Flat Market Ahead?

One of the truisms in investing is that periods of unusually broad gains are followed by years when more moderate increases are likely. Most of us recall less than fondly that the decade from 2000-2010 was a span when market prices went nowhere, albeit with a fair amount of volatility along the way. The decade included the debacle of 2001-2002 as well as that of 2008-2009.

In the wake of the Lost Decade, prices have again been on the rise, capped by the unusually broad gains registered last year. Indeed, until volatility returned with a vengeance this past February, it looked like the upsurge was well on its way to an encore.

That, of course, has not happened. Yet, in retrospect it appears that with its usual ability to look ahead, the stock market jump of 2017 anticipated the 20+% bottom line gains that are likely this year. First, prices rose. Then, earnings followed. As a result, valuations became rather stretched, but with a resumption of sideways price movement they are back in the normal range of 16-17 times earnings, which is quite reasonable when viewed against the background of still-low interest rates.

The bigger concern now is the substantial deceleration in earnings gains likely during 2019. A substantial chunk of this year's advance is due to reduced taxes. That won't be repeated next year or thereafter. What's more, given the hefty additions to the U.S. national debt and the increased interest burden that will come as a result of rising rates, a rise in taxes would appear to be inevitable sometime down the road.

That doesn't completely wipe out prospects for gains in investments, but it does mean that the focus should be on shares of well-financed companies growing at above average rates accompanied by short- to intermediate- term fixed income holdings. Proper asset allocation and selection within the asset classes should continue to provide the potential for worthwhile gains even if the market treads water for an extended period.