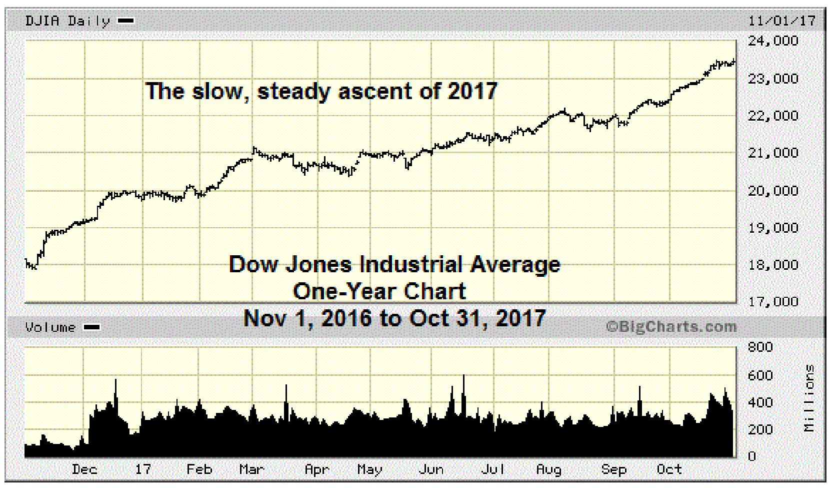
American Heritage Financial

November Update **November 1, 2017**

The Big Story of 2017

Is there something new in the air this year? Was a massive cloud of Novocain released? Or, maybe we were lulled by the amazing weather (of course that mostly applies to Ohio and surrounding areas). More likely, we are still numb after 2016. (Remember, long ago, when the stock market plummeted in panic [January-February 2016], oil buckled to $27 a barrel, China appeared near collapse, U.S. growth slowed to a crawl—and all that was ***before*** the most bewildering election ever.) Whatever has caused it… 2017, thus far, has been a year of ***muted*** *reactions to astounding news.*



The news we are referring to includes political, social, weather, economic and, of course, market news: everything from numerous horrific natural disasters, North Korean rockets, global cyber-attacks, data-hacks, deadly assaults by maniacs or terrorists and an incomprehensible flow of stories and Tweets from our Capital. Oh, there has been "good news" too: record low unemployment, huge advances in cancer therapies, a global economic expansion, a total solar eclipse, did I mention good Ohio weather(?), and—to our subject, ***the stock market has been amazing!***

The stock market has delivered a long string of new highs throughout 2017 and the endless bull market is way overdue for a "correction"—all of which you have heard many times lately. *The amazing thing is the total disregard the market has shown for the dramatic headlines of 2017.* Any number of the "bad" news stories alluded to above could have sent the stock market reeling. Instead, the market has not only continued its ascent (the Dow is up 18%, the S&P 15%, year-to-date through October) but it has maintained a level of volatility rarely seen and probably underappreciated by most of the investing public. **The big story of 2017, thus far, is this amazingly low volatility**—especially in the face of unsettling news.

According to Dorsey Wright Associates, the S&P 500 Index has achieved the year's advance with the lowest "path of 'ups and downs' as has been seen in over 40 years." There was a string of 58 days that the benchmark index went without a move more than 1% above or below its previous closing price—one of the longest such streaks on record. And, it has been 249 trading days (since 11/7/16) since the index moved 2% in a single session. (The longest streak on record without a 2% move was 680 days, from Late 2003 through June 2006.) Said another way, 96% of all trading sessions have settled with less than 1% moves this year, while the historic average of such sessions is just 76%, according to Dorsey Wright. While 2017 is not yet over, we've not seen a full year with such a high percentage of low volatility days in 45 years (1972)!

There are two interesting aspects of this low volatility. One, as we pointed out, it shows how the market refuses to react (or over-react) to on-going scary events. The second is somewhat opposite: many investors are ***"feeling" volatility where none exists*** and that is probably due to the constant barrage of bewildering events and vitriolic news. They are feeling the negative psychological reaction that is natural when one is constantly fed negative news. So, while "big scary things" may continue to dominate your daily news, keep in mind that, so far in 2017, those frightening stories have not been recognized within the behavior of the stock market.

Of the above discussion is all history. What will the rest of the year, and beyond, bring? Liz Sondles of Fidelity points out that gains typically accelerate in the final innings of a bull market as investors become more confident and push more money into equities. Recall John Templeton's famous quote, "Bull markets are born on pessimism, grown on skepticism, mature on optimism and die on euphoria." This bull market has fed off skepticism for much of its duration and is only recently beginning to display optimism. It is not yet at the euphoric stage.

Something the stock market needed to extend its gains was good earnings and, so far, the third quarter earnings season is delivering. With 62% of S&P 500 companies reporting as of October, overall earning have been encouraging. Of companies reported, 78% out-performed expectations and the average earnings "beat" is 4.4%, according to Wells Fargo Securities.

Earnings season has produced a bit more volatility among the winners and losers. On the winning side, big technology companies have lit up the board with very strong numbers. The last Friday in October saw blow-out numbers from Amazon, Intel, Microsoft and Alphabet (Google). The four companies beat sales estimates by a combined **$3.6 BILLION** (half credited to Amazon) and the increase in market value for the four that day totaled **$146 BILLION**; essentially adding more market value than all of IBM, which carries a market cap of $143 billion, according to the Wall Street Journal. On the other side of the spectrum, biotech and pharmaceutical stocks, darlings of the market up until the past few weeks, have been hit with a wave of disappointing earnings, poor results from drugs in development and a general failure to meet very high expectations. The stocks have paid the toll with the ARCA Pharmaceutical Index down 4.6% from its October 19th peak and respected names like Merck and Celgene plunging 13% and 25%, respectively, in that time frame.

Extending the good news related to earnings, global economic growth continues to be the highlight of the year and earnings and stock prices are seeing positive effects from Europe to Japan and, most importantly, China. Foreign markets returns are helping boost investment results while they diversify portfolios and offer an alternative to those who are concerned about the run in U.S. markets.

On the *"good news is bad news"* front, the economy continues very strong and strains of over-heating are beginning to surface in manufacturing, consumer confidence, employment and select commodity prices—even oil has shown life of late, trading above $50 per barrel for most of the past six weeks. Should the recent spurt in economic growth continue, we are sure to see higher inflation and higher interest rates—two things which definitely could weigh on stock prices. For now, we will try to filter all the good news, bad news, fake news and just plain stupid news out and, instead, focus on what the economy and markets tell us about the best way to continue to position portfolios for solid long-term results.

Best regards,

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Questions or comments?
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