You Can Put It On My Gravestone: The Stock Market Is Overvalued
Don's Blog 2017.10.10

Each Monday morning as I attempt to conjure up something to write, I think to myself: self, what more can you say? Nothing seems to change. Ever since the election of "The Donald," the stock market has advanced and everything else seems to only fluctuate. During the Fourth Turning turmoil, faith in conventional institutions are lost and we are seeing such, except for the Federal Reserve. The Fed has told us—at least we think so—they will not allow this market to decline. Honestly, that appears to me the only reason one can account for arguably the highest valuation in the market's history. Good 10 to 15 year performance cannot come from valuations this high! They just can't! I think it is possible cash at 0% interest may be a better investment, but I said that a year ago as well as even before that. I would suggest that anyone who operates as a fiduciary should read what John Hussman had to say in his latest piece on 10/09/2017. Unless the earth is really flat, I think he's absolutely correct.

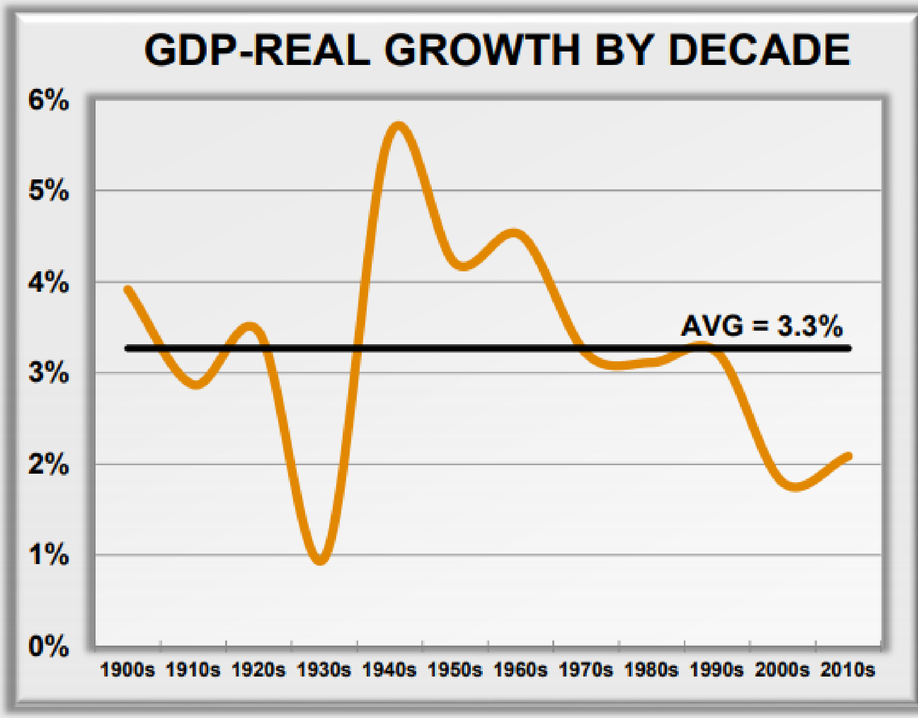
As we all agree, the future is only known when it's in the past, and of course, that's too late to be of any help. Take a peek at Ed Easterling's chart (chart #1) below. It is possible that our real GDP is headed for that 1% experienced in the 1930s? Wall Street is calling for a return to something in the 3's. Rather than 3, might we be headed for 1? On a per capita GDP basis, we are already there. Now in case you have written me off as some conservative nut, please understand that the pro-Keynesian liberal group such as the Levy Institute of Bard College is expecting 0% real growth in 2018 on its way to a -2.5% in 2020. Even I can't get that negative.

As we are looking at historical charts, I thought the following (chart #2) from Gary Shilling's Insight publication would be of great interest. This harkens back to my recent blogs concerning inflation. Almost to a man, all analysts expect inflation to pick up as well as real growth. That, and low interest rates are their justification for high stock valuations today. Although one might quibble with the 2001-2014 War on Terror designation, it's obvious in relative peacetime conditions that inflation is not much of a problem. Could it be that WWIII is being discounted by the stock market?

I need to comment briefly about the recent Nobel Prize economic winner, Richard Thaler. He, along with several others were the ones who drew me to the behavioral school of economics.

Most others, particularly Keynesian followers, built models based upon humans always acting rational. Now I ask you: how often have you observed others always being rational? What about yourself? Supply-demand curves work only in the classroom. Human behavior hasn't changed in 5000 years or so.

Chart 1



	COMPOUNDED ANNUAL RATES OF CHANGE				
BY DECADE	GDP NOMINAL	**GDP REAL**	GDP INFLATION	POPU-LATION	GDP PER CAPITA
1900s	5.3%	**3.9%**	1.4%	1.9%	1.9%
1910s	10.0%	**2.9%**	7.1%	1.5%	1.4%
1920s	3.1%	**3.4%**	-0.4%	1.5%	1.9%
1930s	-1.1%	**1.0%**	-2.1%	0.7%	0.2%
1940s	11.3%	**5.6%**	5.7%	1.3%	4.2%
1950s	6.7%	**4.2%**	2.5%	1.8%	2.4%
1960s	6.9%	**4.5%**	2.4%	1.3%	3.2%
1970s	9.9%	**3.2%**	6.7%	1.1%	2.1%
1980s	8.0%	**3.1%**	4.8%	0.9%	2.1%
1990s	5.5%	**3.2%**	2.3%	1.2%	2.0%
2000s	4.1%	**1.8%**	2.3%	1.0%	0.8%
2010s	3.7%	**2.1%**	1.6%	0.7%	1.3%
1900-2016	6.1%	**3.3%**	2.8%	1.3%	2.0%
1900-1949	5.6%	**3.4%**	2.3%	1.4%	1.9%
1950-1999	7.4%	**3.7%**	3.7%	1.3%	2.4%
2000-2016	3.9%	**1.9%**	2.0%	0.9%	1.0%

Chart 2

Historic Inflation and Deflation

Period	Military Engagement	No. of Years	Annualized Wholesale Price Change
1749-1755	Peacetime	6	-0.50%
1756-1763	French-Indian War	8	2.27%
1764-1774	Peacetime	11	-0.35%
1775-1783	American Revolution	9	12.31%
1784-1811	Peacetime	28	-1.91%
1812-1815	War of 1812	4	7.78%
1816-1845	Peacetime	30	-2.36%
1846-1848	Mexican-American War	3	-0.40%
1849-1860	Peacetime	12	1.05%
1861-1865	Civil War	5	14.75%
1866-1916	Peacetime	51	-0.74%
1917-1918	World War I	2	23.92%
1919-1940	Peacetime	22	-2.31%
1941-1945	World War II	5	6.12%
1946-1992	Cold War	47	4.20%
1992-2000	Peacetime	8	1.43%
2001-2014	War on Terror	13	2.81%
2015 – Q2 2017	Peacetime	2.5	1.42%

	No. of Years	Avg. Price Change
Wartime:	96	8.20%
Peacetime:	170.5	-0.47%
Total:	**266.5**	**3.86%**

Adapted from Gary Shilling's Insight, October 2017