2017 STIR Market Outlook
Marshall Schield, Chief Strategist

2017 STIR Market Outlook: 20+% Gains!

In 2016 the consensus by strategist was for mid-single digit gains. STIR Research went on record saying the estimates were too low and to expect a gain of double digits with a goal of 2500 for the S&P, and that is what the market delivered! We mention this not to toot our own horn, but to point out that we believe the consensus is again too low.

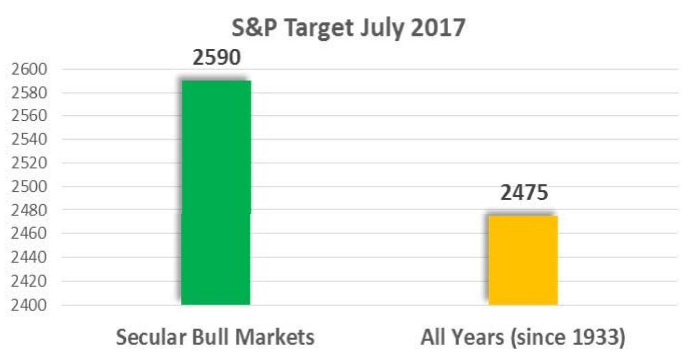
In ten Wall Street Forecasts for 2017 in the 12/19/2016 Barron's Magazine, the low estimate for the S&P 500 was 2300 and the high was 2575. Thus a range of just a 2.7% to a 15.0% gain, with the average at 6.3%. Only one strategist was calling for a double-digit gain in 2017. STIR Research is looking for a high in 2017 of the S&P 500 above 2700!

The Low for the Year, Probably Will Hit in January!

There is a good chance by the time you are reading this the lows for 2017 may have already been made. 'History never repeats itself, but it rhymes' is a Wall Street adage (the original quote from Mark Twain) and one investors should pay attention to. Here is the history of annual lows in secular bull markets (1949-1968, and 1982-2000).

- 30% of the time the low for the year is hit within the first two trading days of the year.
- Almost 60% of the time the low occurs in January.
- And when the low does occur in January, nearly 90% of the time the year finishes with a double digit gain, the average rise is over 24% and with no losing years.

Expect a Great 1st Half



The majority of the gains could occur by mid-year, followed by a fall sell off and finishing with a strong close. The gains could be front loaded because of what happened in July of 2016. On July 11, 2016 the S&P 500 had gone over 300 days since its prior high back on 5/21/2015 of 2130 before making a new high of 2134. Historically, the one year following a lapse of at least 300 days since a prior high is quite bullish, especially in secular bull markets.

In all years where a lapse of over 300 days between record highs occurs the market has gained almost 16% the following year. In secular bull market years the gain jumps to over 21%.

The reasoning why a long lapse can be so positive is the market has taken that time to digest the gains from the 3+ year run up to the previous high on May 2015. The one year lapse in new highs provides the time to work off the excess enthusiasm by investors.

Then when the market finally breaks out to new highs it is ready to start a fresh advance. Using the average gains from previous observations of this occurrence gives us a target between 2475 to just shy of 2600 by July 2017.

+20% Gains are Normal in Secular Bull Market Years!

By studying history, we see that big, powerful up years are common in secular bull markets. In fact, over 50% of the time the annual return will exceed 20%! The probabilities favor double digit returns. And therefore when strategists are timid in their expectations they must be looking at negatives that will bring the returns down, instead of expecting the normal.

20+% Years Common in Secular Bull Markets, Over 50% of the Time!

1949-1968		1982-2000		2011-30 est.	
1949	23.7%*	1982	37.3%*	2013	32.4%
1950	27.9%	1983	23.2%	2017 est.	20+%
1951	26.8%	1985	31.4%		
1954	48.1%	1986	24.1%		
1955	35.0%	1989	30.2%		
1958	37.8%	1991	22.1%		
1961	30.1%	1995	38.4%		
1963	22.2%	1996	23.6%		
1967	20.9%	1997	31.8%		
		1998	25.5%		
		1999	21.5%		

* partial year, start of secular bull market — Source: DQYDJ.com

Earnings will be the Driver for Higher Prices!

A bull market has always followed every economic recession. This time we did not have an economic recession (two quarterly declines in GDP) but we had an earnings recession that lasted over five quarters (year-over-year earnings comparisons were negative).

The nine month correction between May 2015 and February 2016 coincided with the earnings recession. That ended with Q3 2016, when year-over-year earnings finally posted a small gain. Both top line and bottom line numbers are expecting to improve over the next 12 months.

- By next December, reported Q3 2017 S&P earnings are expected to be 28% higher over Q3 2016.
- Full year earnings growth for 2017 is currently expected to gain over 23%.

"It's an odd environment," says Ed Yardeni, Chief Investment Strategist at Yardeni Research. "In some ways it feels like the end of recession and the beginning of a bull market." Barron's Magazine, December 26, 2016.

