11/21/2018

Back to the 90s: 10 Ways Today is Like the 1990s and Why It's Not

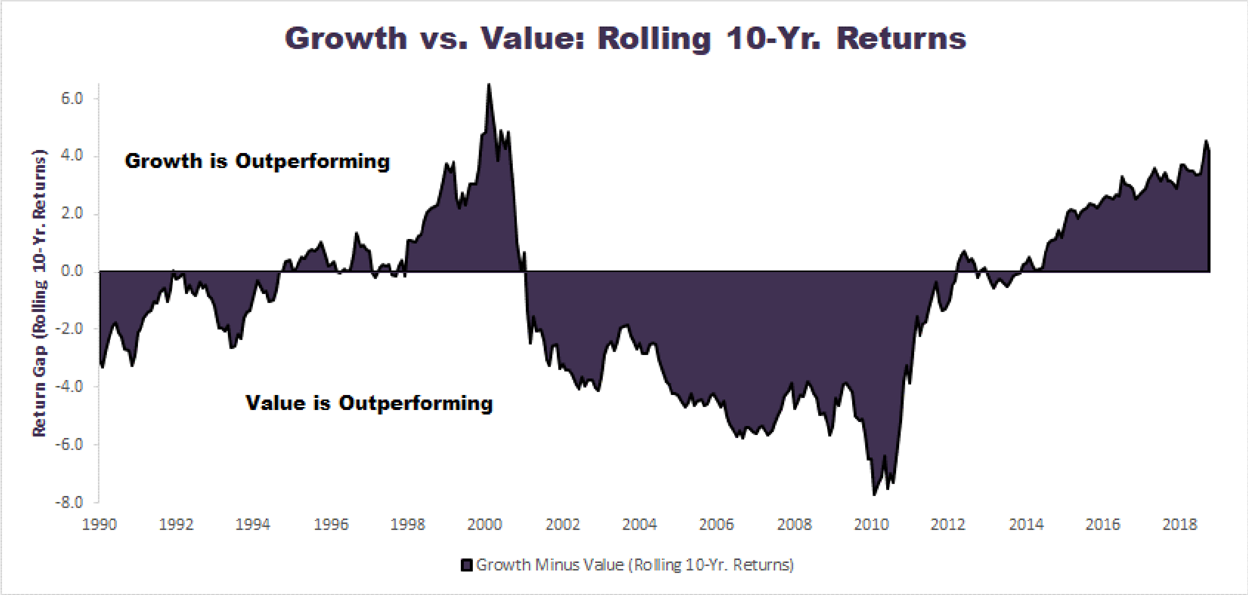
In many ways, today feels like a sequel to the late 1990s. While both periods are known for being bad eras for Star Wars films and phases of Britney Spears relevance, today's market environment has some parallels to the '90s as well. For example, value stocks have lagged significantly behind growth stocks, tech stocks have led the bull market, and U.S. equities are outpacing international stocks. While there are also stark differences, the long list of commonalities with 1990s is noteworthy.

As far as the markets are concerned, we have identified 10 areas in which current market conditions closely resemble the 1990s. After reading about their similarities and differences, find out what we think this means for the markets and what we recommend you keep an eye on in the coming months.

Data as of 10/31/2018

1: Growth Outperforming Value

Growth stocks have lately outperformed value stocks for the longest stretch and widest margin since the late 1990s, albeit not as extremely. Outsized gains in the technology sector was the impetus for strong growth stock performance in both periods.



Source: Cetera Investment Management, Morningstar, Russell Investments. Rolling 10-Yr. returns are annualized. Growth stocks are represented by the Russell 1000 Growth Index and Value stocks are represented by the Russell 1000 Value Index. Data as of 10/31/2018.

1990s

- Over the duration of the entire 1990s bull market, growth outperformed value by 5.8% annualized.
- Over the final 18 months of the 1990s (July 1998-December 1999), the Russell 1000 Growth Index was up 53.4% compared to a 10.7% gain for the Russell 1000 Value Index.

