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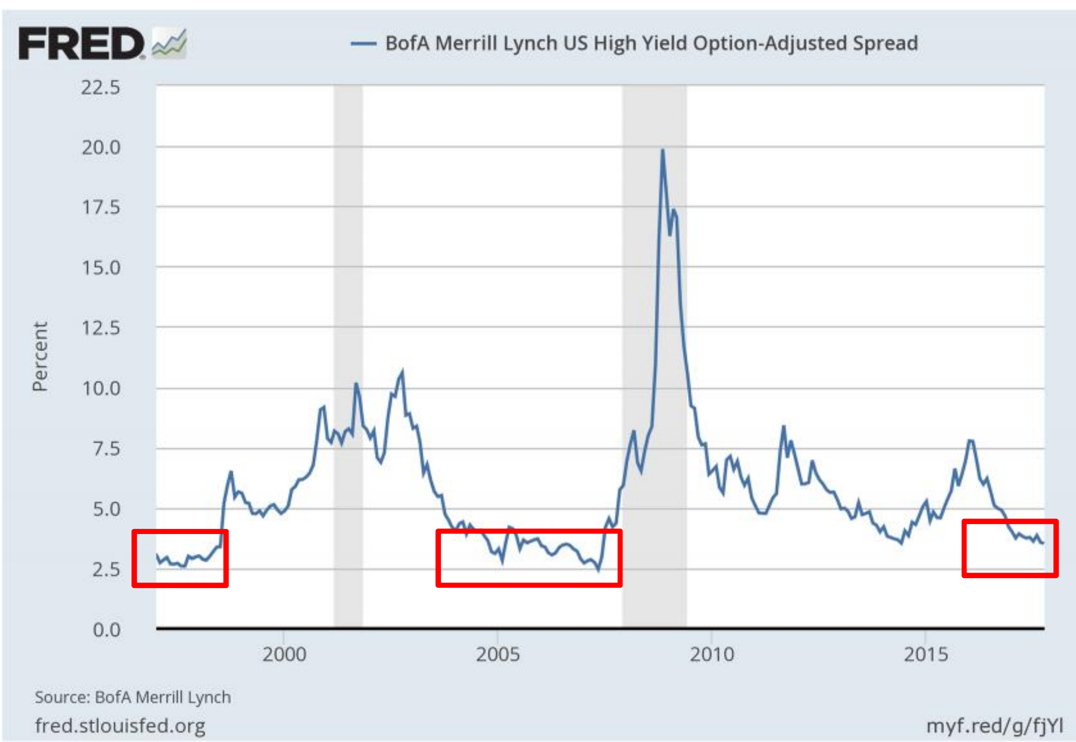
Archer October 2017 Update and Outlook:

Dow 1 MILLION! (22,260 as of October 4, 2017) It must be so. Warren Buffet says so. A closer look at this number means we will be earning about 4% per year for the next 100 years,less than we have earned over the last 100 years. This kind of Euphoria gives us pause as people create a herd mentality in the stock market. In the last quarterly newsletter, we spoke of the market needing to pause. We have now seen the market continue to move higher as both common investors and professionals seem to have forgotten about risk. Are we that far removed from 2008-9 to not remember the problems we faced? The chart below shows the spread between High Yield (Junk) and the 10 yr Treasury. If you are good at looking at pictures, you can see how investors have forgotten about risk as they are willing to buy junk. JUNK – 10yr is near 3.5% The previous 1998 and 2007 lows were about 2.5%. We all know the result of 2000 and 2008.

