Up, Down & Sideways

In past years, summer brought with it a time to turn one's thoughts to more blissful endeavors. Although childhood may have been many years ago, what lingers is the apparent freedom from care we felt when at last we were done with school. Much has changed since those halcyon days when time hardly seemed to move. Back then, the days went by slowly and the important decisions were few. Now it's almost as if you don't know which direction to turn first.

It's all about communications and the seeming necessity of keeping up to date with what's going on. Much of the rising flow of developments may have little impact, but even so it's no longer a time when we can disconnect until September.

From an investment perspective, the challenge is to sort through the rapidly growing mountain of information to isolate the data that's critical and take action, where needed. On a grand scale, it's a matter of separating the wheat from the chaff. Hardly a part-time job.

Short term, it seems as if everything has an impact on market prices. That includes the ongoing hubbub in Washington, hearings on the Supreme Court nominee, actions by the Fed, and who-knows-what with North Korea. That's only a start. So it's not at all surprising that as news breaks, the major market averages move sharply in both directions. Yet, with the exception of the first few weeks of this year, it has been largely a matter of big ups, big downs, and a net result of ending up pretty much in the same place as where we were six months ago. Far better to slow down, take a deep breath, and try to get a handle on where things stand. That's essentially a return to the basics of investing.

Over meaningful periods of time in the world of investing, that's a market cycle of three to five years. However much effort is spent trying to analyze the broad range of available opportunities, it's critical to remember that the value of efforts to understand and make worthwhile portfolio decisions increases as time extends. What happens over weeks, months or even a few years may end up far off from what may have been expected. Price movements in the short term are driven primarily by changes in investor psychology. Witness the recent market reactions to the developments on the Korean peninsula and announcements of a nascent tariff war.

Geopolitical issues, though troublesome, usually have little to do what the ability of the corporate community to move ahead. Global business issues may be more meaningful, but for the most part they do not move the needle much either. Far more important is the rate of progress from year to year. At the moment, thanks to a substantial reduction in the corporate tax bite, U.S. companies are enjoying unusually broad increases in profits.

That's the good news. The bad news is that what's in store for 2019 will be a substantially slower advance. The problem is that by comparison those year-ahead numbers may well be disappointing.

Now that we're nine years and counting from the low point of 2009, it seems increasingly likely that a pullback of some sort lies ahead. That's a pullback, not a plunge. Why the distinction? In most years, there's a downdraft of at least 5%, more likely 10%, which takes place sometime during the course of the year and then passes. It's like breathing out and breathing in.

One of the issues that stood out at the beginning of 2018 was the richness of stock valuations. Back in January, it seemed as if we were off to the races and valuations swelled to the upper end of the normal range. Then we moved into a broad span of marking time accompanied by a huge uptick in volatility.

That dramatic turn was a change for the better since underlying earnings continued to climb while prices remained on a wide plateau. The net result was a return toward the middle of the historical valuation range. So on the basis of valuations, there seems to be no compelling reason for a big dive. Even so, the market tends to look ahead and what it sees will be a decelerating rate of growth in the new year. That, combined with further increases in interest rates, may well be enough to prompt less enthusiasm by investors.

The question now is whether we're looking ahead to an earnings slowdown or actual downturn in bottom lines. At the moment, the odds favor the former, but in the wake of the big gains registered last year, it would not be unreasonable to deal with a more moderate showing ahead.