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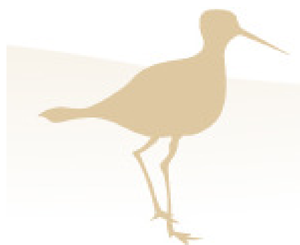
Sandpiper Capital

Gleanings



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"Over the last eight years, average annual Treasury returns and average annual S&P returns have been almost identical, just in opposite sequences."

Déjà vu all over again,

Market Returns Annually and Ten Years Ending 09/30/2015

Index	2013	2014	YTD	10 Yrs
S&P 500	32.4	13.7	-5.3	**6.8%**
ML 1-5 yr Gov't/Corp	.3	1.5	1.6	**3.5%**
EAFE (Dev Fgn Mkts)	22.8	-4.9	-5.3	**3.0%**
Emerging Markets	-2.5	-2.1	-15.3	**4.6%**

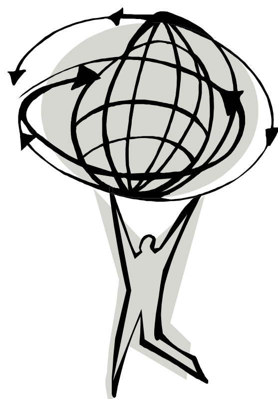
With the stock market's recent plateau evoking memories of 2008, I thought it might be good to look back over the last couple of market cycles to get a sense of where we might be and perhaps, what lessons we might learn from the past.

The fact that the market peak of summer of 2000 was followed by another in the fall of 2007 has little bearing upon the likelihood that summer 2015 marked another seven year top. The progress, however, in sales, earnings and the markets from the *economic* peaks that are the normal feature of a cyclical economy do shed some light on our current situation. In the table below, you'll note that while the recent recovery has brought sales and earnings back to a level that reflects 2% and 3% respective annual growth rates, the Index (including dividends) has returned 8%. In the previous cycle, 2000 to 2007 saw earnings and sales grow at 5% and 7%, but the market only returned 2%, reflecting how overvalued 2000 was. Looking over the last fifteen years, (peak to peak to peak) gives more representative numbers: sales growth of 3%, earnings 5%, and a total market return of 4%. Thinking about future returns makes more sense if you consider where you are in the economic cycle. Peak to peak returns are much greater than peak to trough and much less than trough to peak. If we are at a peak in the cycle then market returns going forward might well be about 4-5%.

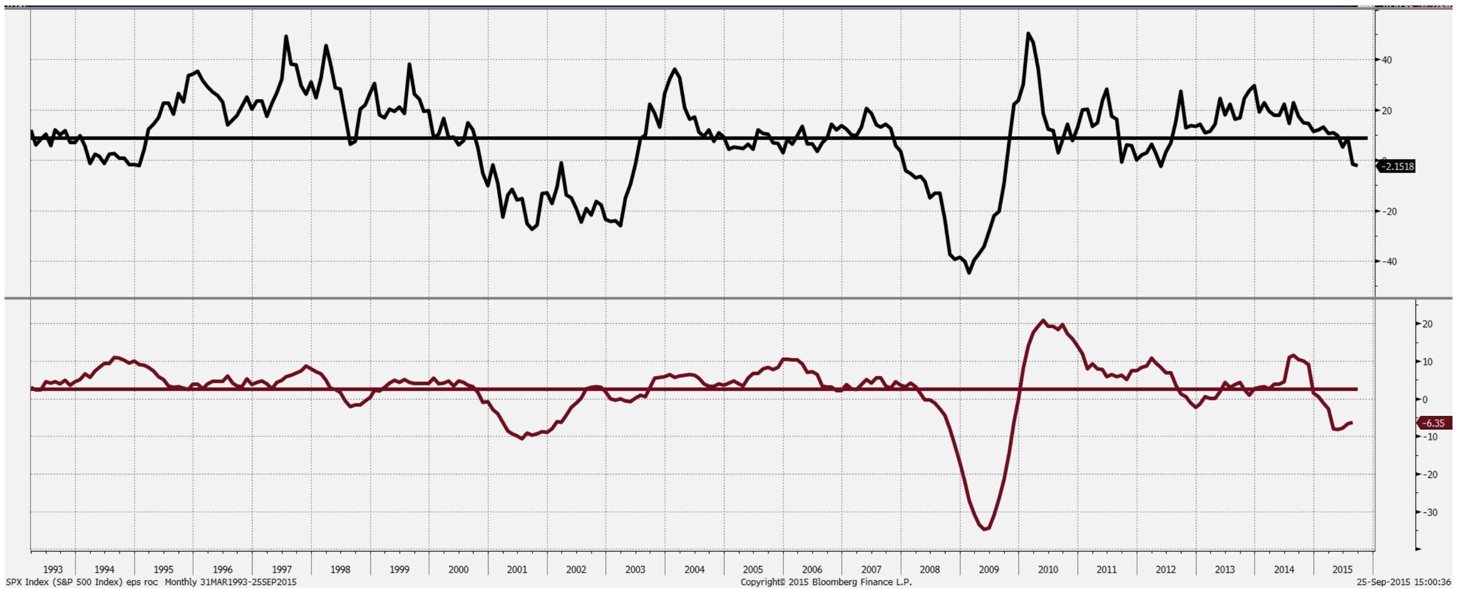
	S&P Sales	S&P Earnings	S&P Total Return Index
2007	1013	89.79	2447
2015	1145	113.38	3939
%/yr	1.7%	3.4%	8.3%

