Time For A Reality Check

Lest anyone be lulled into a sense that the steady and stable market advance that we enjoyed over the last year was a precursor of a new normal, I strongly suggest that it's time to get real. Although there are substantial reasons to look forward to a further rise this year, hopes that it will be a mirror image of 2017 are ill-founded.

We should be encouraged that the economic recovery that began here in the wake of the 2008-9 Great Recession has been followed be a rebound across most global markets. So it's no wonder that we've seen broad-based advances almost everywhere. It's important to recognize, however, that the U.S. was far ahead of other countries in getting things back together and, as a result, domestic markets have climbed toward the upper end of their traditional valuation ranges.

Markets abroad got in gear much later so they're still much more reasonably priced. Those of developed countries are selling at about a third lower than the U.S. Those of emerging markets are selling at a discount of about 50%. Yet over time the latter are likely to experience growth well above the global average. That adds up to a more favorable risk-reward ratio.

Another key part of the investment equation is fixed income, which is well past its three-decade-long rise and subsequent span of marking time. A series of interest hikes lies just ahead. So as interest rates climb, the value of individual bonds will fall.

Current interest rates are still quite low, though some worthwhile opportunities remain in short-maturity high yield bonds, deep discounted closed-end funds, and emerging market debt. Long-maturity treasury bonds, which were the sole standouts in the 2008-9 market bust, are now among the least desirable fixed-income holdings.

These things aside, investors should be prepared for an uptick in volatility. In the first few weeks of the new year, we've already seen a number of several-hundred-point swings in the Dow. Look for more of the same. Of course, with that indicator up near 27,000, a 300-point move is only a little more than a 1% move.