Don't Time a Correction

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The stock market is on a tear. The S&P 500 rose 19.4% in 2017 excluding dividends, and is already up over 4% in 2018. It's not a bubble or a sugar high. Our capitalized profits model, says the broad U.S. stock market, is, and was, undervalued.

We never believed the "sugar high" theory that QE was driving stocks. So, slowly unwinding QE and slowly raising the federal funds rate, as the Fed did in 2017, was never a worry. But, now a truly positive fundamental has changed – the Trump Tax Cut, particularly the long-awaited cut in business tax rates. With it in place, we think our forecast for 3,100 on the S&P 500 by year-end is not only in reach, but could be eclipsed.

Before you consider us overly optimistic, we did not expect the stock market to surge like it has so early in the year. In fact, we would not have been surprised if the market experienced a correction after the tax cut. There's an old saying; "buy on rumor, sell on fact." So, with tax cuts approaching, optimism could build, but once they became law, the market would be left hanging for better news.

We would never forecast a correction, because we're not traders. We're investors. Anyone lucky enough to pick the beginning of a bear market never knows exactly when to get back in. In 2016, it happened twice and we know many investors are still bandaging up their wounds from being whipsawed.

The market got off to a terrible start in 2016, one of the worst in years. The pouting pundits were talking recession and bear market, only to experience a head-snapping rebound. Then, during the Brexit vote, the stock market fell 5% in two days – which was seen as another indicator of recession. But, it turned out to be a great buying opportunity, like every sell-off since March 2009.

The better strategy for most investors is don't sell. Some sort of correction is inevitable but no one knows for sure when it will happen and few have the discipline to take advantage of the situation.

This is particularly true when risks to the economy remain low and the stock market is undervalued, which is exactly how we see the world today.

Earnings are strong (even with charge-offs related to tax reform), and according to Factset, since the tax law passed analysts have lifted 2018 profit estimates more rapidly than at any time in the past decade. Even the political opponents of the tax cuts are saying it will likely lift economic growth for at least the next couple of years.

Continuing unemployment claims are the lowest since 1973, payrolls are still growing at a robust pace, and wages are growing faster for workers at the lower end of the income spectrum than the top. Auto sales are trending down, but home building has much further to grow to keep up with population growth and the inevitable need to scrap older homes. Consumer debts remain very low relative to assets, while financial obligations are less than average relative to incomes.

In addition, monetary policy isn't remotely tight and there is evidence that the velocity of money is picking up. Banks are in solid financial shape, and deregulation is going to increase their willingness to take more lending risk. The fiscal policy pendulum has swung and the U.S. is not about to embark on a series of new Great Society-style social programs. In fact, some fiscal discipline on the entitlement side of the fiscal ledger may finally be imposed.

Bottom line: This is not a recipe for recession.

It's true, rising protectionism remains a possibility, but we think there's going to be much more smoke than fire on this issue, and that deals will be cut to keep the good parts of NAFTA in place.

Put it all together, and we think the stock market, is set for much higher highs in 2018. If you're brave enough to attempt trading the inevitable ups and downs of markets, more power to you, but as hedge fund performance shows, even the so-called pros have a hard time doing this. Stay bullish!

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-16 / 7:30 pm	Empire State Mfg Survey – Jan	19.0	**18.0**	17.7	19.6
1-17 / 8:15 am	Industrial Production – Dec	+0.5%	**+0.5%**		+0.2%
8:15 am	Capacity Utilization – Dec	77.4%	**77.4%**		77.1%
1-18 / 7:30 am	Initial Claims – Jan 13	250K	**251K**		261K
7:30 am	Housing Starts – Dec	1.275 Mil	**1.262 Mil**		1.297 Mil
7:30 am	Philly Fed Survey – Jan	24.8	**31.8**		27.9
1-19 / 9:00 am	U. Mich Consumer Sentiment- Jan	97.0	**97.0**		95.9