HOW MUCH LONGER CAN THIS BULL MARKET LAST?

MILLS WEALTH ADVISORS

The Longest Bull Market in S&P 500 History

In the Wall Street Journal on Tuesday August 22, 2018 there was an interesting article that included the picture below (Fig 1) showing the S&P 500 Index on the verge of becoming the longest S&P 500 bull market ever. It has now lasted over 3,455 days, since the credit markets froze up and hit a low of 666 on March 9, 2009. Monday, the S&P 500 closed at 2862.96. While many investors likely did not get in at the exact bottom (those where scary times), any capital that has remained broadly invested in equities has received a very attractive long- term gains with many investors earning 300-400% on their equity investments in this long running bull market.

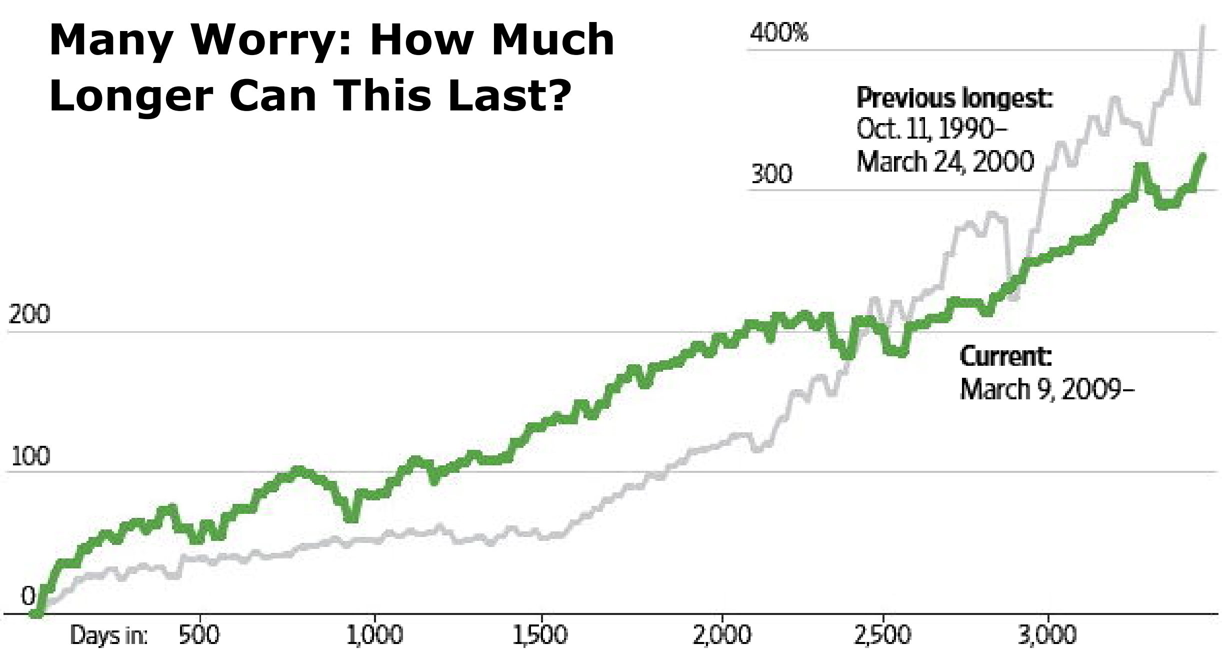


Fig 1 : Source: Wall Street Journal, August 22, 2018 Edition

Many investors have asked us if they should they get out of the stock market? I believe if you are a long-term saver you should never get All-Out or All-In of a core holding. We can't predict what the stock market will do tomorrow. Being out of the market typically involves much bigger loses of wealth as compared to the short-term paper losses that can occur in a correction. It also causes investors to miss out on large gains that occurred over short periods of time while they delay getting back in.

Additionally, the transaction cost of trading, the market impact cost and taxes are often punitive to those that constantly get in and out.

