Stirling Bridge
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MARKET COMMENTARY – NOVEMBER 1, 2017

Let them leave you up in the air.
Let them brush your rock and roll hair.
Let the good times roll. ~ The Cars, 1978

The new wave rock music of The Cars, for us, your friendly writers, has been an acquired taste. By the time we were aware of musical trends many of their chart-topping songs – such as *My Best Friend's Girl*, *Just What I Needed*, and *Let's Go* – were already staples of popular radio. But it was only after many years of repetition that we finally began to appreciate their ditties as simple elegance. We now even have a favorite, called *Drive*. Give its haunting, synthesized chords a listen if you are unfamiliar or would like to reminisce.

But none of those songs is a part of today's discussion. *Good Times Roll* was not the band's highest chart topper, peaking only at number forty-one. But in light of the rather terrific stock returns for the past twelve months, we are reminded, not of its staccato guitar riff, but of its lyrics. By the end of the song, with phrases like, *Let the good times roll, let them knock you around* or *Let the good times roll, let them make you a clown*. We're left wondering. Are the times the songwriter refers to actually that good? Similarly, in today's market, fundamentals are good. But are they good enough to justify Dow 24,000 or S&P 2,600?

Yes. Or, rather, yes, *but…*

Earnings are among the most important fundamental metrics that underpin the setting of prices in markets. With the third quarter earnings season mostly complete we can parse the numbers to divine trends and their sustainability. So far about 77% of U.S. companies have beaten earnings expectations. In order to put up these impressive numbers they've grown revenues, or their top lines, by 6%, a strong showing. Their bottom lines have increased 7%, very solid, surprisingly robust for this late in the recovery cycle. Profit margins remain near all-time highs. Even the most circumspect bear must admit that these are great fundamentals.

And while we're piling on the good news, inflation is subdued, with prices rising less than 2% for U.S. consumers since last year. Global Central Banks are pursuing somewhat coordinated courses to normalize, in a predictable manner, their policies to end the elaborate fixes that occurred during the Great Recession. Japan voted to continue its reforms known as *Abenomics*. Americans may get a tax cut. Energy companies have right-sized their operations and are profitable again even with low oil prices.

So, apart from an unexpected geopolitical event, there is nothing on the immediate horizon that should abruptly cause prices to reverse course and plummet. But there are important factors to consider that ought to temper our enthusiasm for ever-higher prices.

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Fear, or volatility, continues to bounce around all-time lows. As measured by the Volatility Index (VIX), the market seems to shrug off any hint of bad news that may have worried it at other times. It is worth noting that periods of a low VIX are often followed by periods of higher volatility when complacency is expunged from the market. In a similar vein, the sometimes contrarian indicator of newsletter writer optimism is at the highest reading since 1987. Is it possible we are entering a period of excessive happiness?

To paraphrase John Templeton, this bull market was born on pessimism, grown on skepticism, and has matured on optimism. He might wonder if we have entered the phase where he said bull markets die on euphoria.

Also, valuations are high by historic standards. The S&P 500 stands at nearly 22 times trailing earnings. The PE falls to 18.3 when looking to the earnings expected for this time next year. But earnings must grow 18% from today in order for the PE to fall to such *cheap* levels. And that is to assume the S&P 500 does not move an inch in either direction from here – something that rarely happens over a twelve month span.

To summarize, the market fundamentals are truly admirable. *They're great*, as Tony the Tiger might say. But they must stay great and get even greater to justify today's prices. Without any negative catalyst or shock, there is no reason to think they will take an immediate leg down, but it is the prudent thing to do for thinking investors to pay close attention to the risks they are taking. It might make sense to take profits in particularly heated portions of the market and reallocate those resources elsewhere or even pay down debt to the extent one has such a burden. Remember the old business adage, *pigs get fat, hogs get slaughtered*.

And once you and your advisor have reviewed and properly allocated your holdings you can more fully enjoy yourself as you follow the advice of more of Ric Ocasek's spirited lyrics. *If the illusion is real, let them give you a ride. If they got thunder appeal, let them be on your side. Let them leave you up in the air. Let them brush your rock and roll hair. Let the good times roll.*

Stirling Bridge Wealth Partners, LLC remains committed to providing customized investment solutions and robust financial planning wrapped in an exceptional service package for our high net worth clients throughout the country. We thank each of you for your dedication to us, for your trust, and for the referrals you've sent our way.

Sincerely

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