Spring 2019

Toward the end of 2018, *Market Watch* ran an opinion piece titled, "Why is the US Stock Market Weak? Because the Economy is too Strong." By the end of this year's first quarter, the S&P 500 was up 13%. How can this be? Perhaps an analogy, provided by Ralph Wagner, who writes about small-cap investing, and enhanced by us, will provide some insight.

Picture a woman walking from Columbus Circle, in New York City, through Central Park, to the Metropolitan Museum of Art. She's got a male Border Collie (the "hyperest" of all breeds according to folks who document such things) on a long leash. She's walking at an easy lope, say three miles per hour. The dog is, of course, running amuck. Sniffing grass and trees. Jumping on passersby. Chasing squirrels. There's no way to predict where he'll bolt next. But you know he's heading northeast at an *average* speed of three miles per hour, and eventually he, along with his owner, is going to end up at the Met.

The Border Collie in the above is the stock market, often behaving erratically and impulsively. The woman is the economy, slowly and predictably making its way uptown. The two are clearly connected, but look dramatically different, even if they're going in the same direction and will end up at the same destination.

Just as folks in the park are likely focused on the excited dog, investors too often stay fixed on the fluctuating stock market.

There's a long history of markets not doing what is expected of them, even in the most ideal of climates. In 1994, for example, the US and global economies were recovering from the 1991 recession. GDP growth jumped from 2.7% to 4.0%. Corporate profits continued to rise. Inflation was slowing, more jobs were being created, and interest rates fell. It was the best macro economy in the past five years. Yet, the S&P 500 index inched just 1.3%. A robust economy was resulting in disappointed investors.

Why? Because the economy grew better than anticipated. Inflation was tame. Corporate profits were greater than expected. So, investors became fearful the economy would slow. And there were plenty of trees to sniff and squirrels to chase in the way of the Bosnian War, the Whitewater scandal, the Northridge earthquake, and Orange County, CA declaring bankruptcy due to financial mismanagement and questionable investments.

None of those concerns were fleeting-continuing to grab headlines for years-but from 1995 through 1999, the global markets soared. The S&P 500 rose 250%, the MSCI EAFE rose 86.9% and the S&P TSX Composite nearly doubled.

Viewing the decade as a whole, Wagner's analogy becomes crystallized. In 1990, the US GDP was $5.9 trillion. By 2000, it had nearly doubled to $10.3 trillion. Canadian GDP went from $593 billion to $742 billion. Global GDP from $22.6 trillion to $33.6 trillion. If investors were watching the owner, steadily striding forward, and not the Collie, darting to and fro, they more easily weathered the decade's market turmoil.

It's important to keep that in mind when looking at the recent tumult. Yes, November and December of last year were rough. The equity markets turned drastically and wiped out the previous ten months' return. The US Federal Reserve had raised short-term interest rates (which some expected would hurt the economy) and more were expected in 2019. The pending Mueller Report created fears the president might lose his job. Up north, the Canadian prime minister was embroiled in his own political scandal. The Brexit battle continued, ultimately being postponed until October. China and the US were mired in their still-ongoing struggle for a trade deal.

Then came 2019, and the market rallied. And positive forecasts abound. Keep in mind, since 1935, every time the S&P 500 scored a gain of 10% or more in the first quarter of a year, the market climbed up 6% on average the rest of the year, with positive performance during 11 of the 12 times (BMO).

All along the global economy (and individual economies) has been growing. Rising populations are necessitating more housing, food, energy, healthcare, education, financial services and entertainment. World GDP continues to expand, topping $80.7 trillion as of 2017 (the most recent data). The US passed $19.3 trillion (2018 estimates are $20.9 trillion), and Canada stands just shy of $1.6 trillion. China, which back in 1990 barely cracked $360 billion, has exploded into the second largest economy at $12.2 trillion in 2017. While the Border Collie may be more exhilarating to watch, it's the owner who dictates where both are heading. Her destination is the dog's.