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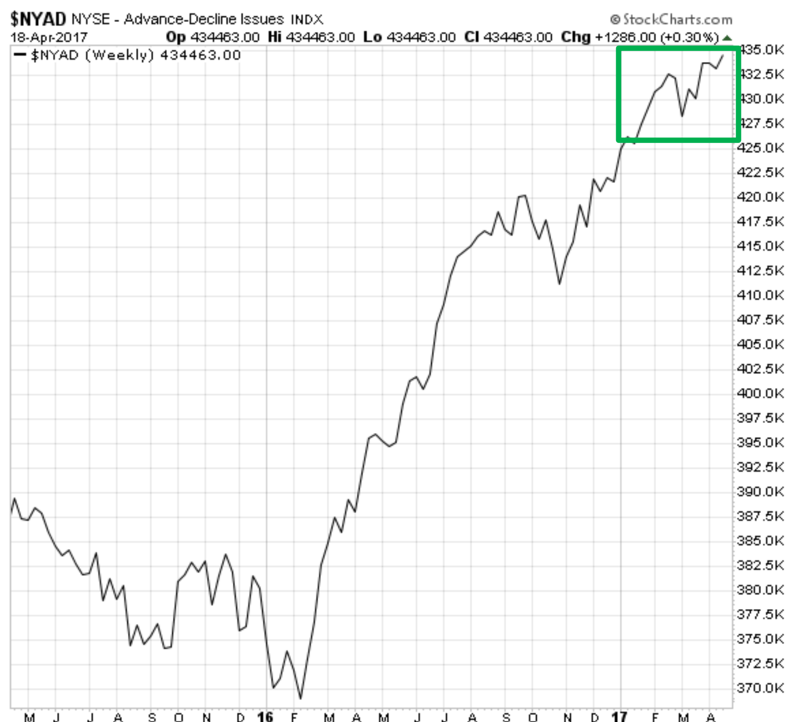
Archer April 2017 Update and Outlook:

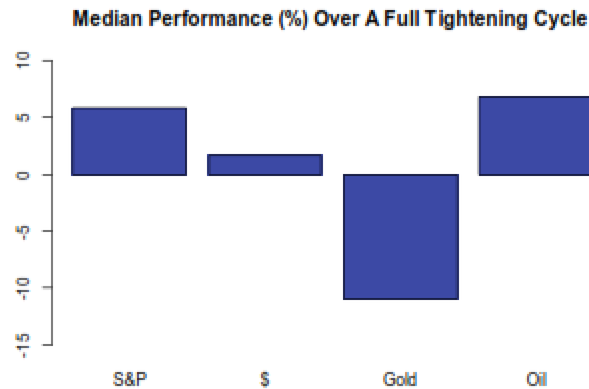
In our 2017 outlook we estimated a 9-12% return in the market and we are third of the way there, through a third of the year. Now the Trump Train has pulled into the station. We have seen the market stall a bit here in April when generally April is a very strong month.

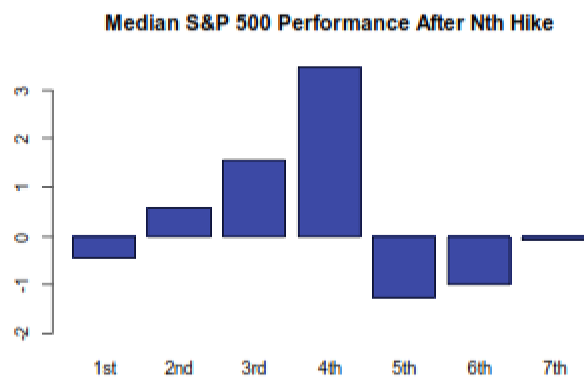
I am not ready to throw in the towel yet to see the market decline near-term. If you look at the Advance Decline Line here, we are still seeing new highs as more stocks are advancing on volume than those declining. If this turns back down near the 420.0k level, we would likely be concerned the rally is ending. However, at this point, the trend remains upward and to the right.



We may sound like Captain Obvious, but the market has been rolling along on the tracks and has performed very well even amidst the geopolitical turmoil in Syria, Russia, and North Korea. Only 12% of stocks in the S&P 500 have a trailing P/E of 14 or below. This is below the average of 25% since 1994. The market by most accounts is overvalued by 12-20% on all factors except earnings yield compared to the 10yr Treasury. If rates stay relatively low, as of this writing (April 19), the 10 yr. has rallied again to the 2.21% level, the market is fairly valued based on earnings yield. The average spread of earnings yield is 1.3% over the 10yr since 1994. This puts the market squarely on firm footing. The next big question is: What if rates rise? Let's take a look below.

With manufacturing hot and the Fed raising rates for the second time, we can conclude we are in a full tightening cycle by the Fed. The average number of increases in a full tightening cycle is 7 (since 1972). Twice there was only one increase and we will exclude those for this exercise. The median performance for the S&P over a tightening cycle has been about 6% annually. We can see how other investments have fared as well. The second chart shows that typically through the fourth increase up until the 5th, the S&P continues to move in the green. Once the 5th increase comes, typically the Fed (as is the case most of the time) is behind the curve and rates have risen too far.





If we assume manufacturing continues to expand and the Administration is effective in its "buy American" theme, the markets can continue to move higher on higher earnings. Higher earnings would push the Earnings Yield up and thus keep the market fairly valued. We have been in the camp of higher interest rates for some time (incorrectly at times), but believe the 10 yr should approach 3% by the 5th rate hike. This will mean we will need some decent earnings increases in the S&P 500 to continue this catapult higher by the stock market and keep the train rolling along the tracks.

Looking Ahead:

As we stated in January of 2017, we think there is another 4-8% (9-12% for 2017 total return) left to move higher in this market in 2017. This will probably outperform bonds for the rest of 2017 given rates would tend to move higher across a tightening cycle. Currently, geopolitical risks have moved rates down in favor of safety, but we believe this will subside as it has in the past. With valuation levels of the market well above average it is prudent for most investors to stay balanced and have an asset allocation strategy to fend off any short-term downturn the market may give us.

Regards,

The Archer Team