Digging Deeper – Is the Stock Market Healthy?

There are a lot of competing takes on the Stock Market's current flirtation with a Correction (decline of 10% or more). Some see it as a "buy-the-dip" opportunity caused by a confluence of factors; trade fears, rising rates, & uncertainty around the mid-term elections. Others see it as the beginning of the end of the bull market that has been kept alive by what had been massive outperformance of only a few big names in the S&P500; Facebook, Amazon, Apple, Netflix, & Google (FAANG). Now that even some of these big names are starting to crack, so the argument goes, they can no longer hold-up what has been a very unhealthy Market.

There is a lot of evidence to support the Bearish take. Looking at the S&P500 it is clear that its rise over the past year has indeed been fueled by a small number of big companies. The FAANG stocks make up nearly 13% of the entire S&P500's value. But if you look under the hood, what you find is that **70%** of the stocks are down -10% from their most recent high (that's 353 stocks out of the 505 that make up the S&P500). Furthermore, 179 stocks in the S&P500 are down -21% from their most recent high. This means that 70% of the S&P500 is already in official "correction" territory. The Small-cap Russell 2000 index is even worse, having fallen approx. -15% since August. Wolf Richter, an analyst/writer with a daily blog puts it this way, *"These are the hallmarks of a market that is rotting gradually, as the Fed would say, at every corner underneath the covers – the covers being a few large stocks, such as Apple, that have held up reasonably well. But they can no longer cover the rotting process".* Tough to find a more Bearish take than that.

There is however, a way to look at this same information and read a Bullish case into the data. While admitting that FAANG have really been what has driven the market over the past year, one can look at the data above and note that the Market has already corrected – not that it cannot fall further, but that there is less "need" for the underlying holdings to fall as they have already done

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so. In fact, looking at the S&P500 excluding FAANG, the P/E ratio relative to next year's earnings estimates is downright cheap (about 13).

Another argument on the Bullish side is that the economic fundamentals simply do not support a market crash – corrections are a normal part of Bull markets. Further buttressing this case is that the PMI numbers that came out today (10/24/18) show an increased rate of growth in both the Service & Manufacturing sides of the economy. The Service side had slowed a bit lately (slower growth, not contraction) but today's report from IHS Markit shows an uptick from 53.9 in September to 54.8 in October (over-50 means growth, under-50 means contraction). Manufacturing rose slightly from 55.6 to 55.9. Both side of the economy are showing increases in their rates of growth and a sharp rise in new business. So again, a massive market sell-off is unlikely based on the fundamental economic data.

Personally, I believe the markets will recover and end the year on a positive note. I, of course, do not have a crystal ball but economic fundamentals are what govern market performance in the grand scheme even if scary headlines or sentiment may drive shorter-term swings.

Thanks for Reading & Fell Free to Share,

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