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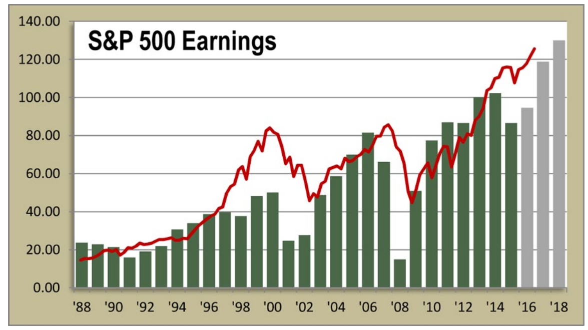
The stock market continues to deliver impressive results. Since the last correction ended on February 11, 2016, the S&P 500 has posted an increase of more than 31%. A number of significant events made headlines as well.

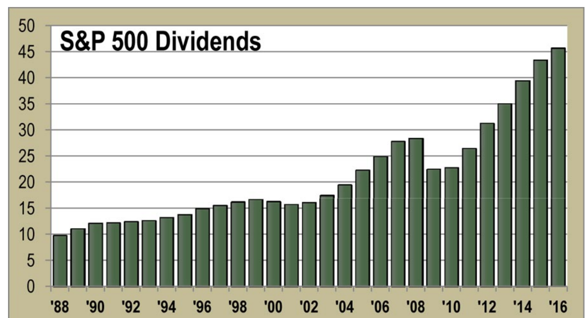
Last June, we heard about the BREXIT catastrophe. Stock prices tumbled for about a week before erasing their declines. Then in November, the US election results surprised almost everyone. Stock futures tumbled overnight indicating a harsh decline to start the next day. However, by the opening bell, the impact of the shocking result faded and erased the predicted losses.

Earlier this year, the Dow Jones Industrial Average pushed through the 20,000 level, and broke 21,000 in very short order.

The current bullish run has increased worries about a significant adjustment in stock prices. Even in good times, potential corrections—a decrease of 10% or more in stock prices—lurk in the shadows. While unpleasant, we believe these temporary set backs pose no major threat to your longer term success as an investor. In fact, you should expect these interruptions at least once every year.

Many people have expressed their concerns about the overall investment climate. Many of the worries stem from the current political climate and the new president. So we offer you our reasons to be optimistic and also concerned.





The first graph shows the earnings on the S&P 500 Index since 1988. The red line represents the quarterly closing value of the index over the same time period.

The second graph represents the dividends paid on the S&P 500 Index since 1988.

REASONS FOR OPTIMISM

Some of the upswing since November relates to a pro-business optimism. Campaign promises of regulatory and corporate tax reform boosted the rally into the new year. Taxes and regulations decrease profitability. Reducing some of those burdens should improve earnings and shareholder value.

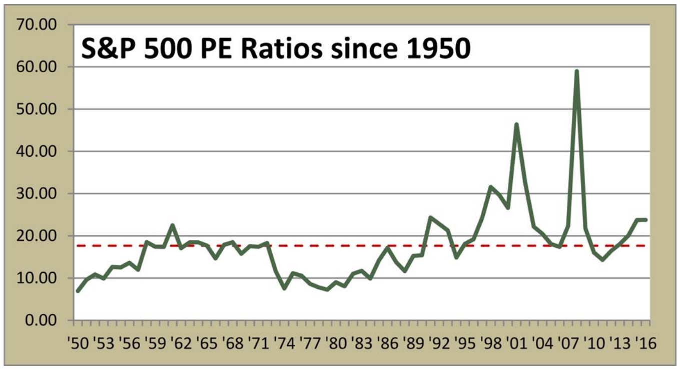
Over longer periods of time, stock prices follow the growth in corporate profits. The story for stocks improved prior to the election. Corporate profits hit a slump in 2015. However, earnings grew in 2016 and are projected to grow again in 2017. Earnings in 2018 are also forecasted higher, but those estimates should be viewed with a cautious eye.

Rays of sunshine exist on the larger economic front as well. Despite sluggish improvements in gross domestic product (GDP) and employment, other bright spots point to an improving economic picture both in the US and globally.

REASONS FOR CONCERN

Valuations are a concern. An individual company or the market as a whole can be described as either expensive or cheap. Dividing the price you pay by the profits generated tells us the price-to-earnings ratio. PE ratios above a certain level—historical average—indicate something is expensive, while lower readings describe it as cheap.

Data for the charts above was provided by the S&P Dow Jones Indicies. Earnings for 2016-2018 are estimated by Standard and Poors and could be revised in either direction. The chart is not intended to be a forecast of future events.



The average PE ratio for the US stock market since 1950 is 17.65, indicated by the dashed red line in the chart. Most people would consider the market fairly valued at this level. At year's end, the PE ratio measured over 23, which indicates a more expensive environment.

Some experts like to use this metric (or other variations of it) as the basis of their predictions. While not a precise indicator of impending doom, historical PE Ratio data indicates a more difficult environment for equities in the future.

Washington DC is also on the radar. As mentioned earlier, some of the opitimism comes from promises of tax and regulatory reform. Making meaningful progress in those areas may prove to be very difficult. In fact, the media recently assigned "lack of progress" as a reason for a 1+% decrease on March 21. For the optimism to continue, elected officials must make progress.

We are also concerned about the volatility of human behavior. Over longer periods of time, markets tend to be very efficient. The prices of securities generally reflect their underlying fundamental characteristics. However, the human element can create extreme swings in prices which ignore those characteristics.

How Could Higher PE Ratio's Impact Future Returns?

Visit our blog to find out how different levels of market valuations have influenced future returns for stocks. Also we look at how this information impacts the expectations we use in the planning process.

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We live in a world where events are sensationalized to create an emotional reaction. One event could be the starting point of the next irrational move in the prices of any asset class. Many investors may not pay close attention if prices are pushed higher. However, when values move in the opposite direction, people notice. These trends can continue further and last longer than anyone can predict.

WHAT CAN YOU DO?

We remain firmly optimistic about the long-term story for stocks. Ten to twenty years from now, we believe the stock market will be higher than it is now. It also will not happen without periods of adversity, some of which could be extreme. The discomfort associated with a significant decrease in account values makes it more difficult to stick with your long-term plans.

For some, now is an appropriate time to reduce—NOT eliminate—total exposure to equities. The adage says to. "Buy low, sell high." Rebalancing now while stocks are near their all time high is "selling high." We have already taken steps to do this for many of our clients.

For others, particularly those still in an accumulation phase, a downturn of any significance should not be a major concern. A correction gives you the opportunity to acquire shares of great businesses at discounted prices.

We are here to help guide you through both the good times and the tough ones. Thank you for your continued business. We are grateful for the opportunity to help you plan and build for your future.

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