<u>The Outlook: Dec. 14, 2016</u>

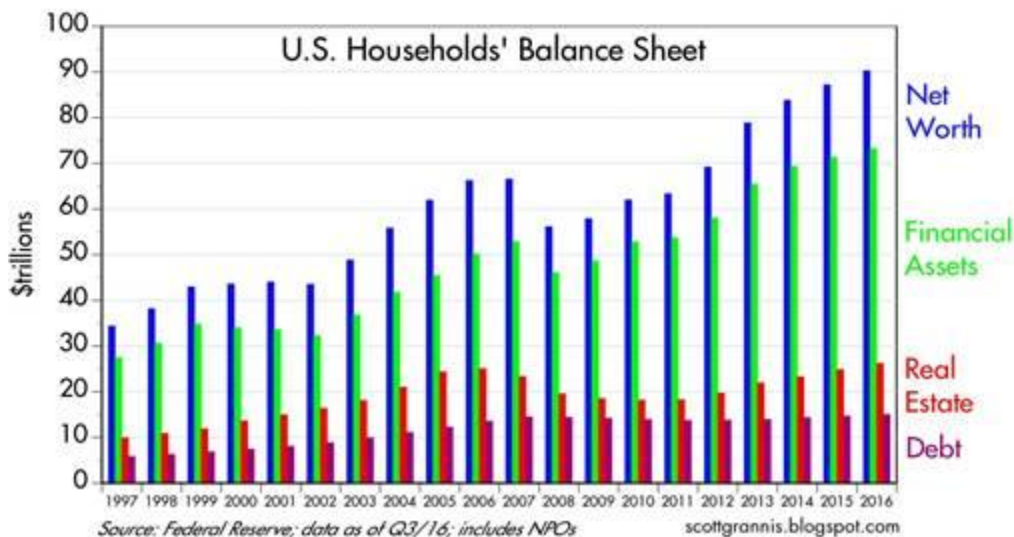
Stock market up? How we got here.

One of the most enjoyable things about a career watching the stock market is its constant ability to do the unexpected. ("Enjoyable," of course, also means "nerve-wracking," "puzzling," and "astounding" among other adjectives.) Sometimes the market's "unexpected" behavior is plain silly. Sometimes it turns out be sensible and far-sighted. Why can't it settle down and be only one thing? Because, of course, the market is not a profound mystery, but a vast collection of human beings sometimes being silly all together, and sometimes sensible.

The two recent examples of "unexpected" behavior are the "Trump rally," and the oil rally.

Countless experts write and talk about the markets every week, so we mustn't say that "nobody" foresaw those rallies. But those who did are mighty thin on the ground, and they're swamped by the overwhelming crowds of those who did not. Notable this week, among that big crowd, are the number of experts saying "Oops!" while officially shifting their positions from bearish to bullish, on the market and oil. Having the discipline and courage to do such about-faces is how short-term forecasters make a career out of forecasting, rather than just one rocket ride up when they happen to get it right, followed by a dive off the cliff when they inevitably get it wrong.

We aren't in the short-term forecasting business at Outlook, but we stayed firmly bullish on stocks and energy before the election and the November OPEC meeting, despite having no real clue how those markets would behave. Why? Here are just a few reasons, and naturally they have to do with deep changes and trends rather than last week's variety.



U.S. Households' Leverage
Household Liabilities, % of Total Assets
25%
20%
15%
10%
5%
0%
Source: Federal Reserve; as of Q3/16
Includes NPOs
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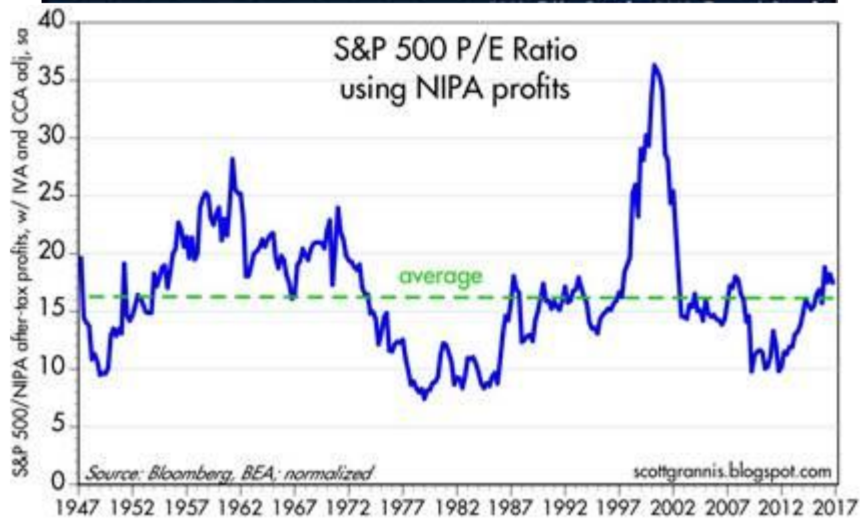
1952 1957 1962 1967 1972 1977 1982 1987 1992 1997 2002 2007 2012 2017

CPBICPAT 1589.80 As Of 09/30/16 Billion
US Corp Profits With IVA and CCA Domest... Bureau of Economic Analysis
CPBICPAT Index
Line Chart


S&P 500 P/E Ratio
using NIPA profits
S&P 500/NIPA after-tax profits, w/ IVA and CCA adj, sa
40
35
30
25
20
15
10
5
0
average
Source: Bloomberg, BEA; normalized
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1947 1952 1957 1962 1967 1972 1977 1982 1987 1992 1997 2002 2007 2012 2017

Notice that all 4 of these charts are 20-to-70 year charts . . . not 6 weeks to 12 months. They mean this:

- U.S. households' financial strength has improved astoundingly since the Calamity of 2008 – 2009.
- U.S. households' debt position has improved astoundingly since the Calamity. It's down to where it was in 1990.
- U.S. corporate profits have tripled since 2000. If that doesn't deserve the term "astonishing," nothing does; especially when we remember that 2000 was the peak (and end) of the famous "Tech bubble."
- The stock market's valuation of those profits is near its 70-year average. That valuation is way up from the "end of the world" days of the Calamity, but way below anything we can call historically "silly" or "expensive."

As Outlook has noted rather often, all this happened because determined people behaved normally during and after the terrible crisis of the Calamity. Company leaders strengthened their firms, so they could not be killed by any repeat of the Calamity. Individual consumers strengthened their finances, for the same reason. People do that kind of thing when they're in trouble. The more frightening the trouble, the faster and more effectively they act.

The talk this week has been of "Dow 20,000," as if that's some kind of magical level which carries deep meaning: either bad or good. It does not. What carries meaning is how we got here, much of which is captured by those 4 charts. Anxious and fearful markets are always forced to recognize reality eventually—as are exuberant and silly markets. But today, as we near the end of 2016, economic and business reality is not something dangerous and fearful. It's something remarkably solid, and pretty impressive when we look back at "how it got here."

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