Today

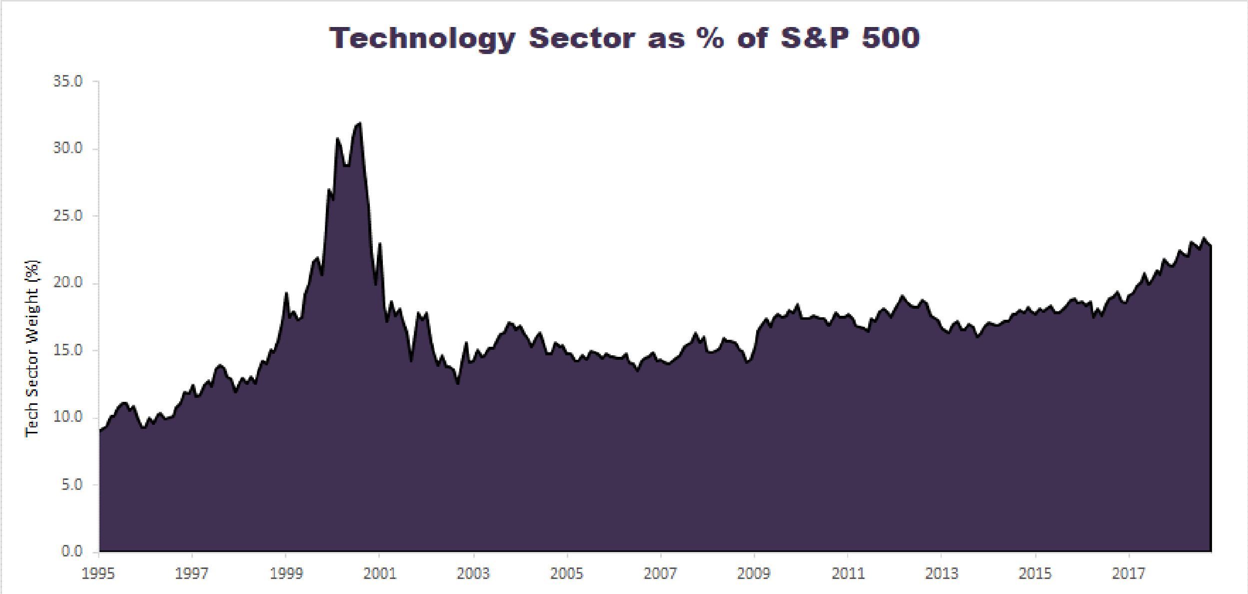
- In the current bull market, growth stocks have outperformed value stocks by 2.3% annualized.
- Since the beginning of 2017, the Russell 1000 Growth Index is up 38.8% compared to a 12.0% gain for the Russell 1000 Value Index.

What Does It Mean?

The relationship between growth and value stocks is cyclical. Value stocks have produced superior long-term performance, but there have been long stretches of underperformance, as was the case in the 1990s and the current bull market. Strong value outperformance lasted for more than a decade following the 1990s and if history is any guide, we may see value stock outperformance again in the next cycle.

#2: Technology Sector Made Up Large Portion of S&P 500

In both the 1990s and in the recent bull market, the technology sector made up a large portion of the market and attributed to much of the returns from both periods.



Source: Cetera Investment Management, Morningstar, Standard & Poor's. Data as of 10/31/2018.

1990s

- Technology stocks drove the returns in the 1990s.
  - The tech-heavy NASDAQ Index produced a return of 1,389% in the 1990s bull market.
- With high returns, the size of the sector grew. From 1995 to 2000, the technology sector grew more than threefold within the S&P 500.
  - In 1995, technology represented 8.9% of the index. By the end of 1999, the sector accounted for over 30% of the index.