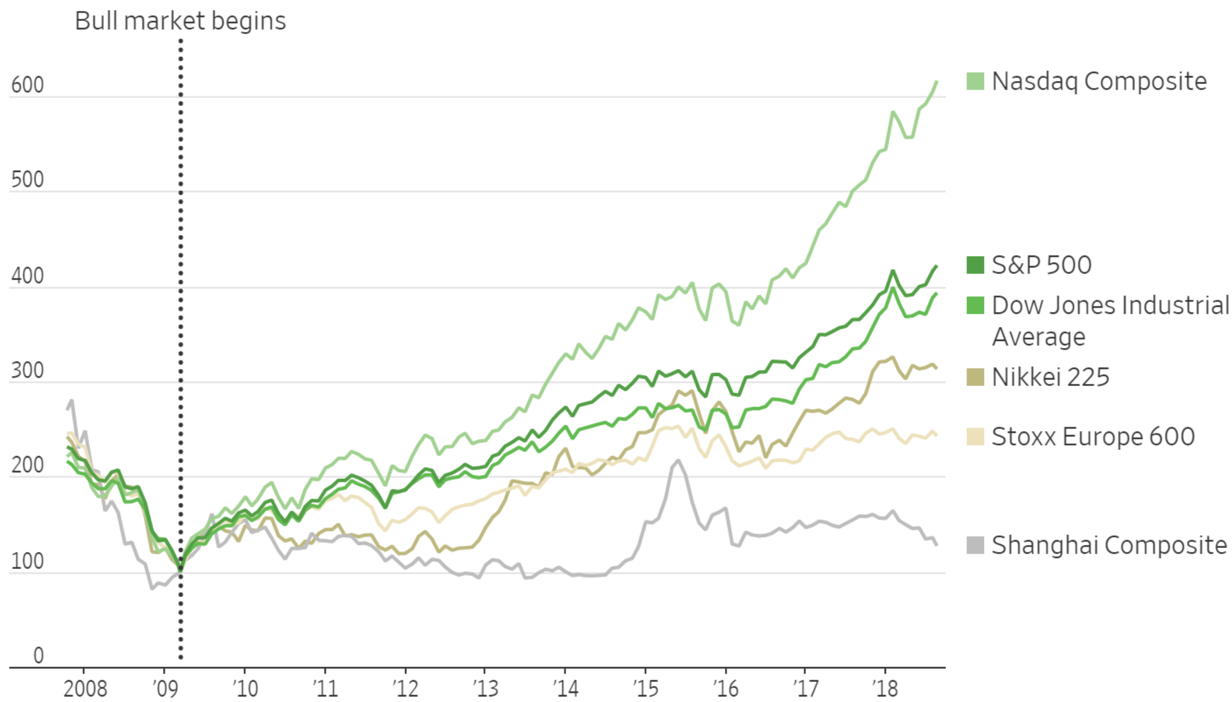


Fig 2 : Source: Wall Street Journal, August 22, 2018 Edition

How to Prepare for the Future

Nevertheless, now is a great time to reassess your cash needs over the next 5 years. If there is anything on the horizon that would affect your savings ability (e.g. losing a job, starting a business, retiring, buying a home, etc.), having a little more defense (e.g. cash and bonds) in your investment portfolio will likely add to your confidence and make the next market decline look and feel more like a market opportunity and not a wealth destroyer.

All past bull markets have come to an end at some point; we just don't know when that will occur for the current bull market. The best time to rebalance and take some profit and reduce risk is when markets get out of balance and don't match the risk characteristics needed to achieve your goals. Remember the market makes something cheap every day. Right now, the US Stock Market collectively would not be considered cheap by most measures; so, one strategy is to make sure your portfolio has plenty of the assets that have lagged the US Stock Market such as stocks of Foreign Companies in both Developed and Emerging Markets. These out of favor areas generally have much more attractive long- term return prospects for the risk assumed.

