**Records Are Made to Be Broken**

We hear it all the time: “Records are made to be broken.” We celebrate record-breaking winning streaks by our favorite teams. Conversely, we hope they avoid long strings of losses.

The bull market that began in 2009 is not the best **performing** market since WWII…that title still resides with the long-running bull market of the 1990s. But the current market is the longest **running** bull market since WWII as measured using the S&P 500 Index (*Sources:* St. Louis Federal Reserve, Yahoo Finance).

According to the National Bureau of Economic Research (NBER), which is considered the official arbiter of recessions and economic expansions, the current expansion began in July 2009. It has run exactly 10 years, or 120 months, matching the 1990s expansion–see Table 1.

**Table 1: Economic Expansion “Scorecard”**

|  |  |
| --- | --- |
| **Expansions** | **Length in Months** |
| July 2009 – Current | 120 |
| Mar 1991 – Mar 2001 | 120 |
| Feb 1961 – Dec 1969 | 106 |
| Nov 1982 – Jul 1990 | 92 |
| Nov 2001 – Dec 2007 | 73 |
| *Average Length* | 64 |
| Mar 1975 – Jan 1980 | 58 |
| Oct 1949 - Jul 1953 | 45 |
| May 1954 – Aug 1957 | 39 |
| Oct 1945 – Nov 1948 | 37 |
| Nov 1970 – Nov 1973 | 36 |
| Apr 1958 – Apr 1960 | 24 |
| Jul 1980 – Jul 1981 | 12 |

*Source: NBER through June 2019*

Barring an unforeseen event, the current period now heads for the record books.

While the economic recovery could soon enter a record-setting phase, it has also been the **slowest** expansion since at least WWII, according to data from the St. Louis Federal Reserve.

For example, starting in the second quarter of 1996, U.S. Gross Domestic Product (U.S. GDP), a broad measure of economic growth, exceeded an annualized pace of 3% for 14 of 15 quarters. It exceeded 4% in nine of those quarters (*Source:* St. Louis Federal Reserve).

Growth was much more robust in the 1960s. We also experienced a strong recovery from the deep 1981-82 recession.

Economic booms and long-running expansions can encourage risky behavior. People forget the lessons learned from prior recessions and overextend themselves.

Consumers can take on too much debt. Businesses may over-invest and build out too much capacity. Euphoria took hold in the stock market in the late 1990s and speculation ran wild in housing not too long ago.

That brings us to the “silver lining” of the lazy pace of the current economic expansion.

Many economists believe “slow and steady” has prevented speculative excesses from building up in much of the economy. In other words, the mistaken conclusion that “good times will last forever” does not appear to have taken hold in today’s economic environment.

**Causes of recessions**

The long-running expansions of the 1960s, 1980s, and 1990s led to the mistaken belief that various policy tools could prevent a recession. However, expansions do not die of old age. A variety of events can trigger a downturn.

Let’s look at the most common causes and see where we stand today.

1. **Rising inflation leads to rising interest rates.** In the early 1980s, the Federal Reserve pushed interest rates to historically high levels to snuff out inflation. The Fed’s policy prescription succeeded, but led to a deep and painful recession.
2. **The Fed errs.** A Fed policy mistake can be a trigger; for instance, if the Fed were to raise interest rates too quickly, the move could restrict business and consumer spending. This is a derivative of point number one. Some expressed fear that the Fed was headed down this road late last year. Credit markets tightened until the Fed reversed course.
3. **A credit squeeze can snuff out growth.** In 1980, the Fed temporarily implemented credit controls that briefly tipped the economy into a recession.
4. **Asset bubbles burst.** The 2001 and 2008 recessions were preceded by speculative excesses in stocks and housing.
5. **Unexpected financial and economic shocks jar economic activity.** The OPEC oil embargo in the 1970s exacerbated inflation and the 1974-75 recession. The tragedy of 9-11 jolted economic activity in 2001. Iraq’s invasion of Kuwait pushed oil up sharply, contributing to the 1990-91 recession. Such events have not occurred often historically, but we must acknowledge their possibility.

**Where are we today?**

Inflation is low, the Fed is signaling a possible rate cut, and credit conditions are favorable as measured by various gauges of credit. For the most part, speculative excesses do not appear to have built to dangerous levels.

While stock prices are near records, valuations remain well below levels seen in the late 1990s (using the forward Price-to-Earnings ratio for the S&P 500 Index as a guide). Besides, interest rates are much lower today, which lends support to richer valuations.

None of this means we will not experience market volatility. Stocks have historically exhibited a long-term upward bias, but the upward march has never been and never will be a straight line.

Your financial plan should be designed, in part, to keep you grounded during periods when volatility may tempt you to make a decision based on emotions. Such reactions are rarely profitable.

