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Buckle up

And so, the most obvious question is, *"has the recovery finally to come to an end?"*

It's not surprising that, even after having achieved overwhelming portfolio success and personal wealth, many still feel as if they are not yet secure enough to take a deep breath, relax, and enjoy the windfall they have achieved from investing during the last decade. This, despite the fact that they were fortunate enough to have lived during the nation's most expansive and longest-lasting economic boom in the last century.

Strangely, the longer the expansion lasts, the more people become convinced that the end is near, and a recession is inevitable.

What are the reasons for such pessimism? It could be that the memories of previous "generation-specific" collapses...like the dot.com folly of 1999 or the Great Recession of 2008.....are piercingly imprinted on the brain.

But while the expansion might be in its later stages, there are critical factors which make its potential fall dissimilar from other economic dislocations. I do not dispute that the recovery is getting extended nor that the "right side of the parabolic curve" is an inevitable outcome. But we believe that the severity of a capitulation could be significantly less earth-shattering than many are expecting.

When citing current financial integers as justification for a market collapse, experts point to unimpressive earnings projections, yield curve inversion, political tensions and the breadth of wage inequality. Indeed, stock prices have multiplied too quickly to maintain, and price-to - earnings (P/E) ratios are vastly bloated. These data, alone, stoke the fears of financial ruin and foretell, for those who subscribe to the notion that good times are likely to end.

We know that all cycles ebb and flow to a specific pulse. That is the basic tenet of quantitative methodology. Peaks precede valleys, and valleys inevitably lead to upswings. But when the next downturn occurs....and it will occur...does it mean the end of the party, or just a temporary and necessary lull before the next cycle commences?

Markets

There is a school of thought that believes that *the bigger the upswing, the bigger the downward response*. However, history has shown us that while nadirs and zeniths interchange, they are not necessarily of co-equal duration or magnitude. In fact, the historical diagonal of the financial markets always seems to lean from a bottom left to top right axis of ascent that never varies. In other words, *reversion to the mean* is not such a bad thing for those who invest and are looking to take advantage of buying opportunities for the purpose of realigning and rebalancing risk.

In particular, while we have already acknowledged that this bull market is long in duration, its breadth of participation is actually quite shallow. Ask your neighbors if they feel secure or "wealthy" and a majority might tell you "not completely." Real income growth, while improving, is not happening for everyone nor certainly at a pace at which everyone has benefitted. Concurrently, retail spending and consumer confidence are only moderately emergent.

These measurements, and others, *do* matter because they operate not in a vacuum, but in the real lives of everyday citizens. The onslaught of ubiquitous news and information technology rewards everyone with the kind of stimulus...both positive and negative....that keeps nerves constantly in a state of flux. Consider that in the last 20 years the proliferation of technology has changed the internal dynamics of recessions and bull markets from *something you read about in yesterday's newspaper* to *something the pundits...and your neighbors and friends....are predicting will happen tomorrow!!*

We know also that if a recession were to occur today that it does not have the constituent elements of a dot.com internet bubble nor the excesses and greed that lead to a housing/credit crunch. Let us remind ourselves that all market reversals are preceded by a bull expansion. We stated that above. And while earnings are weakening in the face of tariff wars, geopolitical turmoil, and uncertainty about the future, the doubters today are living in a vastly different world than the one we inhabited 10 or 20 years ago. A build-up of risky imbalances does not persuasively change the dynamics of the recovery or the future of investment potential going forward. With the exception of political uncertainty, external shocks have already been baked into the market's equation. We will not be as easily caught off guard or unprepared for market disturbances as we might have been a generation ago.

The likelihood of an unexpected bubble bursting is quite low because there are fewer unknowns in this age of continuous information.

We should also acknowledge that simply because the current recovery has lasted nearly a decade that it should mean a capitulation will also last equally as long. While it is understandable that pent-up fears about the market's progress are deeply held, some of those fears reflect more about our memories of recessions in the past than indications are about the future.

In truth, the structural imbalances that led to past collapses are not indicated by the data we have today. The housing market is robust, albeit contained, and certainly not in a bubble fueled by excess and illegal lending practices. The technology boom is no longer in its infancy as examples abound about how its influences permeate throughout the globe. We welcome, too, the current discussion about self-regulation and governance amongst all new technology and information providers. Finally, inflation is not the worry that it once was thought to be, which incentivizes global central banks to re-think their strategy about tightening the money supply or limiting spending.

Conclusion

In no way does our enthusiasm expressed in the previous paragraph diminish potential warning signs about the road ahead. In fact, we have been actively rebalancing our client's portfolios in the last few months to lock in existing profits and to take the measure of alternative strategies that are available. The level of global debt incurred during the recovery is a potential impediment that deserves our attention. Hopefully, debt levels and leveraging will be uppermost on the minds of our political leaders as they shape tax and fiscal policies for the decades ahead.

Accepting that cycles are a part of the investment/economic paradigm is the first step in mitigating worries that precipitate knee-jerk behavior or unsavory thoughts. One cannot become paralyzed from acting upon the myriad number of real social and moral investment opportunities that are yet to be fulfilled in areas such as healthcare, energy, agriculture, infrastructure, and technology.

Buckle up, enjoy the ride, and get ready for what comes.

Suggested balanced account asset allocation, Q3, 2019
Equity: 34%
Fixed Income: 41%
Cash: 25%

Arlington Econometrics is a quantitative market tool. Utilizing proprietary algorithmic equations, AE offers solutions for market-timing, asset allocation, and macro economic analysis. Using historical time-series measurements, Arlington Econometrics optimizes the analytical process and forecasting coefficients to make economic forecasting more objective.

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