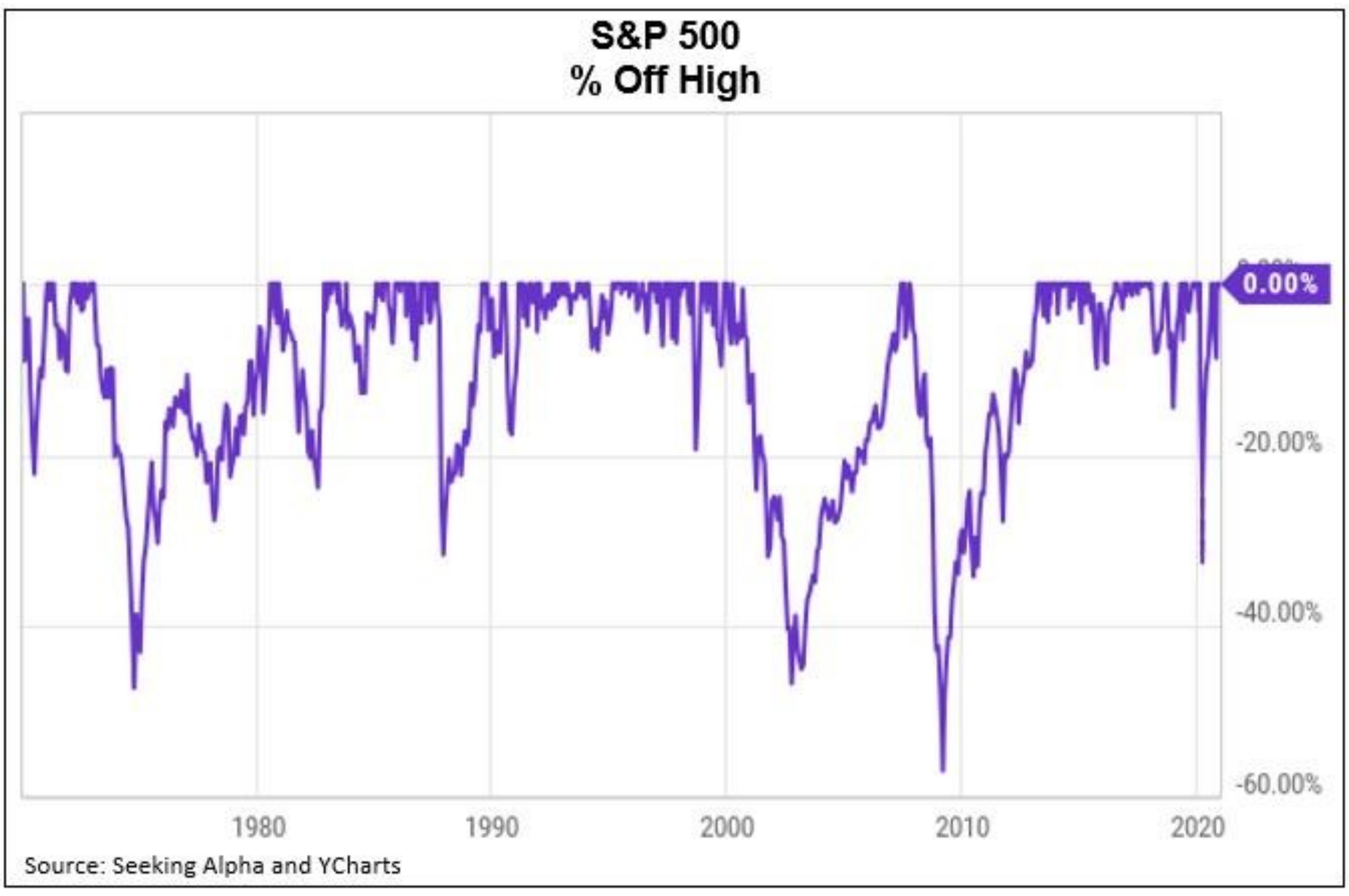
Chart of the Month

January 2021



With the major stock market indexes trading at all-time highs, we are beginning to witness signs of froth not seen since the tech and internet bubble in 2000. While not forecasting an imminent decline, we believe a more cautious approach in the months ahead is the prudent course of action. As a result, we have been paring back some positions and taking profits with the goal of not letting the equity exposure in client portfolios outstrip our desired weightings.

