quarters are typically the strongest periods for stocks, that's not a guarantee. It would be helpful to stay tuned to what's going on in D.C. And it would be at least as helpful to take a hard look at portfolios and seriously consider taking a less aggressive stance. Prune the biggest gains as well as those positions that have disappointed and replace with holdings less susceptible to the ripple effects of overall market weakness.

Better to take action now than wait to hear folks calling Timber! That's a word to the wise.