BNY MELLON
WEALTH MANAGEMENT

Investment Update

Common Misconceptions About the Current Bull Market

Mark Twain once said, "If a cat sits on a hot stove, that cat won't sit on a hot stove again. That cat won't sit on the cold stove either. That cat just doesn't like stoves." The volatility scars left by the bear markets of 2002 and 2008 continue to impact investor psychology even today. In fact, as I travel across the country meeting with clients, I get the same sense of foreboding regarding the stock market, with investors wondering how much longer this bull market will last.

I've heard many investors explain why they believe it may be time to exit the market. While I understand their concerns, I believe that some of the most common investor fears are unfounded in this current bull market cycle, and are based on misconceptions that may cause them to miss out on an opportunity.

Is the Market Too Expensive?

Some investors are under the impression that current price-to-earnings (P/E) ratios, a widely used measure of market value, are unreasonably high, and that this means the market is due for a correction. It's easy to see why people might be concerned. But it's important to put current P/E ratios in perspective.

The 12-month forward P/E estimate for the S&P 500 — which includes the next four quarters of earnings — is 18x, just modestly above the historical average of 15.8x. However, given that interest rates and inflation are still rather low, it shouldn't be surprising that investors are willing to pay more for equities. In that context, equities appear to be more reasonably valued.

While bull markets generally start when P/E ratios are low, there's simply no evidence that P/E ratios are a good predictor of near-term returns. Using P/Es as a valuation metric, the market seems reasonably valued. But, it doesn't mean that the market will correct anytime soon.

What can help support the market is better earnings, which we are beginning to see. The current earnings environment seems to be the best in years, with second quarter earnings delivering over a 10% annualized earnings growth rate following a 15% growth rate in the previous quarter. Furthermore, earnings growth is picking up around the world. Right now, earnings are growing faster than prices, and that's a good sign.

Is the Market Too Old?

By most definitions, the current bull market turned eight years old this past March, weathering two corrections in 2011 and 2015. At present, it is the second longest bull market since the end of World War II, and over the past 100 months has gained 265%, cumulatively. I've heard some investors say that because of this market's relatively advanced age, the end must be around the corner — as if the bull market had exceeded its natural lifespan and was living on borrowed time.

But bull markets don't die of old age. Economic factors kill bull markets, like a spike in oil prices, a bubble bursting, or when the Federal Reserve raises interest rates too quickly to combat high inflation and the economy stumbles. For example, the bull market of 1990–2000, the longest on record, didn't die because it was too old. It died as a result of the Fed raising interest rates and extremely stretched valuations within the technology sector.

While this bull is old, I see no indications that a shock of that magnitude is on the horizon. Nor does it appear that the Fed will be forced to aggressively raise rates. In fact, economic data is showing an economy bouncing back after a weak first quarter, with the most recent three months delivering an annualized real gross domestic product (GDP) of 3.0%. Economic indicators, such as jobs growth, manufacturing activity, and consumer and

business spending, appear to be strengthening. Yet there are few signs of inflationary pressures picking up. While the Fed has begun to normalize interest rates, the tepid rate of inflation means they can do so more gradually.

Is the Market Too Concentrated?

A lot of discussion of the current bull market centers around the so-called FAANG stocks: Facebook, Amazon, Apple, Netflix and Google's parent company, Alphabet. The attention focused on these high-profile, high-performing technology companies gives the impression that they are driving a substantial amount of the growth in the market, and invites easy comparisons to the dot-com bubble. However, when you actually compare now to then, it becomes clear that circumstances are very different.

The current bull market is broader than the market was during the dot-com bubble. For instance, in the late 1990s, the five technology stocks that contributed most to S&P returns were adding 1.5% to those returns each month. They also were trading at almost 60x their two-year forward earnings, with the cheapest stock of the group trading at 36x. Today, the FAANG stocks are adding only about 0.5% to S&P returns each month, and among them, only Amazon is trading over 40x its two-year forward earnings.

Opt for a Plan Rather Than Emotion

It's understandable that investors are worried that this bull market may be coming to an end. But, as a long-term investor, it is best to take emotion out of investing. While predicting market tops is difficult and history shows we may be overdue for a small pullback, it's most important to have a plan in place for when the inevitable correction happens. With that said, we don't think this bull market is over.

We have been bullish on stocks since the end of the 2008–09 financial crisis, adjusting exposure to regions and capitalizations based on fundamentals such as growth, inflation and earnings expectations. It's these indicators that we rely on when determining our best thinking. It's our current belief that market fundamentals are improving. We would consider any market consolidation as an opportunity to lean in, assuming the economic and market backdrop remains favorable. You can count on BNY Mellon Wealth Management to reduce risk for you when necessary and to take advantage of potential buying opportunities by adding additional exposure when we believe we're near the next bottom.

While we need to keep an eye on risks, investors should remember that diversification is the best defense against potential pullbacks. It's why we incorporate lower-correlated investments or customized hedging strategies into well-diversified portfolios as a buffer against potential market swings. We currently see no reason to believe that this bull market is imperiled by its valuation, its age or any concentration among particular stocks. While we want to avoid the hot stove for our clients, we also want to make sure that if the stove is cold, clients remain invested to take advantage of this bull market's continued advance.

Jeff Mortimer, CFA
Director of Investment Strategy

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