September 2017 - If you can't beat 'em…join 'em!

Over September, risk assets across the globe advanced higher representing the 8th consecutive quarterly advance. Tokyo (Topix Index) and Europe (Stoxx 600) were top performers delivering 4.2% and 3.9% respectively followed by the S&P/TSX Composite Index, which outpaced the S&P 500 by 1.0% with a 3.1% total return. The primary driver of TSX outperformance was energy stocks which sent the sector higher by +7.4%.

If September is any indication of potential market catalysts, it's going to take more than the President's threats of military action and tearing up of trade agreements to send this market lower, as we again made record highs over the month. In fact there were six consecutive back to back highs made on the S&P 500 as a renewed sense of optimism surrounding potential positive changes to the tax code took hold of risk appetite. And we have to go all the way back to June of 1997 to find similar performance, where the S&P 500 recorded eight back to back record closes. As a matter of context, the all-time record (nine consecutive highs) occurred in 1929, just prior to the great depression. While it's probably just a coincidence that similar market performance preceded past bear markets, the duration of this current rally definitely gives some pause for thought. And after 103 months of market gains, today's bull market is now the second longest on record with price returns of 280% since the March 2009 bottom. Market prognosticators, both retail and institutional alike; seem to be somewhat mystified as to why the rally has gone on for so long. True, there's little argument over the state of the economy as labour markets and manufacturing activity remain solid. And when combined with consumer confidence levels, the fundamentals all point to continued positive equity performance. Valuations however are a different story and make the argument for further price gains less compelling as P/E ratios remain second only to peak dotcom levels. Not helping equity valuations are extremely low bond yields (thanks to US monetary policy) which leaves investors little investment alternatives outside of equity markets.

While the S&P 500's current 19.3 times forward earnings is the second highest on record, it remains significantly below the peak in 2000 which reached a staggering 27.2 times. Interestingly if you were to apply that peak multiple to the expected 2017 full-year estimate of $132 earnings per share, the S&P 500 would be trading close to 3600, 40% higher than today's level! To be sure, we're not suggesting this will happen but it does highlight the fact expensive markets can get more expensive and valuations alone won't catalyze a sell-off. Unfortunately, valuation metrics such as the P/E ratio are horrible at timing the market and offer no real insight into near term performance. They do however offer a rough gauge of longer-term return generation and also give some idea of the margin of safety built-in (or not built in at all) into stocks. Expensive or not, the old adage "if you can't beat 'em, join 'em" best describes investor attitudes today where we see retail investors getting off the sidelines out of fear of missing out with bulls currently outnumber bears by 4-to-1.

While we remain invested across all developed regions we have not taken any aggressive positions in any of the markets we invest in. Our in-house view remains relatively constructive on markets but we do recognize we remain closer to the end of the business cycle. As such, we remain neutral across our markets in the Active Balanced Portfolios. This neutral positioning ensures we will participate to the upside without exposing client capital to excessive levels of risk.