	S&P Sales	S&P Earnings	S&P Total Return Index
2001	713	55.28	2109
2008	1013	89.79	2447
%/yr	4.9%	7.5%	2.1%

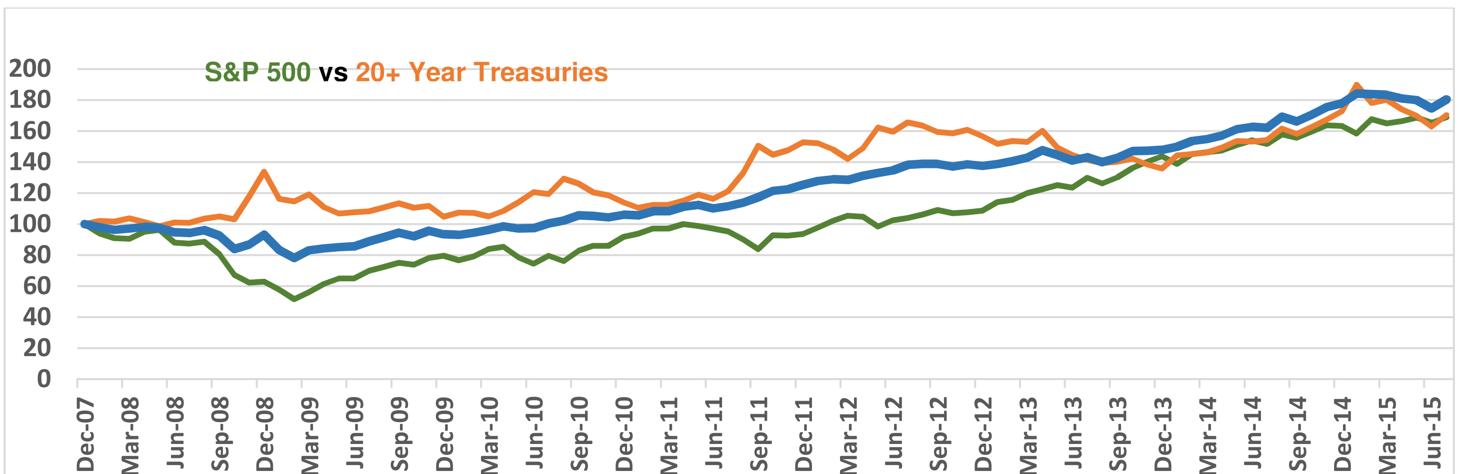
	S&P Sales	S&P Earnings	S&P Total Return Index
2001	713	55.28	2109
2015	1145	113.38	3939
%/yr	3.3%	5.3%	4.3%



So, what is the likelihood that we are again at the peak of an economic cycle? And if so, what can we do to get better returns than the forecasted 4% to 5%? For an insight into the economy, the durable goods orders' rate of change (in red) in the chart below provides some insight. While this is just one indicator of the economic cycle, it *is* pretty compelling. When it turns negative, that historically has been a bad portent for the stock market, (whose twelve month rate of change is indicated in black).



One obvious solution to anemic stock market returns is to also invest in a different asset class. The use of Treasury bonds as a complement to stocks is made all the more persuasive by the fact that their performance is enhanced by periods of fear in the financial markets. In the line chart below, notice how the Treasury index goes up when the S&P goes down. The fear that pushes stocks down, drives the "flight to quality" that pushes Treasury prices up. Over the last eight years, average annual Treasury returns and average annual S&P returns have been almost identical, just in opposite sequences. The opportunity comes from rebalancing between the two. Simple monthly rebalancing would have actually earned a higher return than either alone, (the blue line), with the added benefit of much less volatility. We find that opportunity magnified by using a very simple model that rebalances when either market reaches extreme valuations, (as they routinely do.)



Tom Lukic