Leveraging Research to Improve Returns

Academics have demonstrated that tilting equity portfolios toward three factors in equity markets worldwide has produced premiums (excess returns) over portfolios that are not more weighted to these factors. These three factors are company size (market capitalization), value (price to book value per share relationship) and profitability (cash flow per share). (Fig 3)

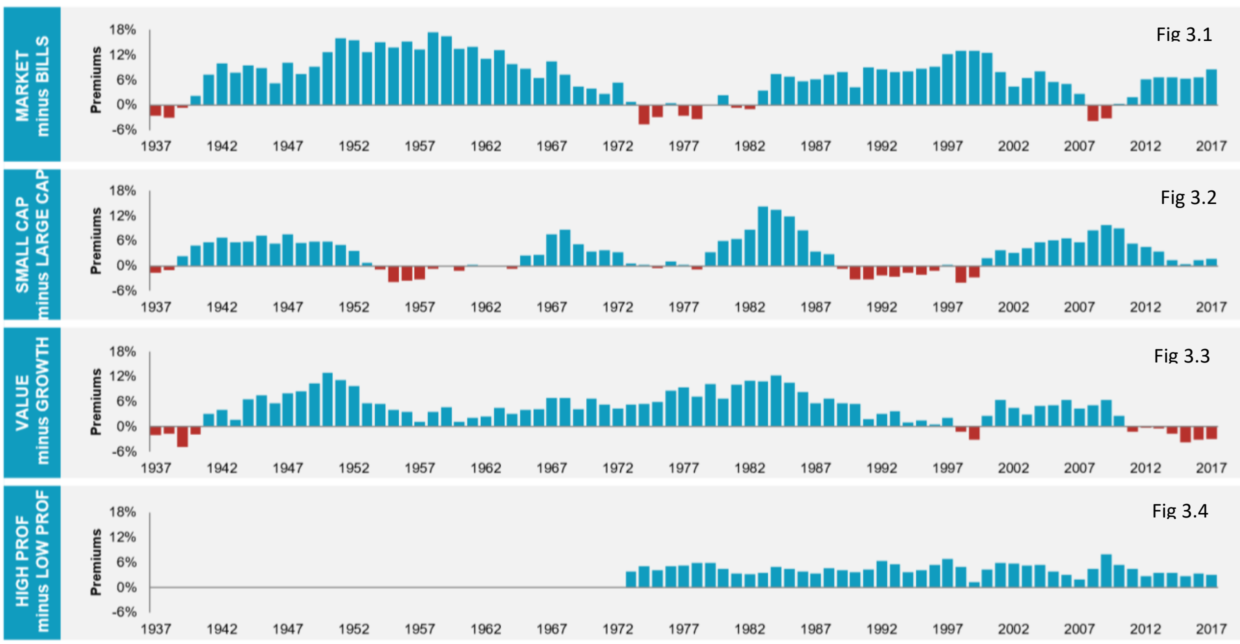
Small companies have historically produced a long-term average of 2-3% per year premium (higher return) over owing the bigger companies (such as those found in the S&P500), albeit with more risk. These premiums show up about 70% of the time when looking at rolling 10- year time periods going back to 1927. (Fig 3.2)

Investors that tilt portfolios toward “value stocks” (those trading at prices closer to their book values) have tended to produce a long-term average of 3-5% per year premium over growth stocks (those trading at higher price to book value ratios). Historically, these premiums show up about 80% of the time when looking at rolling 10-year time periods going back to 1927.   However, in the last 10 years this premium has not been as strong in the US stock market, but very strong in the international stock markets (Fig 3.3). Therefore, diversification is such an important component of a long-term portfolio.

Finally, high profit companies tend to outperform low profit companies by a long-term average of 4-5% per year and this known premium has been very consistent. This premium has shown up 100% of the time when looking at 10 year rolling periods since 1973. (Fig 3.4)

Historical 10 Year Returns of the Factors

Equity, size, relative price, and profitability: US Markets



*Bars represent average annual premiums over a 10-year period. Premiums are the excess returns received due to the described factor.
Note: Fig 3.1 shows the excess return that equities have produced over bills
Fig 3 : Source Dimensional Fund Advisors

Although we have no idea when these historical premiums will show up in market prices, we have a degree of confidence they will. Much research and analysis has shown that these factors are pervasive across markets and persistent across time periods. Investors that maintain exposure to these factors will be rewarded if and when the premiums materialize, which can change or appear on a dime. Thus, we recommend investors maintain long term exposure to these 3 factors because we believe doing so will lead to better long-term risk adjusted performance (premiums).

