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We Have a Winner (?)

There are always some areas world history does not reach, zones of silence and undisturbed ignorance. Fernand Braudel

The Dow Jones Industrial Average closed yesterday at its highest level - ever. It beat the NASDAQ and the S&P 500 to the finish line. Its previous record close was in January of 2000, more than six and a half years ago. Six and a half years ago, my 11 year old son was in Kindergarten and my two teenage daughters still thought I knew a thing or two. Those were blissful times.

For those of you that pay attention to such things, the S&P 500 (the 500 largest US corporations as measured by market capitalization) has not yet reached its previous high set back in 2000, but it's getting closer (the NASDAQ is still only about half its previous level). Back in 2000, the price earnings ratio (price divided by earnings per share) for the S&P 500 peaked at close to 47 times earnings. That means that back then folks were willing to pay, on average, 47 times the profit per share to buy stock in a company. Today that number hovers around 18 (15 if the profit projections for this year are realized). This is still not cheap by long term historical measures (the stock market is usually very comfortable between 10 and 15), but it is a far cry from those heady days of 2000. If you've followed the math so far you may be asking yourself, how can we have the same basic level for the stock market as back in 2000, but price earnings multiples have been cut by almost two thirds? As my high school Algebra teacher used to say "It's all in the denominator" (I always hated that guy). You see, the price of the average stock is basically the same as in 2000 (the numerator), but earnings have increased dramatically since then (the denominator).

This stock market is in far better shape than it was back in 2000. Does that mean I'm not worried? No, I get paid to worry. Here are some factors that will affect the continued recovery of companies:

Oil prices. Although oil hit some pretty lofty heights not long ago, I suspect we will continue the recent downward trend. Reserves are coming online at a rapid clip due to recent high prices that have stimulated technological advances and exploration.

Interest rates. Although the Fed continues to fret about inflation creeping in around the edges, I think that there is enough concern about snuffing out this recovery to keep them sitting on their hands for the time being.

Recession. This is the wild card. I do not believe that the economy can continue to grow at the rate that has been achieved in the past few years, but I'm not yet ready to step in front of a bus. I remain concerned about the level of consumer debt that has been driving this economy for some time. As real estate prices continue to move lower, this may put a real pinch on consumption.

Elections. This economy succeeds despite politicians, not because of them.

My greatest worry (always) is that we will (inevitably) reach levels of unrealistic expectations for stocks (as in 2000) and the cycle will start all over again. Records are meant to be broken, but history it seems, always has the last laugh.

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