Jeffrey D. Saut, Chief Investment Strategist, (727) 567-2644, Jeffrey.Saut@RaymondJames.com **December 18, 2017**

Investment Strategy: A History Lesson

"The bull market needs a pediatrician, not a mortician."

. . . Doug Ramsey, The Leuthold Group (12-14-17)

In 1981, The Leuthold Group was founded by the sagacious Steve Leuthold. It is an independent stock/economic research firm that produces disciplined, quantitative financial and contrarian financial research for investors. The research team is led by CIO Doug Ramsey, who is one of Wall Street's best and brightest. Recently, however, Jim Paulsen left Wells Capital after 20 years to join the eagle-eyed Leuthold Group. We have read Jim's prose for years and have always found it to offer some of the best investment insights around. In fact, in recent history, Jim and I were on CNBC together advocating similar investment strategies, but I digress.

Last week, we read an article on CNBC's web site with the title, "Strategist Doug Ramsey: The bull market needs a pediatrician, not a mortician," which is a fabulous quote! The byline read, "Leuthold Group's Doug Ramsey says the bull market is getting older, but that doesn't mean it doesn't have room to run." Doug goes on to say:

> One of the longest bull markets in history showing little sign of slowing down. . . . It is now the longest cyclical bull market on record. We're closing in on potentially a ninth birthday next March. It's now the second-most expensive market of all time: We're still, on most measures, not all, but on most measures we're still well below the highs that we made in March of 2000.

We agree, but we take issue with the statement "One of the longest bull markets in history," as well with the statement, "It's now the second-most expensive market of all time," a point we have argued against in these missives for years. Ladies and gentlemen, secular bull markets last 15+ years and tend to compound at around 16% per year. For example, the 1949-1966 secular bull market lasted 17 years and took the D-J Industrial Average from its June 1949 low of ~161 to the bull market high of ~995 in February 1966. Were there pullbacks? You bet. The President Kennedy steel crisis of 1962 lopped 26% off of the Dow in about three months, but the bull market persisted. From the 1966 peak, the Industrials were range-bound for 16 years (until 1982). Now, if your definition of bull and bear markets is a 20% rally, or a 20% decline, in that 16-year rangy stock market there were 13 tactical bull and bear markets. However, that is NOT our definition of a secular bull market.

In 1982, the Dow broke out of that 16-year range-bound market and commenced the 1982-2000 secular bull market. Hereto, there were pullbacks, the biggest being the 1987 Crash, but that did not end the secular bull market. In fact, most of the indices were marginally higher in 1987, and the secular bull market extended for another 13 years. In the spring of 2000, the 1982-2000 secular bull market ended and the senior index was again range-bound for 13 years, until April of 2013. The problem many pundits have is they cut off the 1949-1966 secular bull market in 1956 when Egypt tried to take over the Suez Canal and the Industrials lost some 26%, but that did not stop the secular bull market. Again, said gurus cut off the 1982-2000 secular bull in 1987 because of the Crash, yet that too did not end the bull market!

We revisit what a secular bull market is this morning because there is so much misinformation bouncing around the Street of Dreams causing consternations for many investors. We are reminded of the venerable Mr. Partridge, aka "old turkey", in the legendary book *Reminiscence of a Stock Operator*, where old turkey reminds us "It's a bull market you know;" and that's all you really need to know! Indeed, in a bull market, most of the surprises come on the upside. Also worth mention is that secular bull markets have "three legs." We think the first leg began on October 10, 2008, when 92.6% of all stock traded on the NYSE made new annual lows, and ended in May 2015. From there, the Dow went into an upside consolidation for almost a year as the negative nabobs screamed that we were building a giant top that was going to be followed by a stock market crash. The "second leg" began in February of 2016 when Royal Bank of Scotland told us to sell everything except high-quality bonds. The second leg is always the longest and strongest and is driven by the accommodative Fed monetary policy that drove the first leg. However, in the second leg, the economy starts to improve and earnings tend to come in stronger than expected. When the second leg ends is unknowable, but when it does there will be another upside consolidation followed by another upside breakout leading to the third, or speculative, leg of the secular bull market. In the 1982-2000 affair, the third leg began in early 1995 and lasted until the spring of 2000.