Today

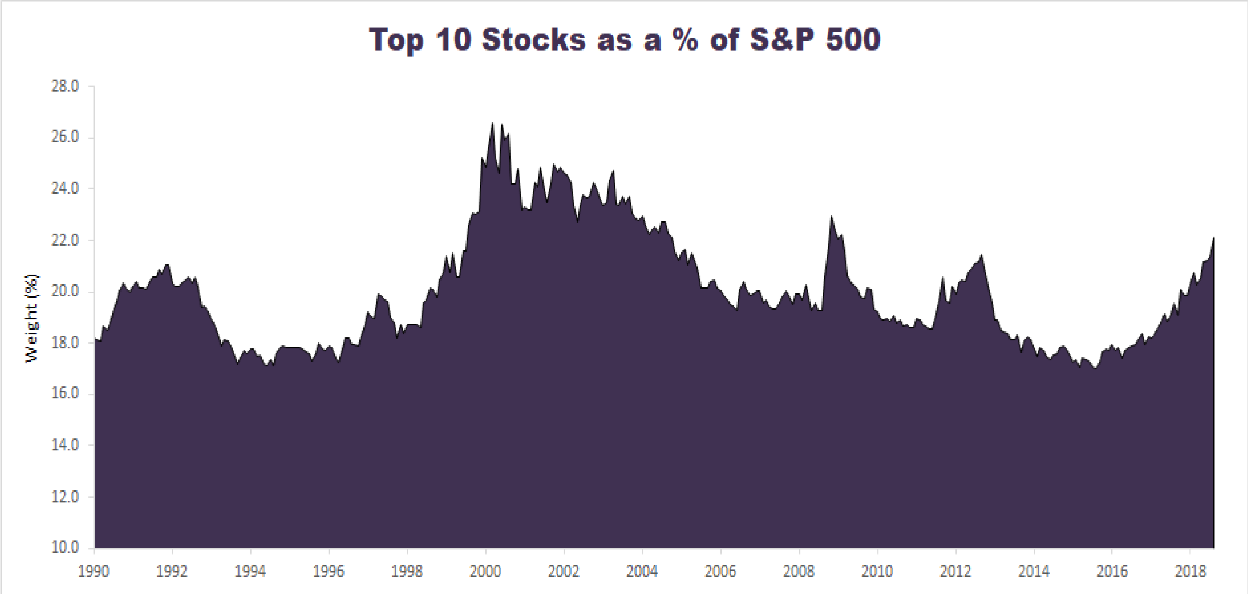
- Tech stocks drove the returns in the current bull market, too.
  - The NASDAQ is up 464% since the bull market began in March 2009.
- The tech sector's weight within the S&P 500 was 14.4% at the end of 2008 and rose to as high as 23.4% this year.

What Does It Mean?

Technology sector performance in the 1990s was more extreme than today. Returns and the size of the tech sector grew at a faster rate in the 1990s than in the current cycle. We do not anticipate the tech sector to grow as large as it did in the late 1990s.

#3: A Small Number of Stocks Make Up Much of the Market

The 10 largest stocks, as a percentage of the S&P 500, experienced a sharp rise in the late 1990s. That trend has repeated in recent years.



Source: Cetera Investment Management, Morningstar, Standard & Poor's. Data as of 10/31/2018.

1990s

- In 1995, the 10 largest stocks accounted for 17.3% of the S&P 500 Index and the combined market cap was $813 billion.

- By the end of 1999, the combined market cap of the top 10 largest S&P 500 stocks climbed to $3.1 trillion or 25.2% of the S&P 500 total market cap.

Today

- The FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) represent approximately 12.3% of the S&P 500 Index. The top 10 largest stocks make up 21.7% of the S&P 500 and have a combined $6.3 Trillion in total market cap.