Performance of the Factors

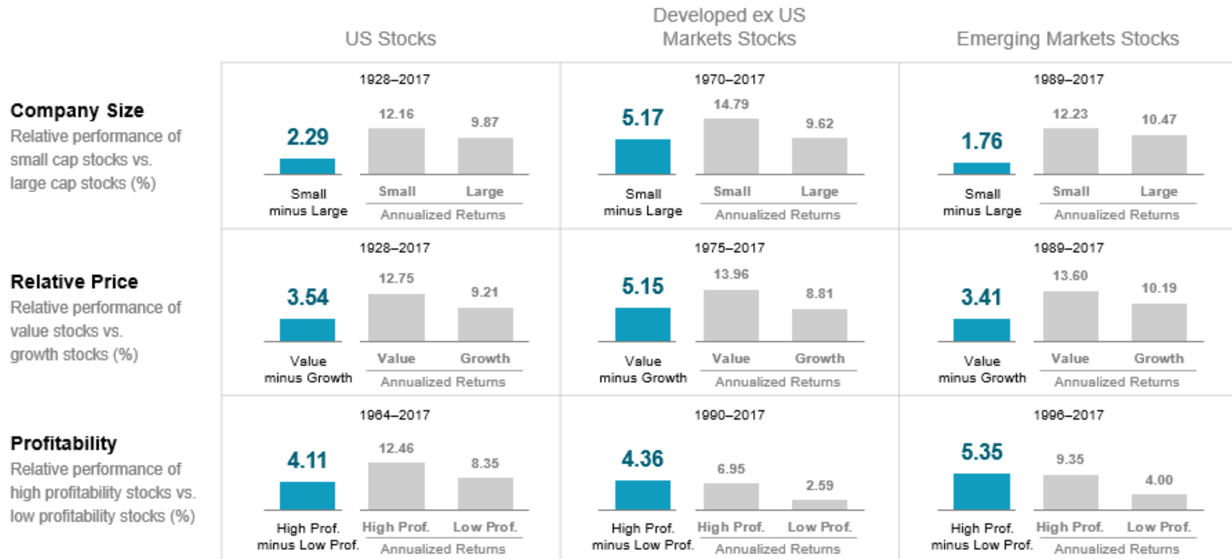


Fig 4 : Source Dimensional Fund Advisors

Importance of Understanding Your Portfolio

Knowing and understanding the characteristics of your portfolio and the strategy you are using makes sticking with it much easier when the bear shows up to take back some of your gains.

Our recommendation is to analyze your portfolio today. Compare your portfolio risk to your personal risk tolerance. Discuss your strategy with your spouse and your financial advisor. Make sure your defensive position (cash and bonds) is big enough to provide the confidence and peace of mind needed to take advantage of stock price declines when they eventually show up. Lastly, remember the 3 biggest items that will affect your future returns are:

— The asset classes you invest in
--- The exposure to the size, value and profitability factors within an equity asset class
— The costs of gaining exposure to the asset classes and factors

The Costs You Don't See

This last item, cost, is not well understood by many investors. It's generally understood that explicit costs are stated in a funds expense ratio and the commission cost to buy or sell a stock or fund are easily found. However, hidden cost buried inside an investments trading and turnover are often much more damaging as these costs are harder to see and an easy place to charge consumers. These implicit costs of turnover can be 3x the typical expense ratio. These costs can have a significant impact on the performance of a fund.

If you want a second set of eyes on your portfolio, your investing strategy, or your entire financial plan, don't hesitate to give us a call. We'd be happy to analyze your total cost (both transparent and hidden costs that are buried inside your investments). We can also evaluate your exposure to the company size, value and profitability factors.

