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OBSERVATIONS ON THE MARKET

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Price, by itself, really means nothing. There must be something that connects a price to some perception of value. The S&P 500, which is the most common measure for the market, hit a new high on Friday. Since the market is up over 400% from its low of 666 in 2009, it is only natural to start wondering if now is the time to take some chips of the table? Add to that the economy is now in its ninth year of expansion, it at least makes you pause and ask, how long can this go on?

Earnings for the S&P 500 are expected to be $158 this year. If those earnings are realized, we are about at the level of what the market has traded at for the last 20 years. We are not going to debate here whether the economy is on the verge of a recession are not. Nobody knows, and recessions almost always appear from a catalyst that nobody really saw coming until after the fact. There has been some speculation that since short-term interest rates are about to move above longer-term rates (a phenomenon referred to as an inverted yield curve), in the past it has been a strong predictor of market declines and recessions. However, the influence of global central bank bond purchases which have created a yield curve that is anything but normal, may change the interpretation, and leave us with a different meaning this time, at least temporary.

In January of 2000, Microsoft's stock hit $60 and earnings for the year were about $.80. Today Microsoft's stock is at $108. Given that information, should you sell it? Well, if you waited 16 years for the stock price to recover to $60 after a decline of 70%, and your sole goal was to break even, you sold your stock last year. If you had an eye towards value, you haven't, because next year Microsoft Is expected to earn $4.90, and they are beating expectations almost every quarter. In 2000, the price was ridiculously overpriced, sort of like Amazon is now (but I digress). Today, while not cheap, the company has a stock price that has doubled from 2000, however, earnings are up six times. Given the two choices it sure seems the price today has a lot more value attached to it. Of course, we don't know the future for Microsoft, but we also don't know the future of anything.

Household net worth hit $100 trillion this year according to the Federal Reserve. This number is 50% higher than it was in 2008. In 2008 all the predictions were that it would take decades to recover, but it took one to double. Good news seems to just get buried in all the bad news. For every good economic number there is also a bad number, and even a few scary ones. There is always something scary if you are looking for it. The stock market is sometimes referred to as a casino. What most people don't realize is that as an investor, you are the house. Just like the house, the economy is going to hit a losing streak at some point. Good management is how casinos stay in business. A growing economy and cash flow will make investors successful over time. Trying to time a $20 trillion economy is futile. You will eventually be right, recessions always come, but will it be 10, 20 or 30% higher then the market is now, and you will reach a point where you can never buy back at the price you sold.

If you sold the S&P 500 in January 2000, it was at 1400. It took the market seven years to recover. It took Microsoft 16 years to recover. Johnson & Johnson recovered from its January 2000 high in just 1.5 years. This does not mean that having some liquidity for opportunities is not prudent, just don't make all or none bets. Price by itself is meaningless, but price and value together may mean the difference between 16 years and less than two.