



## Euphoria Is Not Yet on the Horizon: Here's Why That's a Good Sign

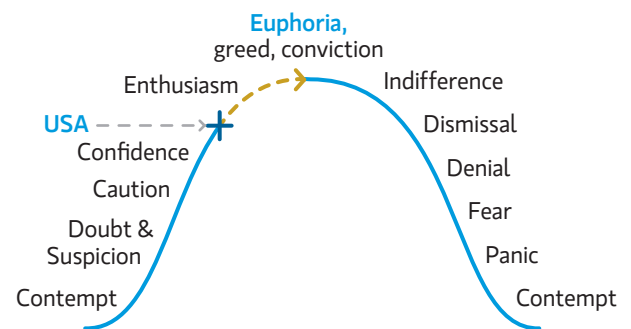
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Investor psychology studies show that euphoria is at the top of an investment cycle, often a prelude to a downturn in the market.

While today's market has risen fairly steadily for the past nine years — a long time by any measure — we still see continued growth before we hit “euphoria” on the investor psychology cycle.

Here are four points to consider in support of our thesis that the recent bull cycle still has room to run.

### The Investor Psychology Cycle



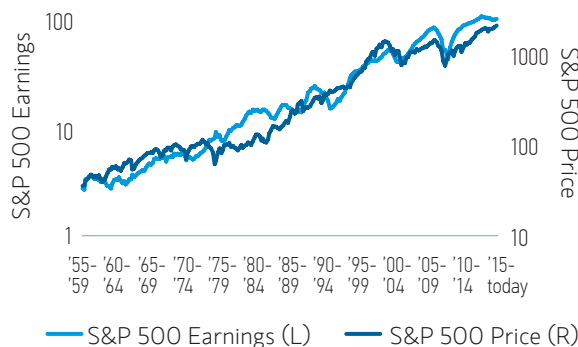
Source: RMB Unit Trusts, Frontier Wealth Management

For illustrative purposes only. This information reflects the views of the portfolio management team. These views may change without notice as circumstances or market conditions change and may not necessarily come to pass.

### 1 Earnings: Follow the earnings, not the headlines

Stock prices are primarily driven by company earnings, not the news of the day. Given the strength of earnings and economic output, we do not see a recession, the precursor to a bear market, in the near future, nor do we believe the market is particularly expensive.

#### Earnings have driven stock prices



Source: Bloomberg as of August 17, 2018

#### U.S. equity P/Es do not appear expensive

Price-to-earnings multiples

	2018	2019
S&P 500 price	2,850	2,850
Consensus estimated EPS	\$162	\$178
<b>P/E multiples</b>	<b>17.6x</b>	<b>16.0x</b>

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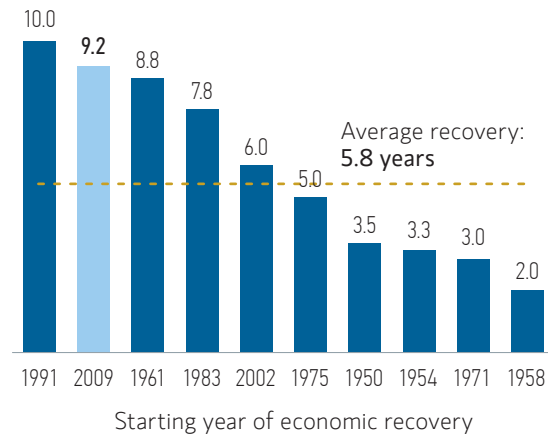
# 2

## Economic cycle: We are not at the end of the economic cycle

The average economic expansion is 5.8 years. Yet since 2009, the economy is in the midst of one of its longest expansions at 9.2 years. While this might suggest that the expansion is near an end, it is important to understand the average 2.3% GDP growth during this expansion is quite low, compared to an average post-recovery GDP of 4.5% since 1950.

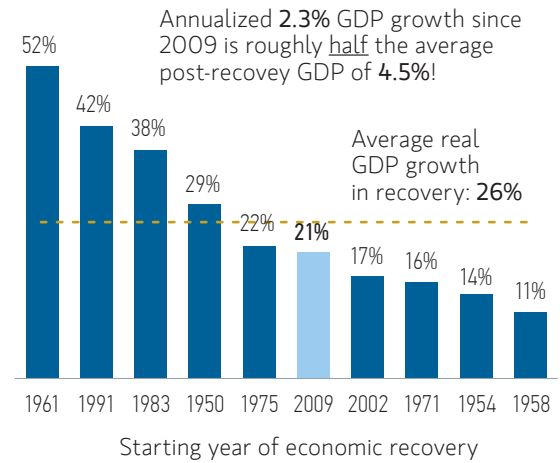
### One of the longest expansions . . .

*Length of US expansion cycle in years*



### . . . yet recovery has been weak

*Real GDP growth in US economic recoveries*



Source: Wall Street Journal, Factset, Morgan Stanley Investment Management, as of June 30, 2018

**Key takeaway:** We believe we need to see GDP accelerate well above its long-term average before we are nearing the end of an economic cycle.