P/E Ratios to Rise, Not Fall

Most of the strategist stock market estimates we saw for 2017 did include good growth in earnings but then lowered P/E ratios to come in with single digit gains. History tells us a different story. During the last two secular bull markets, as optimism rose up so did P/E ratios.

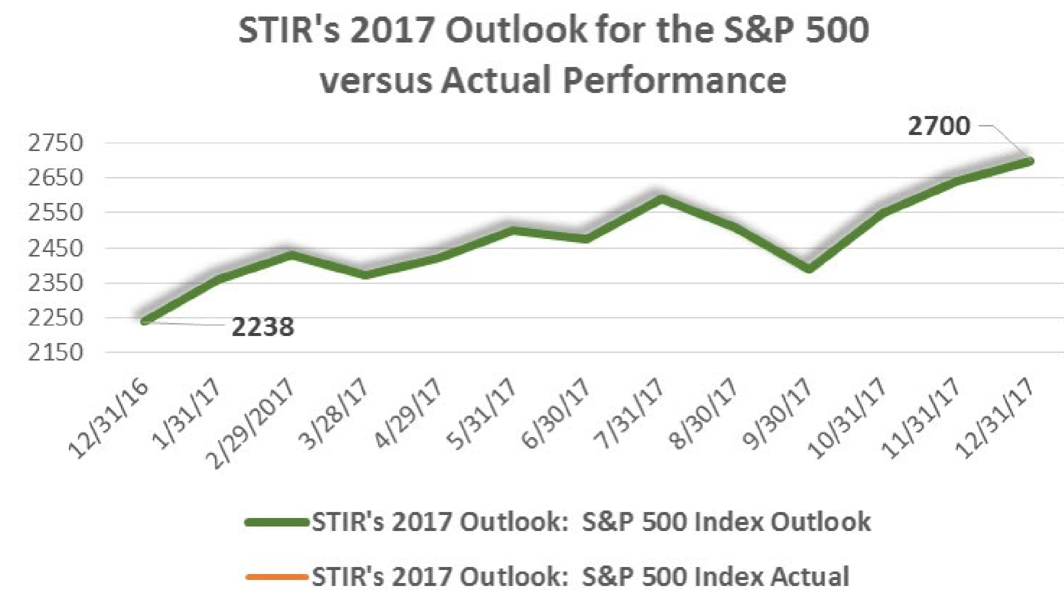
- P/E ratios rose by 289% in the 1949-1968 secular bull.
- By 355% in the period from 1982-2000.
- The P/E ratio since the start of this secular bull on10/3/2011 has risen just 50%.

In our opinion it is a bad bet to predict that P/E ratios will decline, when historically they have risen in secular bull markets. Even a modest increase in the ratio of just 5% to 10%, combined with strong earnings growth, leads to double-digit gains in 2017.

2700 in 2017!

Ignore the comments that the market is in 'its 2nd longest bull market run', they are simply wrong. Since the market lows of 2009, investors have experienced two 'normal' bull markets: 3/2009-4/2011 with a 101.6% gain over 2.2 years, and 10/2011-5/2015 with a jump of 93.9% over 3.6 years. Both bull markets ended with bear markets: 4/2011-10/2011 the market fell over 20% (intraday for S&P and NASDAQ) and -30% for the Russell 2000, and again from 5/2015-2/2016 the market declined over 14% over 266 days, which also fills the definition by many as a bear market. A lengthy but shallower decline than the classic 20% decline archives the same results of a bear market: it wipes out the excesses and investor's optimism reaches rock bottom.

Therefore with a new cyclical bull market starting on 2/11/16, what might we expect by looking at the pattern of other bull markets.



STIR is Not Alone in Calling this a New Secular Bull Market

'Prepare for more record highs over the next few years, says one Bank of America Merrill Lynch Strategist, who says a similar trend in history suggests that this bull market is far from over.'

"We actually think the Dow will surpass 20,000 and go much, much higher than that," said Stephen Suttmeier, his firm's Chief Equity Technical Strategist. "We do believe that we are in a secular bull trend [that was] signaled on the April 2013 breakout in the S&P 500."

Suttmeier points out that much like today, rising bond yields also corresponded to a surge in equities in the 1950s. By the time bond yields moved to 5 or 6 percent in the 1960s, the S&P 500 had rallied about 460 percent over the decade or so. (Editor's note: the 1949-1968 bull market gained +700%).

"That bull run into the mid-1960s was actually an S&P secular bull trend that was associated with a low and rising interest rate environment," Suttmeier said. "That is how we're set up right here." In other words, Suttmeier believes that "there is at least a decade or more to run here on the S&P 500 and other U.S. equity averages."

As always, the STIR Research quantitative analysis will actually guide us through 2017. The Market Outlook only gives us an educated glimpse based on history of what may occur.