Don't Expect Another Big Gain

As has often been the case after the market has turned in an unusually broad advance, the gurus of Wall Street continue to build their cases for more of the same. This most certainly is a replay of a recent film entitled Dumb and Dumber.

Successful investors are best served by planning for the worst while hoping for the best. That's especially so in the wake of a year when almost every asset class delivered fine returns. But a bet on a back-to-back bingo of this sort ignores the writing on the wall, which is anything but encouraging.

For one thing, stock valuations are stretched. Yes, I know that there are seers who find ways to look ahead and opine that when you look far enough ahead today's prices don't seem that high. The problem with this approach is that Wall Streeters don't use binoculars. For these folks, the future is a concept that views the next few quarters, not the next few years. When seen that way, it's not very pretty.

Let's start with the fact that corporate earnings have been on a sugar high, thanks to the recent tax cut. For a short time, it looked like there was a major bottom-line acceleration, not what amounted to a one-time bump that came at the cost of a massive increase in the country's debt burden, which now stands north of $22 trillion. Outstanding debt goes hand in hand with ongoing interest payments, which account for an increasing share of the federal government's annual expenses. As interest costs go up, the funding available for other areas shrinks. When rates rise, the situation will get even worse.

If and when Congress comes to its senses and makes an effort to balance the budget, taxes will almost certainly be moving higher. More likely than not, higher taxes will put the brakes on spending, both consumer and corporate. This is not something to look forward to, nor a favorable wind for the investment markets.

Still, so long as interest rates remain low and credit is widely available, the market may grind a bit higher. If one were forced to speculate about what we are looking forward to, I'd guess that the year-ahead net return will be somewhere between +10% and -10%, with the bias toward the latter number.

In addition to the financial arguments already noted, one would be naïve not to recognize the geopolitical risks involved as well as the impact of the upcoming presidential elections. Put all of this together and we're on the way to a roller-coaster ride.