We do not pretend to be market timers but are mindful of the rising risks based on the unchecked animal spirits and influence of a growing horde of speculators. The excesses are showing up in the record number of initial public offerings (IPOs), never-before-seen level of buying “out-of-the-money” call options, the introduction of special-purpose acquisition companies (SPACs), the tenfold increase from the lows to the highs over the past year in the price of cryptocurrencies such as Bitcoin, and the valuation and market caps of stock-market darlings like Tesla.

The above euphoric actions are fostered by an accommodative Federal Reserve monetary policy, next-to-zero interest rates, and government stimulus that have combined to create an economy awash in cash with financial markets the primary beneficiary of this surplus liquidity. It is unlikely to end well if and when conditions change. In the meantime, however, the partygoers can continue the “good life” until the punch bowl is taken away.

As shown in the graph above, over the past 50 years, the S&P 500 has averaged a 10% pullback about once every two years and a nearly 20%-or-more correction every five years. The more substantial drawdowns, as highlighted in red in the table below, have occurred approximately once per decade. Based on the above, we would expect a 10%-15% reversal in the next year or so, especially in view of what appears to be late-stage market behavior.

We continue to invest in high-quality companies exhibiting strong growth in earnings (think Apple, Microsoft, Amazon, Alphabet, and PayPal) and/or dividends (BlackRock, Johnson & Johnson, J.P. Morgan, NextEra Energy, and McDonald’s). Although these stocks are not immune from a market downturn, we are confident that they would bounce back over time (unlike the speculative assets listed above).

S&P 500
Peaks, Troughs, and Percent Loss

Peak Date	Trough Date	Peak Price	Trough Price	Percent Loss	Number of Days**
4/28/1971	11/23/1971	104.77	90.16	-13.9	209
1/11/1973	10/3/1974	120.24	62.28	-48.2	630
11/7/1974	12/6/1974	75.21	65.01	-13.6	29
7/15/1975	9/16/1975	95.61	82.09	-14.1	63
9/21/1976	3/6/1978	107.83	86.90	-19.4	531
9/12/1978	11/14/1978	106.99	92.49	-13.6	63
10/5/1979	11/7/1979	111.27	99.87	-10.2	33
2/13/1980	3/27/1980	118.44	98.22	-17.1	43
11/28/1980	8/12/1982	140.52	102.42	-27.1	622
10/10/1983	7/24/1984	172.65	147.82	-14.4	288
8/25/1987	12/4/1987	336.77	223.92	-33.5	101
1/2/1990	1/30/1990	359.69	322.98	-10.2	28
7/16/1990	10/11/1990	368.95	295.46	-19.9	87
10/7/1997	10/27/1997	983.12	876.99	-10.8	20
7/17/1998	8/31/1998	1186.75	957.28	-19.3	45
7/16/1999	10/15/1999	1418.78	1247.41	-12.1	91
3/24/2000	10/9/2002	1527.46	776.76	-49.1	929
11/27/2002	3/11/2003	938.87	800.73	-14.7	104
10/9/2007	3/9/2009	1565.15	676.53	-56.8	517
4/23/2010	7/2/2010	1217.28	1022.58	-16.0	70
4/29/2011	10/3/2011	1363.61	1099.23	-19.4	157
5/21/2015	8/25/2015	2130.82	1867.61	-12.4	96
11/3/2015	2/11/2016	2109.79	1829.08	-13.3	100
1/26/2018	2/8/2018	2872.87	2581.00	-10.2	13
9/20/2018	12/24/2018	2930.75	2351.10	-19.8	95
2/19/2020	3/23/2020	3386.15	2237.40	-33.9	33

* Corrections are declines of 10% or more. Bear markets are declines of 20% or more (highlighted in red).

** Number of days includes weekends and holidays.

Source: Standard & Poor's Corporation and Haver Analytics.

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