**A sneak peek at the rest of the year**

The Conference Board’s Leading Economic Index, which has historically shown a relatively good record of foreseeing recessions, is not signaling a contraction through year-end 2019.

One potential worry: a protracted trade war and its impact on the global/U.S. economy, business confidence, and business spending.

The U.S. GDP has risen over the last 20 years. Exports account for almost 14% of U.S. GDP (*Source:* U.S. BEA). However, we have not experienced a U.S. recession caused by global weakness historically.

By itself, many economists believe that trade barriers with China are unlikely to tip the economy into a recession. Per U.S. BEA and U.S. Census data, total exports to China account for just under 1% of U.S. GDP. Even with higher tariffs, economists say exports to China will not grind to a complete halt and erase 1% of U.S. GDP.

Economists find the impact of the trade situation on business confidence and business spending difficult to model. The trade factors could potentially slow domestic hiring, pressuring consumer confidence and consumer spending.

Simply stated, economists say there is no modern historical precedent to construct a credible model; hence, the heightened uncertainty among investors.

**Is a recession inevitable?**

We have certainly experienced recessions in the U.S., while other countries have records that are more enviable.

Earlier in June, the *Wall Street Journal* highlighted, “Australia is enjoying its 28th straight year of growth. Canada, the U.K., Spain and Sweden had expansions that reached 15 years and beyond between the early 1990s and 2008. Without the Sept. 11, 2001 terrorist attacks, the U.S. might have, too.” [*Reference:* <https://www.wsj.com/articles/after-record-long-expansion-heres-what-could-knock-the-economy-off-course-11559591043>]

If trade tensions begin to subside and if the fruits of deregulation and corporate tax reform kick in, we could see economic growth well into 2020 (and with some luck, into 2021 and beyond).

We must **caution** that experts and systems rarely predict the timing of economic turning points accurately and consistently.

**The Fed to the rescue**

Economists trace rising major market indexes for much of the year to positive U.S.-China trade headlines (at least through early May), a pivot by the Fed, and domestic economic growth.

We witnessed a modest pullback in May after trade negotiations with China hit a snag. The threat of tariffs against Mexico added to the uncertain mood until June 4, when Fed Chief Jerome Powell signaled the Fed would consider cutting interest rates to counter any economic headwinds.

While Powell did not promise to deliver any rate cuts, one key gauge from the CME Group that measures “Fed Funds probabilities” put odds of a rate cut at the July 31 meeting at 100% (as of June 28 – probabilities subject to change).

Academic theory explains why lower interest rates have historically been a tailwind for equities. Without getting onto detail, one factor is that stocks face less competition from interest-bearing assets.

Add another wrinkle: economic growth.

Falling rates in 2001 and 2008 failed to stem the outflow from stocks as economic growth faltered. Moreover, rising rates between late 2015 and September 2018 did not squash the bull market.

During the mid-1980s, mid-1990s, and late 1990s, rate cuts by the Fed, coupled with economic growth, fueled market gains.

Economists believe bear markets coincide with recessions and the bulls are inspired by economic expansions. Ultimately, steady economic growth has been an important ingredient for stock market gains over time.

**Table 2: Key Index Returns\***

|  |  |  |  |
| --- | --- | --- | --- |
|  | **MTD %** | **YTD %** | **3-year\*\* %** |
| **Dow Jones Industrial Average** | 7.2 | 14.0 | 14.1 |
| **NASDAQ Composite** | 7.4 | 20.7 | 18.2 |
| **S&P 500 Index** | 6.9 | 17.4 | 11.9 |
| **Russell 2000 Index** | 6.9 | 16.2 | 10.8 |
| **MSCI World ex-USA\*\*\*** | 5.8 | 12.5 | 6.1 |
| **MSCI Emerging Markets\*\*\*** | 5.7 | 9.2 | 8.1 |
| **Bloomberg Barclays US**  **Aggregate Bond TR** | 1.3 | 6.1 | 2.3 |

Sources: *Wall Street Journal*, MSCI.com, Morningstar, MarketWatch, Yahoo Finance

MTD returns: May 31 - Jun 28, 2019

YTD returns: Dec 31, 2018 - Jun 28, 2019

\*It is not possible to invest directly into an index.

\*\*Annualized

\*\*\*In US dollars

**Final thoughts**

Control what you can control.

You can’t control the stock market; you can’t control headlines; and timing the market isn’t realistic. However, you and your financial advisor can control your portfolio.

Your plan should consider your time horizon, risk tolerance, and financial goals. There is always risk when investing, but your financial advisor will tailor recommendations with your financial goals in mind.

If you ever feel unsure or have questions, contact your financial advisor.

*Researched and drafted by Charles Sherry and Horsesmouth.*

Provided by,

Corvus Capital LLC

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