Attractive portfolio returns are likely still available to long term investors. Now is the time to reassess your overall strategy to determine how you can profit in the future.

Best wishes and much success,

Mike Mills, CFP®, CLU®, CFS

1207 S White Chapel Blvd #150 Southlake, TX 76092 | www.millswealthadvisors.com | (817)416-7300
MILLS WEALTH ADVISORS

Fig 1: Wursthorn, Michael, and Akane Otani. “Bull Market Set To Become Longest.” *The Wall Street Journal*, 21 Aug. 2018, pp. A1–A8.

Fig 2: Wursthorn, Michael, and Akane Otani. “U.S. Stocks Poised to Enter Longest-Ever Bull Market.” *The Wall Street Journal*, 21 Aug. 2018, www.wsj.com/articles/u-s-stocks-poised-to-enter-longest-ever-bull-market-1534843800.

Fig 3: Dimensional Fund Advisors LP. https://www.dimensional.com/
Information provided by Dimensional Fund Advisors LP.
In US dollars. US size premium: Dimensional US Small Cap Index minus S&P 500 Index. US relative price premium: Fama/French US Value Research Index minus Fama/French US Growth Research Index. US profitability premium: Dimensional US High Profitability Index minus Dimensional US Low Profitability Index. Dev. ex US size premium: Dimensional Intl. Small Cap Index minus MSCI World ex USA Index (gross div.). Dev. ex US relative price premium: Fama/French International Value Index minus Fama/French International Growth Index. Dev. ex US profitability premium: Dimensional International High Profitability Index minus Dimensional International Low Profitability Index. Emerging Markets size premium: Dimensional Emerging Markets Small Cap Index minus MSCI Emerging Markets Index (gross div.). Emerging Markets relative price premium: Fama/French Emerging Markets Value Index minus Fama/French Emerging Markets Growth Index. Emerging Markets profitability premium: Dimensional Emerging Markets High Profitability Index minus Dimensional Emerging Markets Low Profitability Index. Profitability is measured as operating income before depreciation and amortization minus interest expense scaled by book. S&P data copyright 2018 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. MSCI data © MSCI 2018, all rights reserved.
Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. Actual returns may be lower. See “Index Descriptions” for descriptions of Dimensional and Fama/French index data. Eugene Fama and Ken French are members of the Board of Directors of the general partner of, and provide consulting services to, Dimensional Fund Advisors LP.

Fig 4: Dimensional Fund Advisors LP. https://www.dimensional.com/
Information provided by Dimensional Fund Advisors LP.
In US dollars. US size premium: Dimensional US Small Cap Index minus S&P 500 Index. US relative price premium: Fama/French US Value Research Index minus Fama/French US Growth Research Index. US profitability premium: Dimensional US High Profitability Index minus Dimensional US Low Profitability Index. Dev. ex US size premium: Dimensional Intl. Small Cap Index minus MSCI World ex USA Index (gross div.). Dev. ex US relative price premium: Fama/French International Value Index minus Fama/French International Growth Index. Dev. ex US profitability premium: Dimensional International High Profitability Index minus Dimensional International Low Profitability Index. Emerging Markets size premium: Dimensional Emerging Markets Small Cap Index minus MSCI Emerging Markets Index (gross div.). Emerging Markets relative price premium: Fama/French Emerging Markets Value Index minus Fama/French Emerging Markets Growth Index. Emerging Markets profitability premium: Dimensional Emerging Markets High Profitability Index minus Dimensional Emerging Markets Low Profitability Index. Profitability is measured as operating income before depreciation and amortization minus interest expense scaled by book. S&P data copyright 2018 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. MSCI data © MSCI 2018, all rights reserved.
Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. Actual returns may be lower. See “Index Descriptions” for descriptions of Dimensional and Fama/French index data. Eugene Fama and Ken French are members of the Board of Directors of the general partner of, and provide consulting services to, Dimensional Fund Advisors LP.