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Secular Bulls and Bears

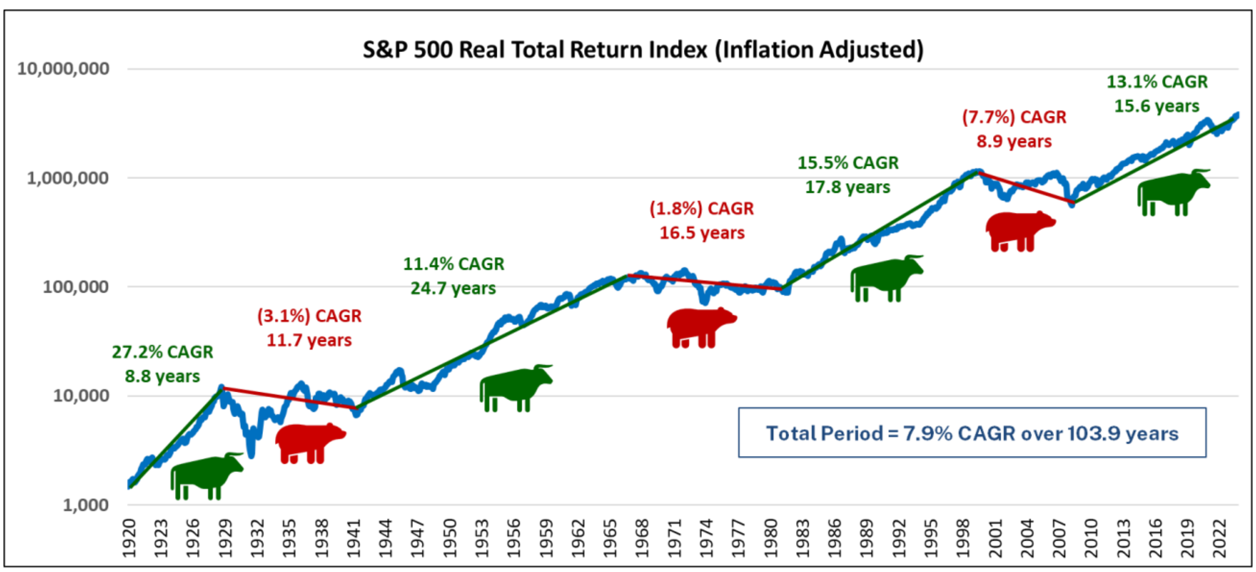
More pundits dissect daily market fluctuations and the latest tick of economic data than ever before. To us, this is like trying to find your way through the forest by scrutinizing the bark of every tree. Investing in companies, public or private, is a long-term endeavor. It requires stepping back to see where you are, to understand where you might be going. In this quarter's commentary, we begin by sharing three observations from our review of US stock market history:

1) US stock market history shows seven secular market cycles over the past hundred or so years – four bulls and three bears.

2) *Long-term* market performance is radically different – alternatingly excellent and destructive – depending on whether you started in a secular bull or bear.

3) The secular bulls and bears are nothing more than extremes in prices relative to profits. The path to investment success is, therefore, to focus on profits and not overpay for them.

Stock market history shows seven secular market cycles over the past hundred or so years – four bulls and three bears. Despite the daily, quarterly, and yearly ups and downs, even despite bear markets defined as declines of 20% or more (there have been 12), the wider vista of market history shows the great bulls and bears have been few and long.



Sources: real EPS data sourced from Robert Shiller dataset October 2024. Analysis by ACR.