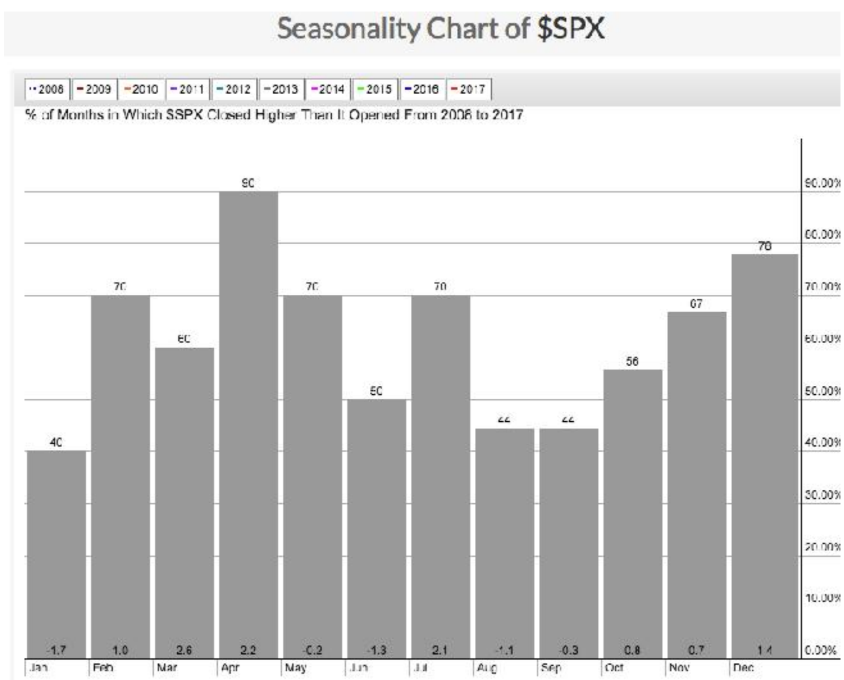


This chart does not mean the market will fall down tomorrow. In fact, we estimate we have another 12 months or more of the stock market running higher before it pulls back. As often is the case, the last people to arrive at the party get there but most of the food and drinks are gone. I suspect barring a major geopolitical storm, the market moves another 20% higher over the next 18-24 months before it significantly corrects. It is possible the correction is light if the economy continues to shine and we "melt up" to a higher market with greater earnings and greater wage growth and lower unemployment.

We said last quarter there were many similarities between 2004-2006. The chart above reiterates that point. In fact, had you purchased the S&P 500 at its then peak of earnings on October 9, 2007 at $84.92 and we told you earnings for the next 10 years would grow at 2% ($104.02 S&P 500 12mo. Trailing Earnings Per Share), you would not expect your return to have been 7.3% Annualized. We doubt anyone would have taken the bet or invested knowing a 2% earning growth was coming. However, the market has clearly rolled forward from 18.4x P/E on 10/9/07 to a 24.5x P/E on 10/05/17. We need earnings to catch up if we want to see the market move higher.

If earnings do not catch up and the Fed begins to unwind or sell off their assets/balance sheet too aggressively, it could cause the market to lose its liquidity and rates will rise too high, too fast. Often is the case the Fed misses the market and moves one way or another too far until the market tells them by moving too high or too low. We suspect this time will be no different.

The seasonality chart we showed last quarter gives a good historical perspective of the typical returns in any given month. It also shows how the markets build momentum into the Holidays. As we approach year-end and everyone looks to 2018, if the market continues to escalate, it would probably mean we are in for a decent first half of 2018 barring any political meltdowns.



Again, the Advance Decline line is showing us the market is continuing to move higher as well. So we have some indications showing the market is over baked, and some showing that signs of life still exist. Should the Advance Decline line move negatively for a longer period of time, we may see the market take a breather before moving higher. Ultimately, should earnings continue to grow, the market should continue to move higher.

The final chart shows the S&P 500 with different valuation levels (1965-2017). Very few times have we reached the peak level we are today. The most significant time period is 1997 heading into the dot com bust. In 1997 and 1998 valuations were extremely overextended. In this market the overextension is relegated to specific equities. One area is growth and mega cap stocks, the other is bonds. The levels stocks have reached today are similar to the 1998-99 time frame. If earning do not materialize much higher, we may see a retracement in those stocks. However, there are stocks undervalued in the market, most have higher dividends.

As we have stated in past issues, unless there are some geopolitical storms on the horizon, the market feels quite comfortable at the levels today. However, as most of you know, weather can change instantly and without notice. The clear skies can roll in the thunder and lightning with an hour and we could have a full monsoon or just some cloudy skies with light rain. Barring any major problems out of the Middle East or North Korea, I see the worst day as being hazy with some fog, but it will burn off by mid day. Regardless of your political affiliation any major tax policy out of Washington would be a win for the market long-term. There is always risk that the rumor has pushed the market higher and the actual news would result in a short-term sell off.

Looking Ahead:

For the rest of 2017 and early 2018, we want to remind all our clients to stay with a balanced portfolio. Although the bond market may be overvalued it should provide some protection if the stock market finds a path lower. However at this time we anticipate the stock market maintaining its current level and not adding much in the way of higher appreciation and the majority of the returns for the rest of this year will come from dividends, buybacks, and return of capital to shareholders. It is possible with an escalation of earnings, the market moves higher similarly to 2017.

Regards,

The Archer Team