EPPOLITO
FINANCIAL STRATEGIES

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HAVING FUN?

Greetings!

I hope you're enjoying the holidays! The following represents my beliefs.

After nearly *two years* of relatively flat markets, both domestic and foreign markets have risen substantially in 2017.

Why Have the Markets Been Broadly Appreciating in the U.S. and Around the Globe?

Although things can change at any time:

1. We currently have "synchronized global economic growth" – i.e. most of the economically important economies of the world are growing.
2. U.S. corporations are poised to pay lower taxes.
3. The cost of money (interest rates) is at historically low levels.
4. Corporate profits have been generally rising since the end of the last recession, which ended in 2009.
5. Profit growth has accelerated recently.

There's Something Going On

Also, "there's something going on" in our economy and around the world that is helping to keep both inflation and interest rates low. It's possible that this is due to "structural economic changes" and may help us to have a very long cycle of economic growth before the next recession comes around. Of course, no one knows.

I believe you'll start to hear more about these forces, as the media begins to pick-up on it. Also, I'll write more on this soon.

But What About the All the Negative News?

First of all, it's important to understand that markets are often not greatly affected by:

- The state of politics (however you'd like to define it)
- Hurricanes, bird flu and other natural disasters

- Geopolitical headlines etc.

Generally, markets move based on the expected future performance of a nation's public companies. Over the long run, stocks have grown with (and in anticipation of) corporate profit growth.

Corporate profits have historically grown with the economy, as measured by **gross domestic product** (GDP) – or what a country produces in goods and services (aka "the economy").

New Highs in the Markets; New Highs in Profits Too

- Like stock market levels, U.S. corporate profits have generally been making record highs.
- Also, 2017 is likely going to be the first year in the last seven when profits are meaningfully positive in all four major market regions of the world (the US, Europe, Japan and, broadly in the emerging markets sector). (1)

New Highs are Nothing New

Although past performance cannot guarantee future results, generally:

1. "The economy" has grown ever larger over the years.
2. This means that corporations have sold an ever-larger amount of goods and services.
3. This also means that corporations have generally been earning an ever-larger amount of profits – as the economy has grown to ever-higher levels.

This is why I believe stocks have grown to new highs over the years.

The simple chart below shows GDP growth, or "economic output" growth since WWII.

- The line represents GDP.
- The shaded periods denote economic recessions.
- GDP tends to fall during recessions, although the period shown is so long the GDP line on the graph does not clearly show this.

The Take-aways Are:

- The rising slope of GDP growth, over the decades.
- Markets have generally followed the growth in GDP.

Question: "This Seems Easy. What's the Catch?"

Answer: "Recessions Come Around Cyclically"

- Someday we're going to endure an economic contraction (a recession) – and, as I've been known to say, "No one is going to like it."
- Recessions are never any fun. Stocks tend to fall well-off the highs.
- Although past performance cannot guarantee future results, all recessions have come to an end – and we've begun a new growth cycle.

"Larry, You're No Fun!"

- In my quest to properly set your expectations, I've been called a "wet blanket" many times!

Is a Recession in Sight?

- As the global economy has been broadly expanding lately, there are few signs of an impending recession.

- An economic shock or a geopolitical event could cause a recession to begin at any time. (This is *always* true.)
- It could be *years* before the next recession. No one knows.

In summary:

- Although past performance cannot guarantee future results, historically, stocks have broadly outpaced inflation by a wide margin, over many years.
- Many investors have a portion of their assets invested in stock-oriented investments in an attempt to offset the deleterious effects of inflation on the buying power of our money.
- Recessions come around cyclically. Stocks can broadly perform very poorly for long periods of time.
- Investors should have *that* amount in stock – as a percentage of all financial assets – which we can live with through good and bad cycles.
- Although things can change at any time:
    - We currently have "synchronized global economic growth."
    - U.S. profits are at record high levels.
    - Impending tax cuts may further aid economic growth over the next several years.
- As I've written before, "New Highs are Nothing New!"

I hope you are all enjoying the holidays.

Best wishes to you and yours for a wonderful 2018!

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Sources:

1. Riverfront Investment Group 11/20/17

Other sources:

- Raymond James Research
- Advisor Perspectives
- Mauldin Economics

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