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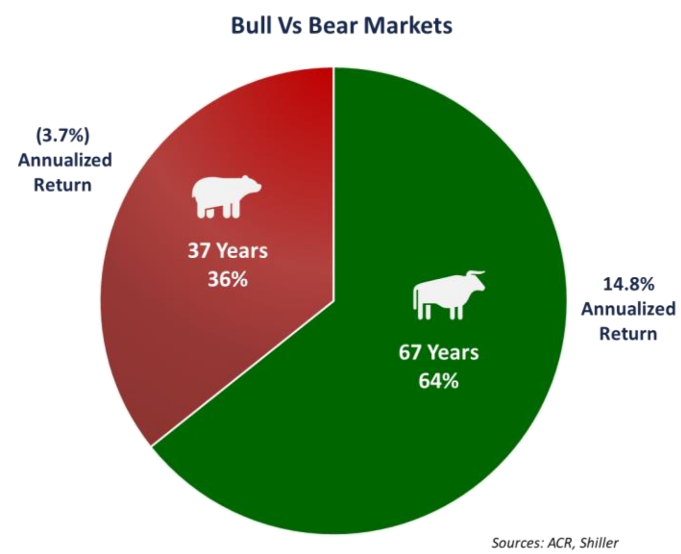
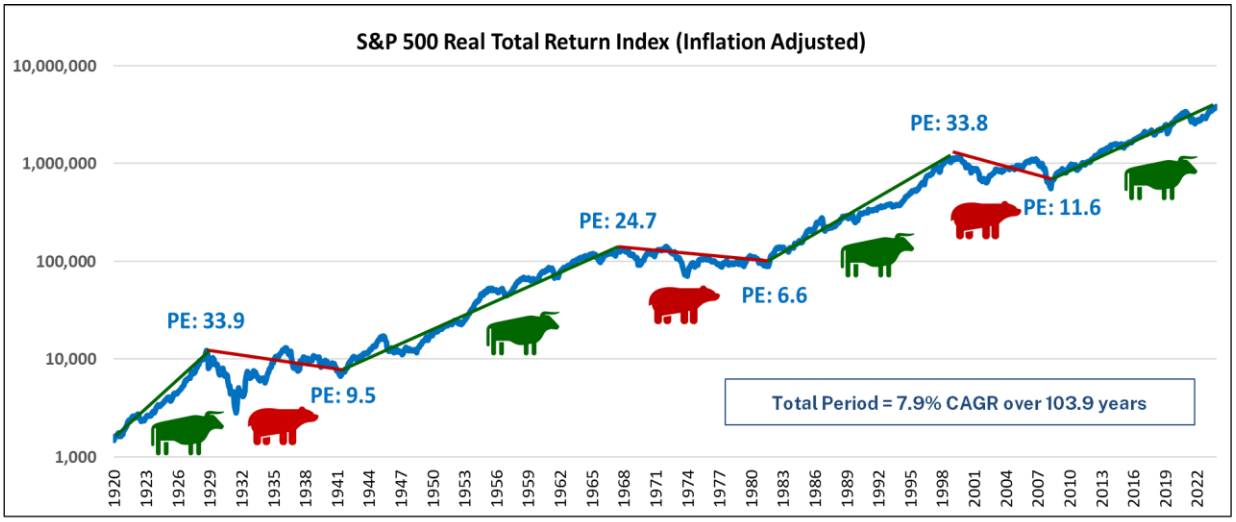
The results above are adjusted for inflation; otherwise, it would be impossible to accurately compare the Great Depression and Great Inflation bear markets. The average bull lasted 16.7 years, and the average bear 12.3 years. Such stretches fall outside the performance measurement horizon of nearly all investors. This is problematic since an effective assessment of results ought to include both types of markets.

Long-term market performance is radically different depending on whether you started in a secular bull or bear. Greater than one-third of the years since 1920 occurred during secular bear markets averaging a real return (inflation-adjusted) of –3.7% per year. Conversely, the secular bull years averaged a phenomenal real return (inflation-adjusted) of 14.8% per year. Most investors want to know at this point: how do you protect from the bears while participating in the bulls?



The secular bulls and bears are nothing more than extremes in prices relative to profit. The path to investment success is, therefore, to focus on profits and not overpay for them. The following chart reveals the compass by which investors can navigate the great bulls and bears. Bull markets always culminate in a historically high P/E. The extremely high valuations then set the stage for long bears which bottom at a historically low P/E.

Please see page 4 for important disclosures.



Note:
ACR CAPE based on Real S&P 500 Price Per Share (PPS) divided by Ordinary Least-Squares Regression (OLS) trendline of S&P 500 Real Earnings Per Share (EPS) from 1926 to June 30, 2024. Sources: S&P Dow Jones Indices; Robert Shiller; BLS- CPI Data; ACR Alpine Capital Research. S&P 500 EPS sourced from Shiller data through June 30, 2024. Data pulled on September 05, 2024.

Sources: real EPS data sourced from Robert Shiller dataset October 2024. Analysis by ACR.

There is no economic law stating that the pattern of secular bull and bear markets should or will continue. Nor does mapping market history allow one to forecast turning points. Yet what we do know is still meaningful. As our data showed from last quarter's commentary (Borrowing from the Future), returns are highly likely to be lower from higher starting multiples, and higher from lower starting multiples. So, what do we do with this knowledge?

Our solution to protect from the bears while participating in the bulls is to carefully prune our portfolios of high prices during the bulls to help assure satisfactory returns during the bears. At historically high P/Es like those today, our portfolios will have very different characteristics and performance than the market. During the current bull, which began after the Great Financial Crisis ended, our flagship Equity Quality Return (EQR) strategy has generated double-digit returns. Yet we lagged the market. We don't mind temporarily falling behind. Our recipe for generating satisfactory absolute and superior relative returns during the 2000-2009 Bear Market required falling behind in the 1990s. The ultimate key is to be well ahead after having gone through both a secular bull and bear, which EQR has done.

The long-term pattern of secular bulls and bears is probably a behavioral phenomenon. One need look no further than the US Presidential Election of 2024 to see that human beings are as emotionally charged (putting it politely) as ever. Therefore, our belief is that we will see a secular bear again someday. Either way, ACR is focused on protecting from unsatisfactory returns by owning a group of companies that are reasonably priced relative to their future profits. Today, that is easier said than done.

Nick Tompras
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