



A BULL MARKET TOP?

As Bull markets go, this one is a little long in the tooth. From a duration standpoint it is the second longest since 1929, having now lasted for 95 months and in magnitude, it is up 239 percent from its origins on March 9, 2009 to the present, making it the third most rewarding. At the moment, I don't believe it has a significant number of major characteristics normally seen at a top. Valuations are only slightly extended with a PE on the S&P 500 of 17.4 times 2017 earnings estimates of \$130.78, according to CFRA Research, which is higher than the average of the past 25 years of 15.9, but with interest rates near historic lows a modestly higher valuation is to be expected. The dividend yield is an attractive 2.2% versus an average of 2.0% and the price to book is 2.7 times versus an average of 2.9 times. One of the measures often sighted for the market's excess valuation is the CAPE or Shiller's PE, which is trading at approximately 28.3 times, against a 25 year average of 26 times. The current Shiller's PE is similar to that reached at the market top in 2000, when the overall market PE topped out at 27.2 times. This is a concern, however for the moment I would temper, some might say rationalize, my concerns by pointing out that the financial crisis and the oil collapse temporarily suppressed earnings and inflated price to earnings ratios, and may account for some of the extreme values imbedded in the Shiller's PE.

Exhibit A

AMAZINGLY, THERE HAVE BEEN CUMULATIVE *OUTFLOWS* FROM DOMESTIC EQUITIES SINCE 2009

Year	Net Flows into Mutual Funds + ETFs (\$BN)					
	Domestic Equity		International Equity		Bond	Money Mkt
	MF	ETF	MF	ETF		
2009	-27.6	30.9	29.6	39.6	417.2	-539.1
2010	-81.1	46.7	56.7	41.5	262.0	-525.1
2011	-133.3	47.3	4.1	24.3	163.7	-124.1
2012	-159.1	80.9	6.4	51.9	358.5	-0.2
2013	18.1	104.0	141.4	62.8	-59.0	15.0
2014	-60.2	143.0	85.4	46.6	94.5	6.2
2015	-170.8	63.1	93.9	109.7	29.5	21.5
2016 YTD	-207.3	137.0	-17.8	8.7	194.2	-38.0
TOTAL	-821.2	652.9	399.7	385.1	1460.6	-1183.8

IPO ACTIVITY MORIBUND IN 2016



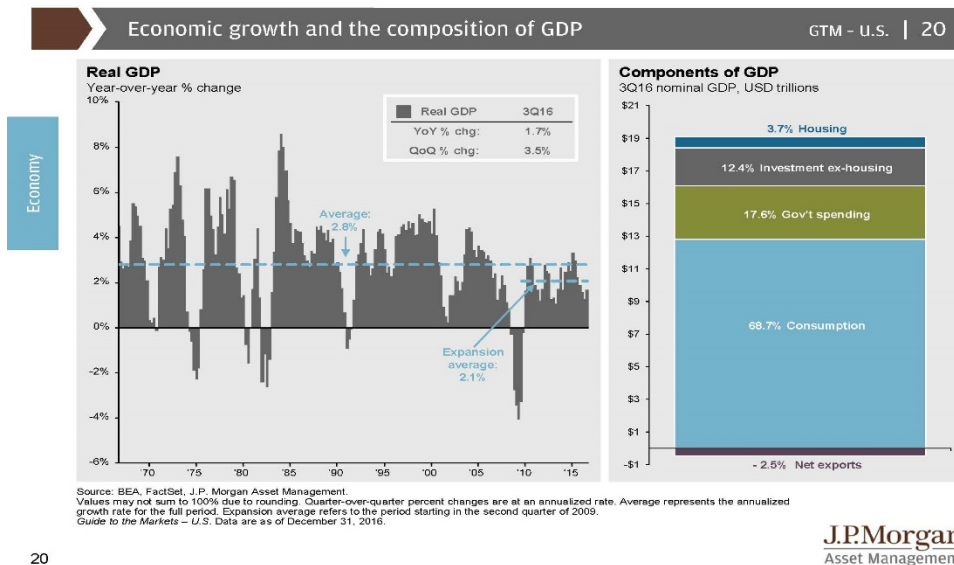
After eight years and trillions of dollars borrowed, you would think we would be at a more obvious extreme in stock prices. Amazingly, according to Strategas Research Partners, the net flow into domestic equity mutual funds and ETFs since 2009 has been negative, with most of the money going to bond and international stock funds and ETFs. For the last several years the number and value of initial public offerings has been on the decline, with 2016 being the most moribund for both since the market bottom (Exhibit A). And, if it had not been for share repurchases and other “financial engineering” there would have been disappointing, if not non-existent, growth in earnings and revenues over the last two years. There are fewer exchange listed companies today than there have been since the early 80's and the average price per share on the New York Stock Exchange is the highest it has ever been, at over \$86. So what should we expect out of this market for the next few years? I think that after all of the distortions imposed since 2009, we are setting up for a very traditional end to the bull market.

Strategas Research Partners – Investment Strategy

Before we get to an end we need to get to some extremes. Some typical things I would look for, that I don't see present, include an acceleration in economic growth. Real GDP growth has averaged 2.8% since 1965. In the current expansion, we have averaged just 2.1% and our current year-over-year real GDP has been 1.7% (Exhibit B). An acceleration in this measure would likely lead to higher inflation and ultimately, higher interest rates. The current round of tightening by the Fed has been halting, at best. Two quarter point increases since December 2015 indicates a Fed that is afraid of getting out in front of an economic expansion and shutting it down. So stronger economic growth, leading to higher inflation rates and finally to interest rates high enough to cut off the economic expansion is a condition that still needs to develop as a precursor to a market top. Second, as mentioned earlier, I would expect to see a change in the flow of funds from fixed income to equity investments. This could be coincident with a burst of speculative excess producing extreme valuations and a blow-off top in stock prices. Policies being discussed by the Trump Administration, like lower tax rates and a lower regulatory environment could lose enough

animal spirits to change sentiment in favor of stocks over bonds. One of the last conditions I would look for is the increase in merger and acquisition activity and a possible increase in initial public offerings. Although, the huge increase in regulation since the financial crisis and greater availability of venture capital could mute the normal acceleration seen in the IPO market.

Exhibit B



There are other markers at cyclical tops in stock prices that show up in sentiment and technical measures, but the things mentioned above are, in aggregate, pretty reliable yardsticks to measure a market in excess. I think a

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timeframe for all of this to work out would be easier to determine if the Trump administration's legislative calendar and outcomes were known. If they were to accomplish most of their objectives in a short period of time, short being the next twelve months, then I would expect the bull to run and fade sooner. If the agenda takes longer or just runs out of steam, then the market top may take longer to develop or could ultimately roll over from a lack of confidence that any serious reform can be completed in the current term.

Respectfully,
James L. Schrott, Portfolio Manager

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