Interestingly, off of the December 1974 low (577.60), the senior index tacked on about 52% into the July 1975 trading top. Off of the generational low in August 1982, the Dow was up some 60% into its near-term top in June 1983. From the March 2009 low into

January 2010 short-term trading top, the Dow rose some 64%. So why is everyone freaked out that since the second leg of the secular bull market commenced in February 2016 the Dow has gained ~54% as of last Friday? We do find it interesting, however, that the 1974, 1982, and 2009 lows were MAJOR stock market lows, while the February 2016 was not, but that is a discussion for another time.

The point of today's diatribe is that there is an old stock market "saw" that goes: "A person will experience three bull markets in their lifetime. In the first one you do not have enough money to do much with it. In the third one you are too old to take the risk of investing in stocks. So, you had better use the second bull market to accumulate wealth."

For the investor born in 1929, at the start of the 1949-1966 bull market, they would not have had much money to take advantage of that secular bull market. In the current 2009 - ? bull market, our investor would be 80+ years old and consequently probably unwilling to be very aggressive with stocks. Indeed, our hypothetical investor would have had to take full advantage of the 1982-2000 secular bull market for wealth accumulation (Chart 1 on page 3). Accordingly, an investor born in 1965 would not have had much money to play the 1982-2000 bull market. But, at the 2009 generational stock market bottom, that investor would have been 44 years old and, therefore, should have the means to aggressively invest in the current secular bull market, which would be the second one of their lifetime. We urge investors to invest accordingly.

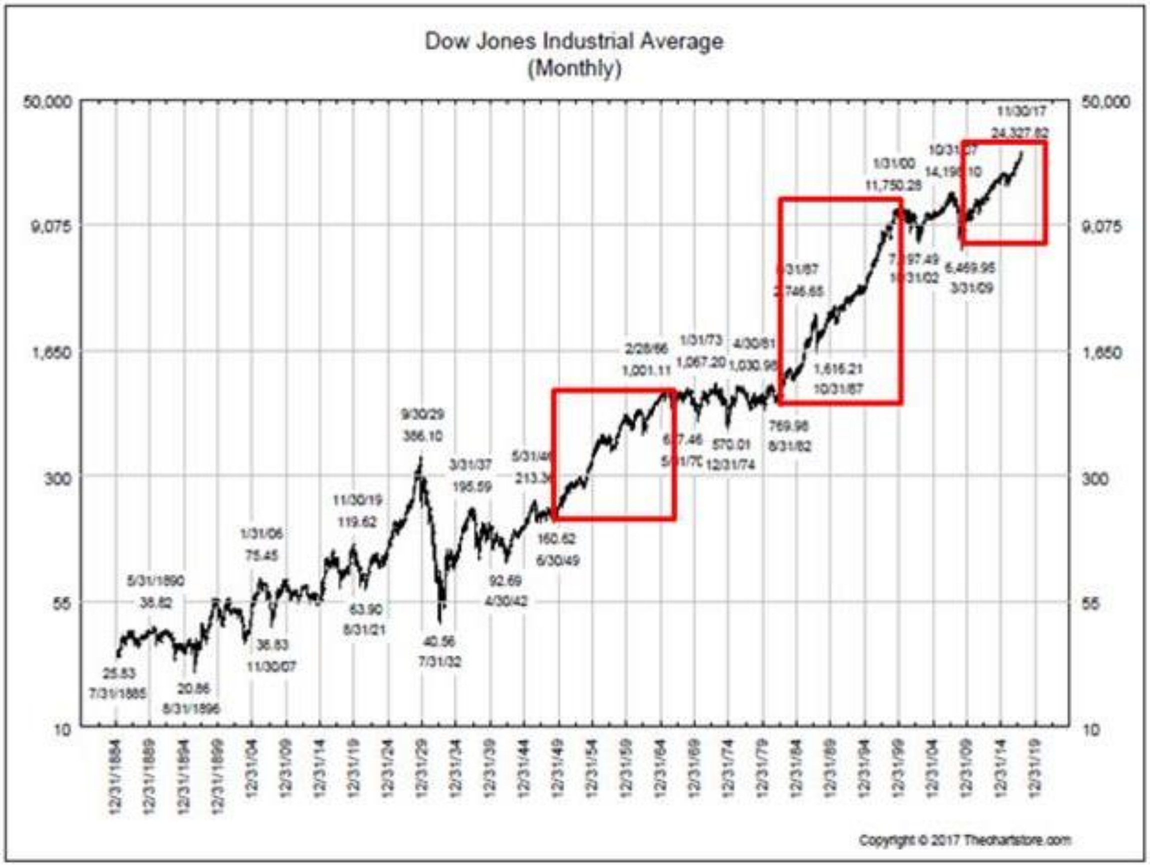
The call for this week: For a long time, we have suggested that the world economies were going into a synchronized economic recovery. Accordingly, it was no surprise when, over the weekend, SentimenTraders' Jason Goepfert wrote:

> Every major Economic Surprise Index across the world is now positive (Chart 2 on page 3). From the U.S. to China, Europe to Emerging Markets, all regions have had economic reports that have exceeded economists' expectation. When we've had such coordinated economic goodies in the past, defensive sectors did the best going forward. The dollar and commodities suffered, the yield curve declined, and emerging markets did the best of all.

Last week, the Technology sector was the strongest and made a new all-time high. If the tax bill "flies," the sectors that should benefit the most are: Financials, Retailers, Telecom, Transports, and small-cap stocks. Indeed, the small-cap Russell 2000 saw a big lift on Friday as it bounced off of its 50-day moving average. Copper's recent rally is also suggestive of world-wide economic strength.

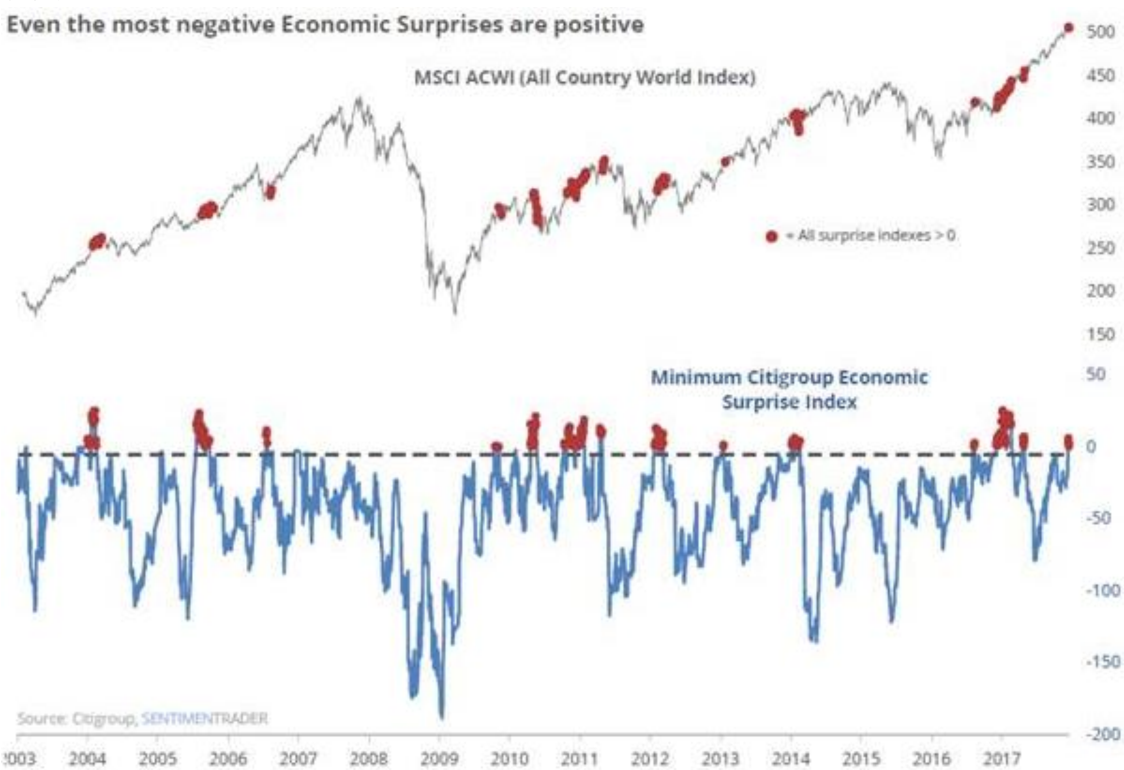
Remember, "A person will experience three bull markets in their lifetime. In the first one you do not have enough money to do much with it. In the third one you are too old to take the risk of investing in stocks. So, you had better use the second bull market to accumulate wealth (like this one)." This morning, the S&P 500 preopening futures are up some nine points on the assumption the GOP tax bill is going to pass and participants also play for the Santa rally.

Chart 1



Source: The ChartStore

Chart 2



Source: SentimenTrader

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