Mitch on the Markets

How to Navigate a Market at All-Time Highs

By Mitch Zacks
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Economic data is arguably firing on all cylinders:

- For the first time in ten years, the GDP growth rate is higher than the unemployment rate[1];
- The August edition of the Institute for Supply Management manufacturing index showed the strongest expansion of manufacturing activity since May 2004;[2]
- The Conference Board gauge of consumer confidence has rarely been higher;
- Wages are rising the fastest since the last recession;
- And the list goes on…[3]

For some investors, this environment enhances the case for optimism. The thinking goes that if the economy is strong and getting stronger, it must be a good time to invest. While true in some respects, it also has the possibility of exposing some of an investor's weakest instincts.

The tendency I've witnessed time and again over numerous market cycles is that many investors latch-on to recent economic indicators (like the ones we're seeing today), and use them as a rational to take-on more risk.

Diversified portfolios turn into portfolios concentrated in dotcom companies. Household borrowing skyrockets as rising home prices, risk-taking banks, and rock-bottom interest rates lure investors into buying homes they cannot afford and home equity lines of credit. Cryptocurrencies all-of-a-sudden become the hottest investment in the marketplace, even though few people understand them at all.

Those are just examples from the last three cycles, but you get the picture. *Strong economic conditions tend to cloud judgment*, with investors getting caught up in the exuberance of the moment. In my view, the more investors see headlines about the economy booming and the markets going up, the more they are likely to want more risk in their portfolios. For me, that would be a warning sign.

On the other side of the coin are those investors who see a strong economy and a market at all-time highs as a paradox. On one hand, strong economic and corporate earnings data would argue for attractive investment conditions. But on the other, a market at all-time highs might indicate that it's too late – or too expensive – to get involved. These investors tend to stay on the sidelines.

In my opinion, investors should be doing neither of these things. They should not see the current strength in the economy as a rationale for doubling down on risky ventures, and they should not see the market at all-time highs as a rationale for staying on the sidelines. In my view, there is a clear middle ground.

To the investor who sees the booming economy as a motivation to concentrate a portfolio into risky assets, I would say you're better off investing in a diversified portfolio of risk assets over long stretches of time. For the investor reluctant to invest with the market at all-time highs, I would say the same thing. In my view, investing is not about making big returns in short periods of time, or trying to time your entries and exits into the market. It's about realizing the long-term value creation of quality companies.

Bottom Line for Investors

Don't get me wrong – I see the current U.S. economic strength as a feature that could endure looking ahead over the next six to twelve months, which should also support higher equity prices. This is a point we've been making regularly here at Zacks Investment Management for some time now.

The thrust of my column this week is a call for investors to recognize if the market being at or near all-time highs brings out any tendencies you might have. Are you feeling as though you need to take more risk? Are you fearful that all-time highs mean you should sell or stay on the sidelines?

If the answer to either question is yes, I'd encourage you to seek the middle ground.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] The Wall Street Journal, September 10, 2018, https://www.wsj.com/articles/white-house-corrects-trumps-tweet-on-gdp-unemployment-1536610078?mod=djemwhatsnews

[2] Trading Economics, September 12, 2018, https://tradingeconomics.com/united-states/business-confidence?utm_source=newsletter&utm_medium=email&utm_campaign=newsletter_axiosam&stream=top

[3] The Wall Street Journal, September 10, 2018, https://www.wsj.com/articles/economic-confidence-is-really-high-perhaps-its-time-to-sell-1536593504?mod=djem10point

DISCLOSURE

Past performance is no guarantee of future results. Inherent in any investment is the potential for loss.