Sugar High

As we move through what in the past has traditionally been the most difficult time of the year for the stock market, we need to take a hard look at where things stand and what's likely to be in store over the next few quarters. A year ago, we experienced an atypically stable advance that pushed stock valuations toward the upper end of the historical range. The upsurge continued into the first few weeks of 2018, then came to a screeching halt and prices pulled back.

The weakness that followed in the early months combined with unusually broad bottom line gains, reflecting the huge corporate tax cut, to bring valuations down to more reasonable levels by midyear. More recently, prices have been clawing their way back up and valuations have become richer.

In reflection of what amounts to a one-time bonus, stocks have been on a sugar high. The problem is that investors look ahead and what they're looking ahead to several quarters down the road will be a marked deceleration in upward progress. If this year's overall increase comes in between 15% and 20%, it's quite likely that what's on tap for 2019 will be no better than half that pace. That prospect is not one that will whet investors' appetites.

Then there's the matter of tariffs now being put in place by the current administration. Tariffs on goods brought in from abroad will raise prices. Rising prices will reduce purchasing power. Reduced purchasing power will mean reduced unit volume of goods being sold. Which means the pace of U.S. business activity will slow.

Let's not forget the Fed, which has been on a track of regular quarterly increases in interest rates. The upticks will almost certainly continue through December, but if the tempo of business activity moderates in the new year, the central bank may well pause its program. With interest rates now up from a lengthy period of nothingness, that could be good news for the fixed income market, but may be accompanied by choppier price action for equities.