

All-Time Market Highs – Too Rosy?

Key Takeaways

- The US equity markets, as measured by the S&P 500, reached all-time highs in January 2024.*
- While this may make some investors uncomfortable, all-time highs in equity markets are consistent with a growing economy.
- In our view, equity markets at all price levels have the same fundamental drivers – growth, interest rates, and inflation – and the outlook for those drivers looks pretty rosey.

All-Time Highs

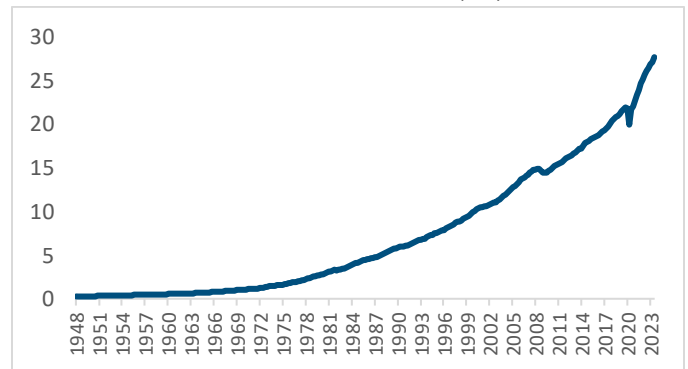
In January of this year, the S&P 500 reached an all-time high of 4,928, eclipsing the previous high set on January 3, 2022.* Understandably, this caused many investors to question whether an all-time high in the equity market is warranted. While all-time highs can pose some short-term risk, future returns depend largely on what happens to key drivers in the economy, like growth, interest rates, and inflation. The current outlook for those drivers appears pretty rosey at this point.

Size of the US Economy

People experience the economy in different ways. That experience can vary widely depending on their individual circumstances, like income, demographics, and location. The most common measure of the health and size of a country's

economy is its gross domestic product – the value of that country's goods and services. By that measure, the US economy is at its largest size ever.

Chart 1: US Gross Domestic Product (\$T)

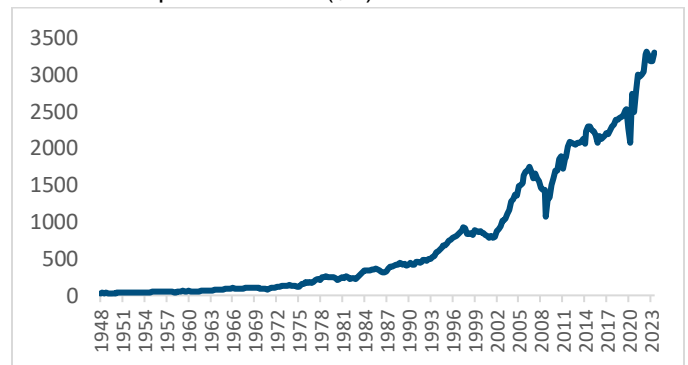


Source: Bloomberg

Corporate Earnings

As you might expect, corporate earnings follow a similar upward trajectory as the economy. However, corporate earnings tend to be more volatile than the broad economy.

Chart 2: Corporate Profits (\$B)



Source: Bloomberg

This is because US corporate earnings are more exposed to short-term factors (like interest rates and foreign exchange rates), tax policies, and economic growth outside of the US (for example, about 35% of sales of S&P 500 companies come from outside the US).*

Despite the more volatile nature of corporate profits, you see in Chart 2 that corporate profits reached an all-time high in 2022 and are currently within 1% of those levels today. Given the all-time highs we are seeing in the economy and close to all-time highs we are seeing in corporate earnings, record highs in the equity markets are not unreasonable, in our view.

Market History

Looking at US market history, we find that macroeconomic factors, like growth, interest rates, and inflation, tend to drive future equity market performance more so than whether or not equity markets are trading at all-time highs.

The US economy has experienced relatively strong economic growth over its history. Consistent with a growing economy, US equity markets have traded at their all-time highs about 40% of the time.* However, there have been long periods during which markets trade at levels below their previous highs. These periods have tended to

occur after the market has experienced a steep sell-off, typically caused by a macro-economic (the asset bubbles of 1999 or 2008) or geopolitical event (the oil crisis of 1973).

Today, the macroeconomic picture looks reasonably rosey, in our view. Despite drastic tightening of monetary policy, economic growth and employment appear sound. Inflation is finally coming down and appears to be approaching levels consistent with the Fed's inflation target. This has led many to speculate that the Fed may lower interest rates sometime in 2024 – another tailwind for the equity markets. We believe this is one of the reasons equity markets rallied at the end of 2023.

There are two areas we are keeping an eye on. First, the elevated geopolitical risk in the Middle East could impact the economy in two ways: 1) higher oil prices and 2) higher shipping costs. Both can have detrimental impacts on growth and inflation. Secondly, there may be some technical or psychological “resistance” to all-time highs. However, history shows that all-time highs are not to be feared. Equity markets have actually experienced above-average returns when trading at their all-time highs.

*Source: Bloomberg

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