Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors May 26, 2017

Stocks rose for the sixth day in a row. With President Trump overseas, attention returns to economics and the news has generally been positive.

One of the headline comments this week came from Professor Robert Schiller, a Nobel laureate, who famously published his book "Irrational Exuberance" just months before the Internet bubble burst in early 2000. He is also noted for developing a valuation tool called the CAPE ratio a tool that measures price-to-earnings in a manner that levels out long term trends. Instead if the conventional method of dividing current price by current earnings, Professor Schiller divides the current price by the average earnings of the past 10 years. Logically, given the history of rising earnings over time, a ten year average, more often than not, would be lower than the most recent earnings. As a result, the CAPE number is usually higher than the 15-16 average P/E using conventional math. But, just as P/Es today are high using conventional methodology, they are also high using the CAPE formula.

The comment from Professor Schiller, normally a very cautious prognosticator, that got market attention, was the thought that stocks could rise as much as another 50% before this bull market ends. If any asset class is in bubble territory today, he believes it is bonds. It's hard to believe that Professor Schiller is as confident as he appears to be in light of the high CAPE numbers and the length of the current bull market. To make things clear, Professor Schiller didn't predict another 50% increase; he simple acknowledged that it could happen within the context of historic precedent.

Let's go further. Markets behave somewhat like metronomes. Psychologically, they move back and forth between despair at the bottom and euphoria at the top. But, while metronomes move in constant rhythms, markets to do. They move from despair to euphoria slowly and cautiously while moving from euphoria to despair rapidly. Therein lies the conundrum. Markets rise slowly. Since 2009, stocks have more than doubled but they have done so over a period of eight years, a steady climb but not exactly a rocket ship advance. But, if you think back to 2008, stocks fell 50% or more in a space of about 15 months.

There is no science that can predict how long a bull market or an economic expansion can last. As long as there is balance in world economies, there won't be a recession. As long as there isn't irrational exuberance, bull markets can continue. Thus, Professor Schiller, in my view at least, is right. This market can keep going up as long as it stays rational in its behavior and economies don't show excesses or stress. That could be one more year or 10 more years. But when it ends, it almost always ends badly.

So how long does one stay? The farther one gets from the median, the greater the risk. But even though we are above the median today, if you compare current valuations to historic peaks, we have a ways to go. The behavior of markets suggests that P/Es keep rising until they don't. That may sound like a stupid statement but it isn't. As investors move from skepticism, where they are today (until very recently they were still pulling money from equities and buying bonds) toward euphoria, P/Es will continue to rise. P/Es simply don't decline in bull markets. They rise steadily. They fall quickly in bear markets.

How does one know when the peak is near? The answer normally is when investors start acting stupid or, in Professor Schiller's terms, irrational. What's irrational? Buying stocks of companies based entirely on promises without any facts to consider. When new issues come to market for companies built on a wing and a prayer. When merger mania makes no sense. When companies go haywire using leverage beyond any capability to service let alone repay the debt. None of those conditions is evident at the moment. Neither is recession. How high is up? I don't know. But I do know earnings are rising and interest rates remain low. The path of least resistance is higher. That is a short term answer to the conundrum we face today. At some point, the near term rewards will be insufficient to offset the risks associated with a widening spread between valuation at the time and normality. We will continue to watch.

Today, Lenny Kravitz is 53. Stevie Nicks turns 69.

James M. Meyer, CFA 610-260-2220

Additional information is available upon request.
* - Boenning and Scattergood may act as principal in buying this stock from or selling it to the public.
# - The author of this report or accounts under his management at Tower Bridge Advisors owns this security.