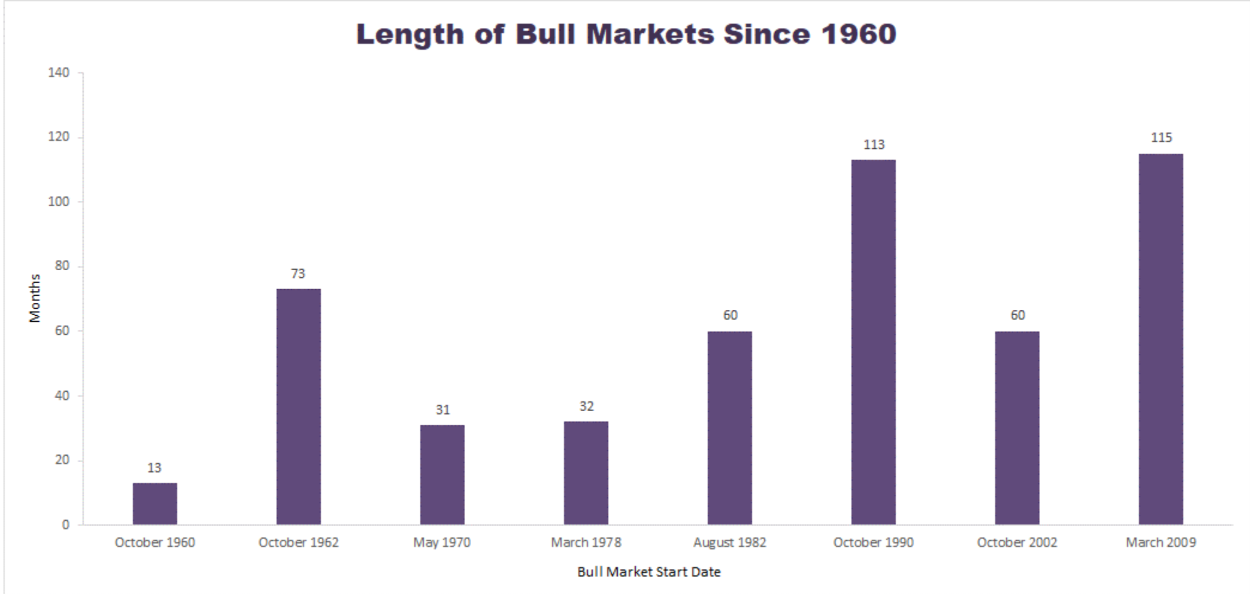
- Last year, the FAANG stocks were up 49.1% (equal weight), more than double the S&P 500's 21.8% return. Year-to-date (as of 10/31/18), the five FAANG stocks have produced an equal weighted return of 22.8% compared to 3.0% for the S&P 500.

What Does It Mean?

Strong gains in the FAANG stocks highlight the narrow market leadership in recent years, reminding investors of the narrow leadership of the late 1990s. At the time, returns were concentrated within mega cap stocks, which were heavily represented by technology companies. We have seen a rise in market share of the top 10 stocks in recent years, but not to the level that was reached in 1999.

#4: Record-Setting Bull Markets

The 1990s and now both have very long bull market runs of over 100 months without a 20% pullback, the threshold for where a bull market ends. The average bull market has lasted 62 months since 1960, almost half as long as the 1990s and current bull markets.



Source: Cetera Investment Management, JPMorgan. Data as of 10/31/2018.

1990s

- The 1991-2000 bull market is the second longest bull market in history, lasting 113 months, with nine consecutive calendar years of positive returns.
- The S&P gained 513% (total return) over the duration of the 1990s bull market. A majority of the gains from the 1990s bull market occurred between 1995 and 1999, when returns surpassed 20% for five straight calendar years.

