Executive Summary
CRESTMONT'S RESEARCH: PUTTING IT TOGETHER
January 31, 2018

1. Average Rarely Happens: returns from the stock market over decade-long periods have rarely averaged the historical 10%; it has most often been well above average or well below average. There is no single factor that has as much impact on the variability of total returns from the stock market over decade-long periods as the change in the level of valuation (P/E ratios).
http://www.crestmontresearch.com/pdfs/Stock-Rolling-Components.pdf

2. The financial markets are much more volatile than most investors realize. The secular bull market of the 1980s and 1990s presented upside (positive) volatility. The bond market as well as the stock market was in a secular bull market trend.

3. In the past 100 years, the annual change in stocks--half of the time--is more than 16%, either up or down.
http://www.crestmontresearch.com/pdfs/Stock-Dispersion.pdf

4. In the past 50 years (since interest rates began responding to the inflation rate), over every six-month period, rates change more than 50 bps approximately 97% of the time and more than 1% (100 bps) approximately 71% of the time.
http://www.crestmontresearch.com/pdfs/i-rate-6-mo-changes.pdf

5. Yet when P/E ratios are trending upward, the volatility is almost always on the upside. When P/E's are trending down from historically high levels (like we're seeing today), the volatility is more often on the downside.

6. Most investors are surprised to find out that real growth in the economy and earnings per share grew at almost the same rate from (1) the mid 1960's thru the early 1980's as it did from (2) the early 1980's through 1999--yet the stock market was flat in the first period and soared 10 times in the later period.
http://www.crestmontresearch.com/pdfs/Financial-Physics-Presentation.pdf

7. Why does this occur and what can be expected? Financial Physics explains it. Financial Physics is the combination of well respected principles of economics and recognized principles of finance.

8. The economy has grown at a fairly constant rate of averaging just above 3% over the past century, and near 3% during the 1970s, 1980s, and 1990s (real GDP grew near 2% in the 2000s and in the 2010s so far; this raises questions about a new trend or the potential for 4%+ growth in the upcoming decade to restore the average). Earnings of public companies grow at a rate just below the economy (due to new start-ups, entrepreneurial companies, etc.).

9. The major driver to stock market returns above or below economic growth is due to the trend in P/E ratios. The trend in P/E's is driven by the trend in the inflation rate. If inflation is headed away from price stability (near 1%), P/E's fall. If inflation is headed toward 1%, P/E's rise.
http://www.crestmontresearch.com/pdfs/Stock-Secular-Chart.pdf

10. The dilemma today is that we're at low inflation and historically high P/E's; so there's little room for rising P/Es. We're in the early to mid stage of what historically has presented itself as a secular bear market.

11. In secular bear markets (which are generally non-directional and highly volatile market conditions), there are a number of strategies that are required. Crestmont refers to it as "Row, Not Sail"...it requires actions rather than buy and hold.

12. These actions include more active investment management, more frequent rebalancing, option writing, higher yielding securities, hedge funds, and other active process strategies.
http://www.crestmontresearch.com/pdfs/Stocks-Rebalancing.pdf

13. It's a good time for investors to step back from such a "micro, market timing focus," and to develop a business plan for investing that considers the expected market environment and incorporates timeless strategies for wealth development and wealth preservation.

14. For more information about Crestmont's research, please see:

Probable Outcomes: Secular Stock Market Insights
www.ProbableOutcomes.com

Unexpected Returns: Understanding Secular Stock Market Cycles
www.UnexpectedReturns.com

The P/E Report
http://www.crestmontresearch.com/pdfs/Stock-PE-Report.pdf

Waiting For Average
http://www.crestmontresearch.com/pdfs/Stock-Waiting-For-Avg.pdf

Portfolio Mismanagement
http://www.crestmontresearch.com/pdfs/Article-Mismanagement.pdf

Markowitz Misunderstood
http://www.crestmontresearch.com/pdfs/Article-Markowitz.pdf

The Truth About P/Es
http://www.crestmontresearch.com/pdfs/Stock-Truth-PEs.pdf