

Politics or Profits?

The latest news from courtrooms in New York and the D.C. area come at a time when the stock market seems to be on a path to new highs. These days of late summer are typically when folks used to take a breather and disconnect from whatever is making headlines in the media.

Those days are gone. It's almost as if someone had orchestrated a nonstop drama that continues to build to increasingly higher pitches. Just when you've begun to get a handle on whatever just happened, there's an even newer announcement that screams for your attention.

What does all of this mean for investors? That remains to be seen. The reality of investing is that the long-term trend of stock prices is driven by changes in underlying earnings. The long-term trend of earnings is up and so is the long-term trend of stock prices.

With that said, however, that trend has not been and will not be a smooth one. Although annual gains over time have averaged about 10% a year, there have been years with losses of 20% to 30% or more. Typically, but not always, the longer-lasting pullbacks have been triggered by economic downturns. And in most years, there have been interim dips of 10% or so that reflect fluctuations in investor psychology.

Where do we stand now? From an earnings perspective, the indications are positive. Thanks to a substantial corporate tax cut, company bottom lines are gaining about 20% this year. What's more, since earnings have climbed more quickly than stock prices, valuations are still in a normal range.

The flip side, however, is a combination of concerns. First, 2019 will see a marked deceleration in the rate of profit improvement. Second, interest rates are slated to have several more increases. Third, for what it's worth, this is the longest-running bull market in history. And finally, what about the impact of the developing trade war? Higher tariffs will lead to rising prices and a resulting reduction in consumer spending. That's not a good thing.

And then there are the courtroom dramas.