Today

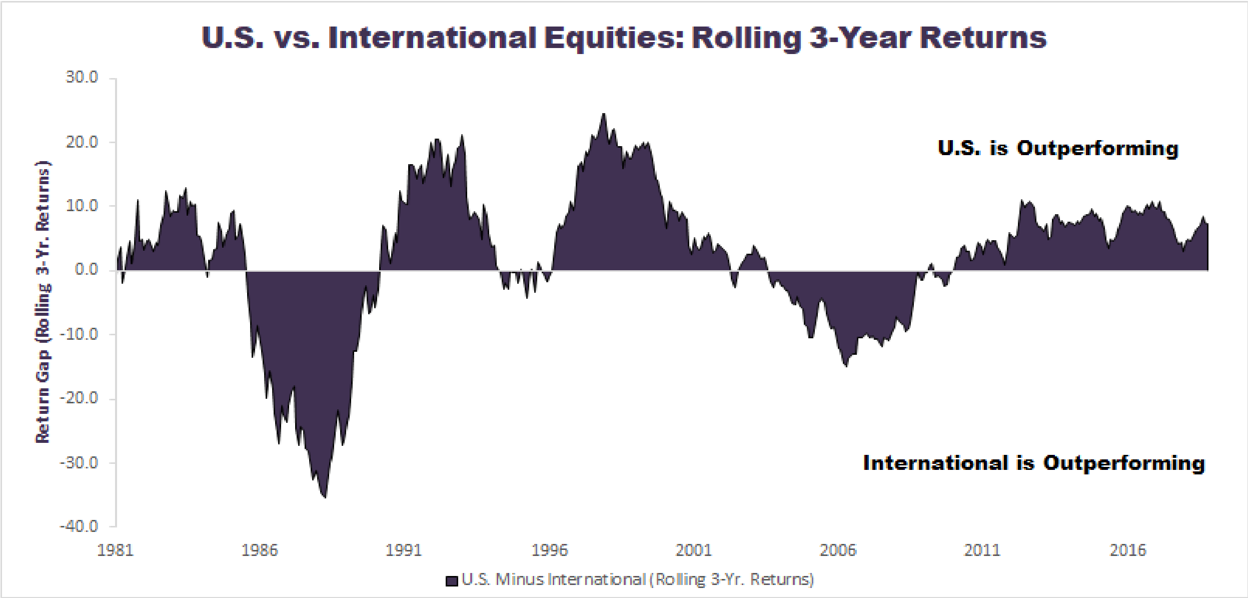
- The current record-breaking bull market has gone 115 months. If the S&P 500 is positive this year, it will be the first bull market to have 10 straight calendar years of positive returns.
- The long grind higher for stocks has produced a 385% gain, but with more modest annual returns.

What Does It Mean?

The most recent run in stocks has not reached the astonishingly high gains of the last five years of the 1990s. This bull market, however, could make history. If stocks finish positive this year, it will mark the tenth consecutive calendar year of positive gains. The 1990s only reached nine years.

#5: International Equity Underperformance

Another common thread between the 1990s bull market and our current one is underperformance of international equities relative to domestic stocks.



Source: Cetera Investment Management, Morningstar, Standard & Poor's, MSCI. Rolling 3-Yr. returns are annualized. U.S. equities are represented by the S&P 500 Index. International equities are represented by the MSCI EAFE Index. Data as of 10/31/2018.

1990s

- The S&P 500 outgained the MSCI EAFE Index by more than 10% annualized from the inception to conclusion of the 1990s bull market.
- A lost decade of Japanese equity returns following one of the biggest equity bubbles in the 1980s suppressed the index returns compared to the U.S. in the 1990s.

Today

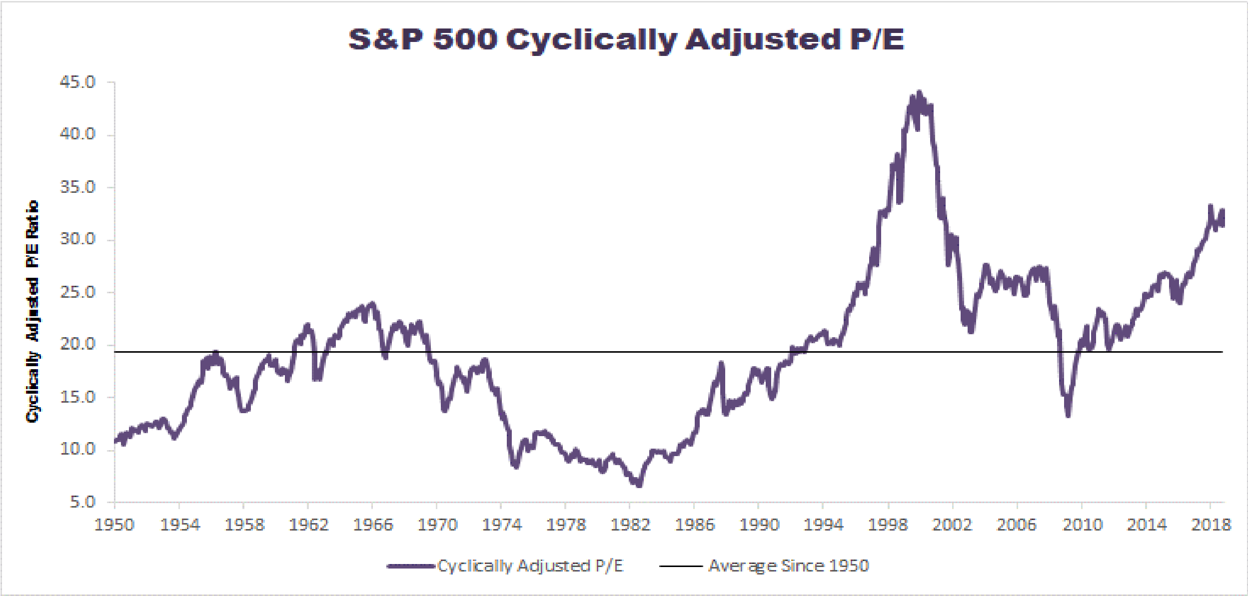
- U.S. stocks are outpacing international equity returns by nearly 7% annualized this bull market. Through October, the S&P 500 has a total return of 385% return versus 170% for the MSCI EAFE Index.
- Japan and Europe both experienced a double-dip recession following the financial crisis, while the U.S. has experienced relatively stable economic growth.

