LPL RESEARCH

WEEKLY MARKET COMMENTARY

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STOCKS REACH RECORD HIGHS

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KEY TAKEAWAYS

The S&P 500's new record high set last week ended a more than 7-month drought without one.

History tells us that new highs should be celebrated, not feared.

Even though the market may be due for a pullback, we think stocks will be higher at year end.

All data are as of April 26, 2019, unless otherwise stated.

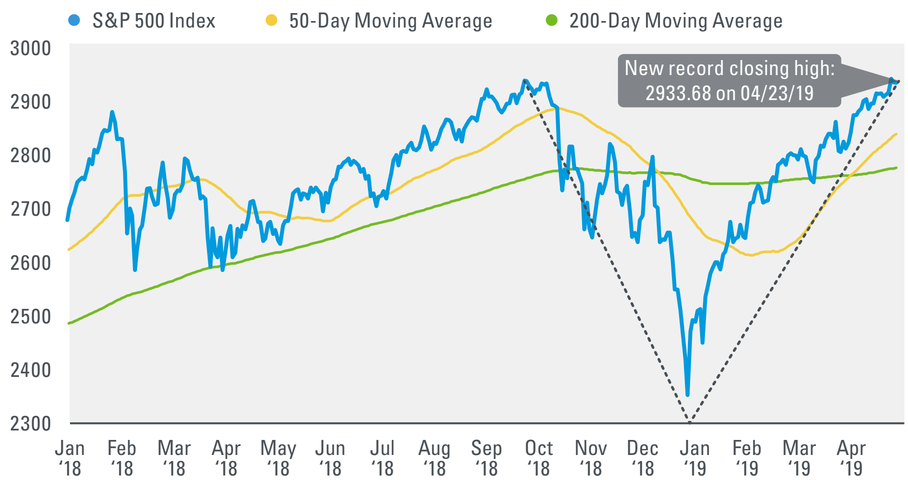
Stocks reached new highs last week. The S&P 500 Index completed a V-shaped recovery last week to register its first record high since September 20, 2018, to close at 2933.68 on April 23 [Figure 1]. Here we share our thoughts on what this record could mean for stocks going forward.

WHERE MIGHT STOCKS GO FROM HERE?

Our initial reaction to the new high last week was to celebrate the crowning of this bull market as the longest ever. If the S&P 500 hadn't made a new high before its next bear market decline (20% or more), this bull would have ended short of the 10-year mark. So let's first celebrate this impressive bull market.

Next, we ask where stocks might go from here. To help answer that question, we calculated the average forward returns for the subsequent 3, 6, and 12 months starting from all record highs in the S&P 500 back to 1950. Stocks have generally done well after reaching new highs, particularly when the time between the new and prior high was more than six months.

1 V-SHAPED REBOUND FROM DECEMBER 2018 LOWS



Source: LPL Research, Bloomberg 04/26/19

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

After setting new highs, the S&P 500 has produced above-average returns over the next 12 months, regardless of when the prior highs were reached. But over the next three and six months after new highs, when the highs were not differentiated by their paths to get there, stocks have pulled back slightly on average [Figure 2]. This analysis, coupled with stocks' tendency to pull back after big first quarter rallies, suggest stocks may need a breather.

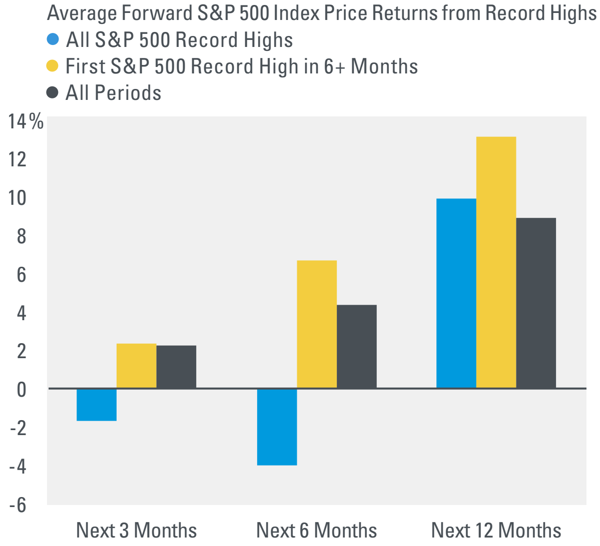
ARE STOCKS TOO FAR OVER THEIR SKIS?

Some investors are no doubt thinking stocks have come too far too fast. Although we think trimming a bit into strength is prudent to rebalance portfolios back to targeted market weight equities allocations, in general we do not think this is the time to get defensive.

We empathize with those who say stocks have had such a great 10-year run that it's time to take some profits, but we don't buy the argument that stocks are expensive because they are up a lot. Based on expected earnings over the next 12 months, the forward price-to-earnings ratio (PE) for the S&P 500 is below 17, very reasonable considering low interest rates and inflation. In fact, the Index traded at a forward PE of more than 17 every day of 2017 and spent a fair amount of time near that level in 2015 and 2016. We would also point out that sentiment is not particularly bullish, based on a below-average percentage of bulls in the mid-30s, according to the American Association of Individual Investors sentiment poll, and other sentiment measures we track.

2 DON'T FEAR NEW HIGHS

Average Forward S&P 500 Index Price Returns from Record Highs



Source: LPL Research, Bloomberg, Strategas Research Partners 04/25/19

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

S&P 500 performance data covers period from 1950 through April 25, 2019, and excludes dividends.

Importantly, we think fundamentals are still supportive of stocks at current valuations. We have global economic conditions starting to improve, led by the United States and China. Friday's strong first quarter gross domestic product report helps. Earnings season is off to a good start. Stimulus impacts are flowing through. If we get a good China trade deal, business confidence will likely increase and more capital investment may follow. Europe and Japan will probably come along for the ride.

SELL IN MAY?

May arrives this week (not Theresa May, the month of May), which will launch a flurry of media stories on the old Wall Street adage "Sell in May." However, this saying hasn't rung true recently: The S&P 500 has risen during this historically seasonally weak six-month period in six of the past seven years. We wouldn't get overly concerned about the calendar here.

At the same time, the ride to further potential gains this year may not be smooth. The average S&P 500 pullback after a double-digit percentage first quarter gain has been about 9%, and there are potential catalysts present for a sell-off. Among them: possible U.S. tariffs on European autos, Brexit and other structural challenges in Europe, pre-prescribed defense spending cuts, the federal debt ceiling, and a possible late-year rate hike from the Federal Reserve.

CONCLUSION

History tells us that new highs should be celebrated, not feared. Even though the market may be due for a bit of a pullback, we think stocks will be higher at year end than they are now. A potential U.S.-China trade deal or better-than-expected corporate profits could be positive catalysts in the coming months, and a pickup in capital spending could extend the business cycle longer than many expect.

We believe there are enough potential positive catalysts to possibly push the S&P 500 through our year-end fair value target of 3,000 this year.

At the same time, we acknowledge the risks, particularly internationally. With stocks near our target and the possibility of a pickup in volatility, despite a favorable fundamental backdrop, we recommend a market weight equities allocation. For those who have ridden this bull for a while and are above their targeted equities allocations, it may be a good time to rebalance. We would be buyers on any material weakness assuming fundamentals remain consistent with what we see today. ■

DEFINITIONS

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

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