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MARKET MATTERS: What's next for the stock market?

Joseph Matthews

What now?

Here we are — the market is at new highs and no one can believe it. Mr. Market made us wait 417 days for the Standard & Poor's 500 stock index to make a new high on July 11. That's the 13th-longest stretch in the history of that index. And, in between those highs, there was a 1,000-point drop in the Dow Jones Industrial Average last August and the worst start to a year ever in January. So what should investors do now?

Well, history shows the market generally does well after extended periods of flat performance, keeping in mind, of course, that past performance is no guarantee of future results. The average rate of return was 3.39 percent within three months of those 13 instances when it took the S&P 500 index at least 417 days to achieve a new high. The return was 6.38 percent after six months.

Prior market action suggests that holding stocks longer can be even more profitable. Take a look at the 28 times since 1900 that the S&P 500 took two years or longer to make a new high. The index was up 25 out of the 28 times within 12 months of hitting the high and with an average return of 16 percent. With everything going on in the world, why would anyone believe history can repeat itself? I might not. Nevertheless, although we believe we are in the latter stages of this business cycle — analogous to the seventh inning of a nine-inning baseball game, some analysts are pointing to several positive signs that lead us to believe equity investors could be in store for attractive returns over the next several quarters.

One important factor suggesting stocks may move higher is the apparent trough in corporate earnings growth during the fourth quarter of last year and first and second quarters of this year.

With “old” economy sectors — industrials, energy and materials — exiting the depression they were in last year, along with a stabilized U.S. dollar creating a more positive backdrop for international trade, we’ve seen earnings expectations for companies collectively revised upward by more than 20 percent. Should these revisions materialize into significantly better earnings than investors expected coming into this year, many concerns expressed by those investors — such as valuation and the business cycle coming to an end — may be put to rest. And with those concerns being addressed, we should see the current high level of negative sentiment shift to a more positive outlook.

A glaring example of this lack of bullishness continues to be recorded by an American Association of Individual Investors’ (AAII) sponsored poll. The results of the poll show that an above average number of investors have been negative or neutral for 71 of the last 73 weeks. Nevertheless, a recent Morgan Stanley poll of high net worth investors shows that 72 percent of those surveyed expect the overall investment climate will be the same or improve over the next 12 months.

With more than $11 trillion in the U.S. still sitting in money market funds, CDs and similar “sidelines” accounts, a moderate change in overall investor sentiment could be a catalyst for higher stock prices as more investors may increase their allocation to stocks.

As with all types of investment decisions, it is prudent to consider how any changes to your portfolio will impact the overall balance between the expected return and the risk associated with that mix of assets. Ideally, your portfolio should be optimized at all times — a situation where your portfolio has the best expected range of performance outcomes for the return you’re trying to achieve. If adding U.S. equities to your portfolio will keep it aligned with your risk tolerance and time horizon, now may be a good time to consider it.

The Investor Pulse Poll surveyed 752 high net worth investors during the spring of 2016. High net worth investors account for 95 percent of total U.S. household investable assets by value, according to Federal Reserve data. The Investor Pulse Poll was conducted by GfK Public Affairs & Corporate Communications using the GfK KnowledgePanel. In order to qualify for this study, respondents were required to have $100,000 or more in household liquid investable assets, be between the ages of 25 and 75 years old.

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