What Does It Mean?

International equities have lagged U.S. equity returns for the duration of the current bull market. The gap between U.S. and international equities was even wider in the 1990s. In both cases market valuations for international equities fell to a low level compared to U.S. equities. Coming out of the 1990s bull market, international equities outperformed U.S. equities. We could see a repeat of international equity outperformance in the next cycle based on the valuation gap and cyclical nature of equity returns between the U.S. and international indices.

#6: High Equity Valuations

U.S. equity valuations in both periods are well above their long-term averages. The historical average for P/E (price to earnings) ratios and cyclically adjusted 10-year P/E ratios (CAPE) are 15 and 19.4, respectively.



Source: Cetera Investment Management, YCharts, Robert Shiller, and Standard & Poor's. Data as of 10/31/2018.

1990s

- The P/E ratio for the S&P 500, based on trailing 12-month earnings, peaked to 28.2 in 1999.
- The CAPE ratio, which looks at the trailing 10 years of earnings, adjusted for inflation, peaked at a historical high of 44.2 in 1999.

Today

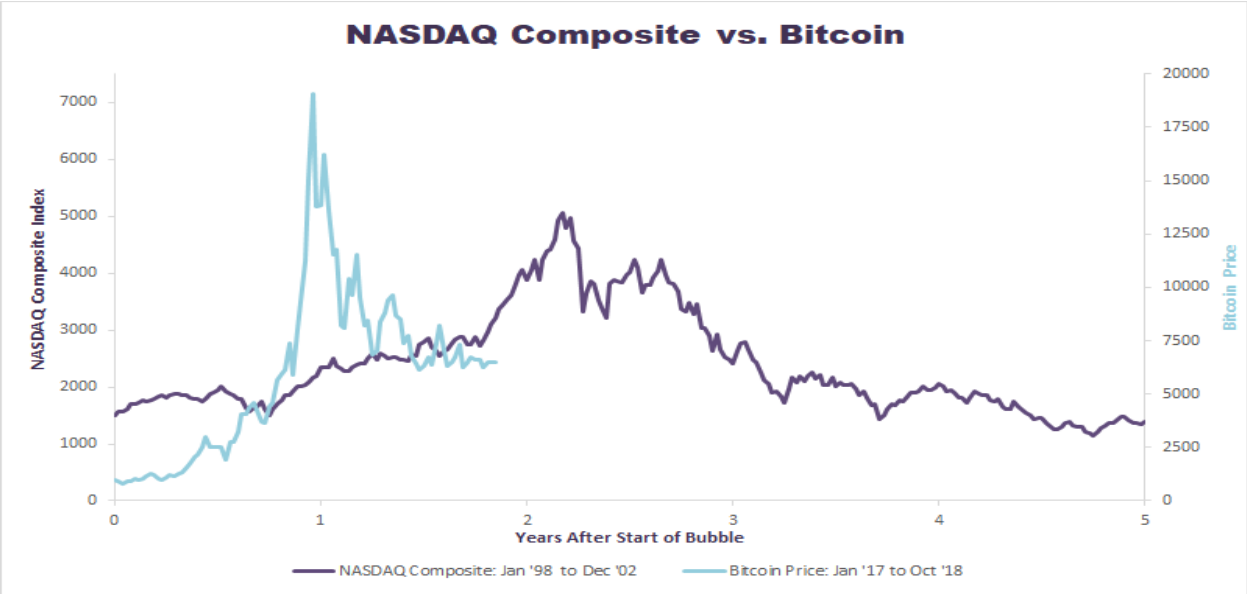
- The P/E ratio for the S&P 500 is currently at 19.1, based on trailing 12-month earnings. The P/E ratio hit a cycle peak in January when it reached 24.0.
- The CAPE ratio is currently around 31.5 and reached a cyclical peak of 33.3 in January. The late 1990s was the only time it has been higher.

