Looking for Patterns in Stock and Bond Returns

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- The S&P500 has earned an annualized return of 15.28% over the past 5 years, well above the S&P's 10% average return
- The pattern of 5-year returns suggests that this past 5-years is unusual
- The pattern of 5-year bond returns is also examined

Many, including me, are concerned about the recent run-up in the U.S. stock market, especially recently. Can we realistically expect more of the same, or are we likely to see a correction, and how bad might it be? A look at the past 5 years compared to the history of 5-year periods provides some perspective, as shown in the following:

	1927-1931	1932-1936	1937-1941	1942-1946	1947-1951	1952-1956	1957-1961	1962-1966	1967-1971	1972-1976	1977-1981	1982-1986	1987-1991	1992-1996	1997-2001	2002-2006	2007-2011	2012-2016
Series1	-5.11	22.47	-7.51	17.87	16.7	20.18	12.79	5.72	8.41	4.88	8.08	19.84	15.37	15.18	10.75	6.22	-0.36	15.28

The S&P500 has earned an annualized return of 15.28% over the past 5 years, through December 20, 2016. This compares to an average 91-year return on the S&P of 10%, so the past 5 years are well above average. It's precisely this above average return that is causing concern that the U.S. stock market is overpriced, but as you can see there have been strings of above average 5-year periods that stretch for 20 years, so this concern might be unwarranted.

<u>So what makes this past 5 years different?</u>

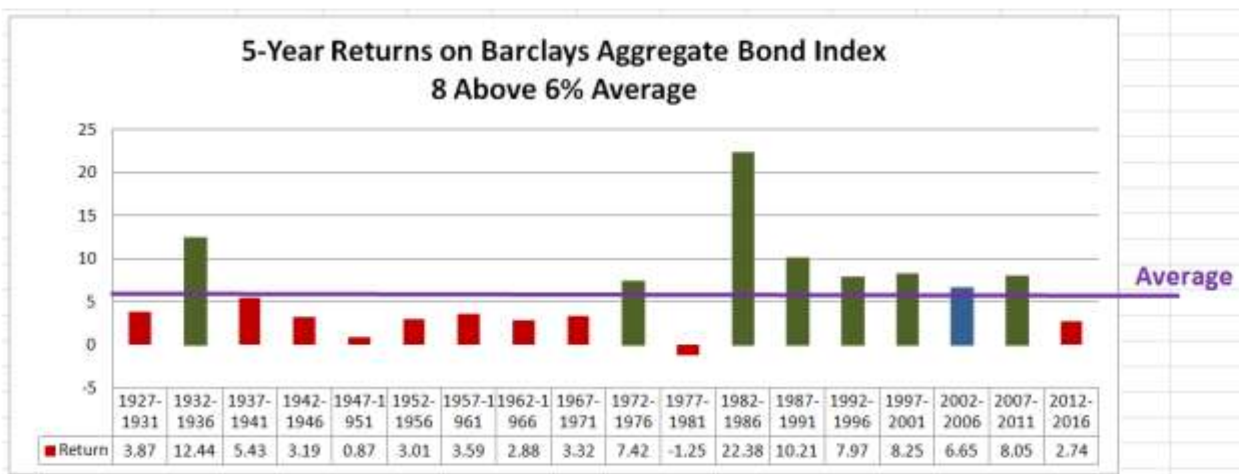
- There appears to be a pattern in stock prices that oscillates on a 20-year schedule – above average for 20 years, then below average, etc. If this pattern is currently repeating we are in a 20-year down period that has been interrupted in the past 5 years.

- This time we have an unprecedented manipulation of interest rates known as Quantitative Easing and a National Debt above $20 trillion.
- Last, but not least, we could be repeating the "Fools Rally" of 1932-1936, when the market temporarily rebounded from the Great Depression, only to be slapped down again in the subsequent 5 years.

As that commercial said "It's not nice to fool Mother Nature." What does your eye and intuition tell you? Are we the optimist falling from the skyscraper saying "So far, so good"?

Bond returns

The following graph shows the history of 5-year bond returns:



The Barclays Aggregate Bond Index has returned 2.74% over the past 5 years, which is below the 6% long-term average, but here expectations should be governed more by the current level of interest rates than by historical patterns. With nominal interest rates near zero, and real rates below zero, something is totally wrong. Will this balloon pop or gradually deflate? Time will tell. Some day Quantitative Easing must end, and it's not clear what the consequences will be.