

Stock Market Observations

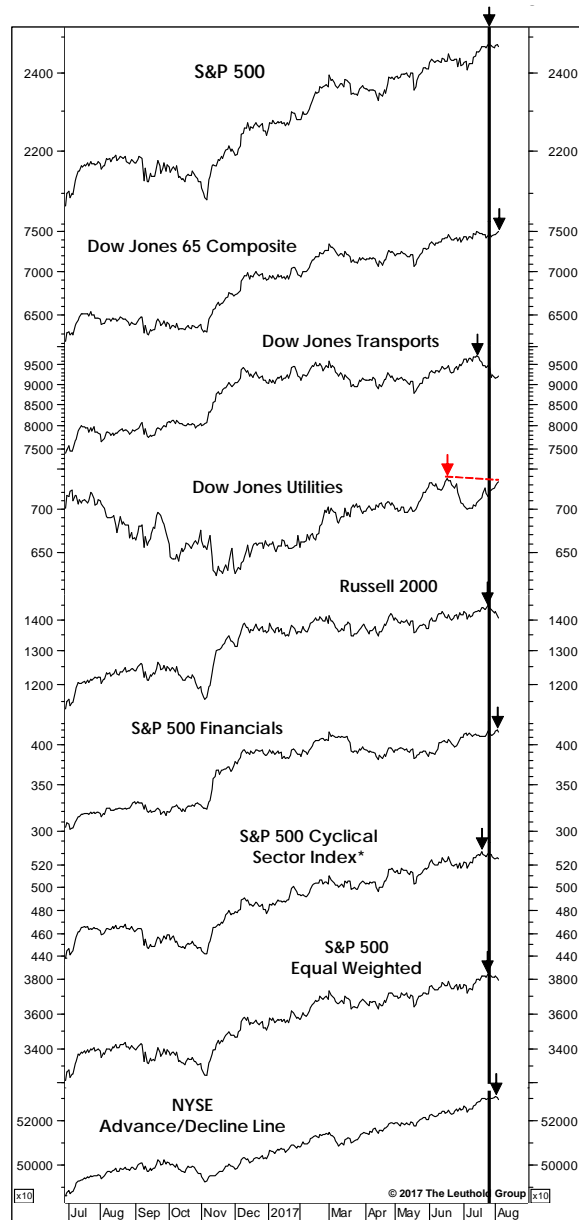
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Charts through July; they do not include August-to-date results.

Chart Line = Bull Market high as of 7/26/17

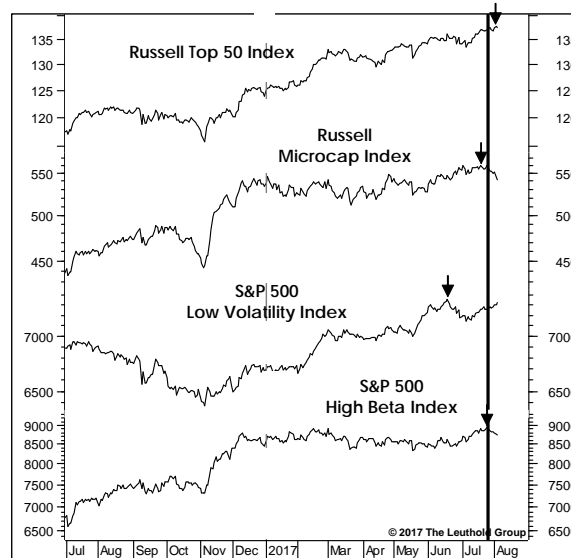
Arrows = Index new highs as of July 31st



*Equal-weighted composite of Consumer Discretionary, Industrials & Materials sectors.

The S&P 500 and DJIA were up 10-11% on the year through early August—solid, but not quite the “melt-up” scenario we’d envisioned earlier this year. Our late summer S&P 500 target zone of 2,550-2,600 is in sight, and six weeks of summer remain. But that timetable (if not the target zone) now looks too optimistic. We think 2,550-2,600 may yet be achieved, but not until year-end. Conditions have slipped into place for at least a short-term correction, and we’ve therefore trimmed net equity exposure in tactical portfolios to 60%, from 67-68% previously.

Our decision to hedge wasn’t a slam dunk. While our disciplined analysis of the outlook for stocks has faded in recent weeks, commodity prices and wage inflation both remain just sluggish enough to let the Fed continue with its glacial pace of normalization, thereby allowing the S&P to “normalize” toward 2x sales and 4x book value. The odds of these developments conspiring to deliver “normal” long-term equity returns have sunk to near zero, but few managers have adapted their portfolios to that likelihood.



“Expected returns” present a long-term problem for the bulls. Conversely, price charts present a short-term problem for the bears. One barely needs to glance at the accompanying charts to recognize a bull market that’s almost fully “in gear,” with traditional bellwethers still joining the blue-chips in their near-daily ascent to new highs.

While the market’s broad new highs are bullish from an intermediate-term point of view (3-6 months), they don’t rule out a near-term correction. In fact, our work suggests that the exceptionally high level of internal market “agreement” observed recently is a minor negative in the very short term—supporting the decision to pull in our horns.

The Leuthold Group—August 5, 2017

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