# 3

## Secular bull market cycle

According to Bloomberg/Robert Schiller, the current bull “cycle” actually started in early November of 2016. We believe the chart below indicates that the current bull cycle is in its infancy and has plenty of room to run

### We recently ended a secular bear market cycle . . .

*Bear cycles*

START	END	YEARS	ANNUALIZED S&P 500 TOTAL RETURN
1/19/1906	8/24/1921	15.6	1.97%
9/3/1929	6/13/1949	19.8	1.00%
2/9/1966	8/12/1982	16.5	4.26%
3/23/2000	11/4/2016	16.6	3.88%
<b>Average</b>		<b>17.1</b>	<b>2.78%</b>

### . . . and entered a secular bull market cycle

*Bull cycles*

START	END	YEARS	ANNUALIZED S&P 500 TOTAL RETURN
8/24/1921	9/13/1929	8.0	29.78%
6/13/1949	2/9/1966	16.7	17.21%
8/12/1982	3/23/2000	17.6	20.22%
<b>Average</b>		<b>14.1</b>	<b>22.40%</b>
<b>11/7/2016</b>	<b>Today</b>	<b>1.8</b>	<b>20.18%</b>

Inception of S&P 500 March 4, 1957

Source: Bloomberg / Robert Schiller as of August 21, 2018

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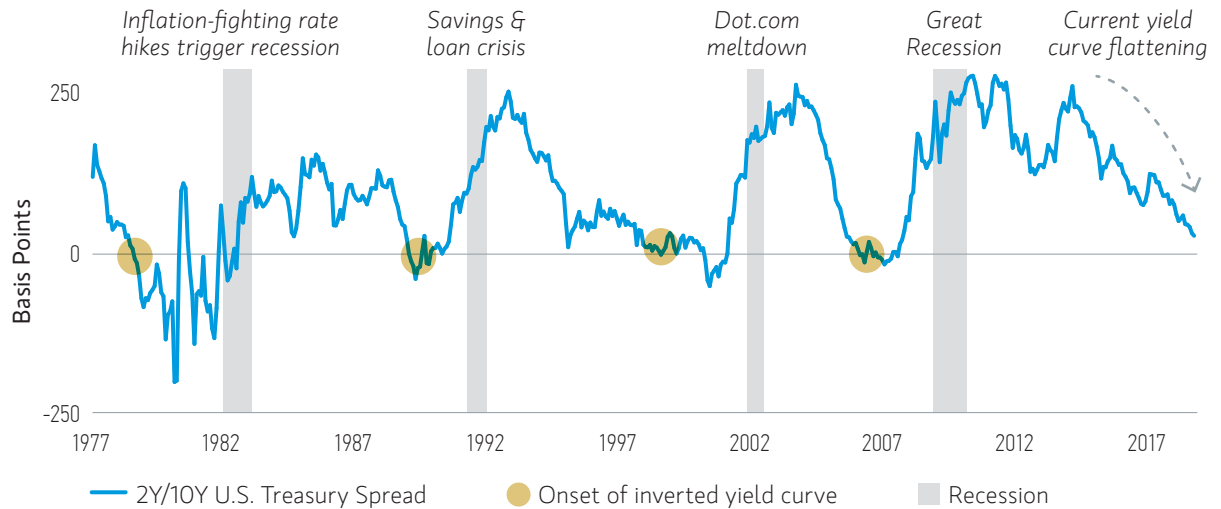
**Key takeaway:** Long-term secular bull cycles have tended to commence around fiscal policy reforms such as tax cuts, which does **not** mean there cannot be cyclical bear markets within secular bull markets.

# 4

## Yield curve: It appears we are heading towards an inverted yield curve

An inverted yield curve, where long-term bond yields are lower than short-term yields, is often a precursor to a recession—but also to a new market peak. Data since 1977 show that the yield curve has inverted four times. On average, after the onset of these inversions, the S&P 500 has gained +40.86% over the course of the next two years (731 days on average).

An inverted yield curve is often the result of rate hikes by the U.S. Federal Reserve (Fed). Since Wall Street currently expects the Fed to hike rate twice more in 2018, and three times in 2019, an inverted yield curve might very well be on the horizon. If that happens, history suggests U.S. stocks could get a second wind.



### Yield curve inversions can lead to new stock market peaks

INITIAL INVERSION	STOCK MARKET PEAK	TIME DIFFERENCE	S&P 500 TOTAL RETURN FROM INVERSIONS TO PEAK <sup>1</sup>
8/17/1978	11/28/1980	834 days	51.57%
12/14/1988	7/16/1990	579 days	41.46%
4/24/1998	9/1/2000	861 days	41.60%
12/27/2005	10/9/2007	651 days	28.80%
		<b>Average:</b>	<b>731 days</b>
			<b>40.86%</b>

<sup>1</sup> Total return

Source: Bloomberg as of July 31, 2018

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### Why we're not there yet

Upward trending market cycles, alternatively expressed as “bubbles” or “irrational exuberance,” end with euphoria. But our contention is that we have yet to enter this euphoric stage. Earnings are strong and the market is not overpriced. The current economic expansion is long, but not necessarily robust. The yield curve appears close to an inversion point, which historically has ultimately led to a significant market rally. Finally, on a longer-term basis, tax cuts have a history of leading to higher equity returns (e.g. secular bull markets).\*

“Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria”

– Sir John Templeton

\* Source: Bloomberg / Robert Schiller as of August 21, 2018. Reflects annualized S&P 500 total returns.

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