What Does It Mean?

Stocks do appear expensive today versus most periods. However, they have not come close to the valuation levels reached in the late 1990s, especially when you factor in the current environment of low core inflation, interest rates, and bond yields. It is likely that today's high valuations will result in returns that are below average over the next five to 10 years, but a repeat of the 2000-2002 valuation-driven crash is not our base case projection.

#7: Speculative Bubbles

The dot-com stock bubble drove the sharp rise in equity prices during the final years of the 1990s bull market. A speculative bubble was also present in recent years within cryptocurrencies.



Source: Cetera Investment Management, Yahoo Finance, Nasdaq. Data as of 10/31/2018.

1990s

- Exuberance over internet-related businesses created a bubble in technology stocks, which peaked in March 2000.
- The eventual crash resulted in the NASDAQ declining by 78% from its peak, while the S&P 500 fell by 49%.

Today

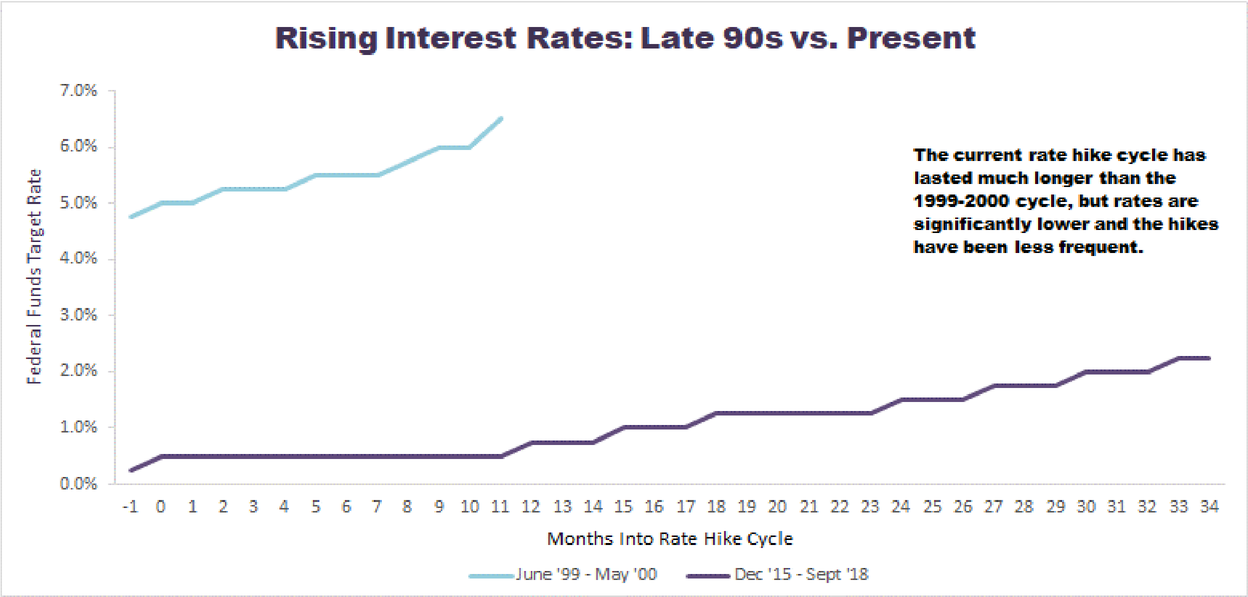
- Cryptocurrencies and blockchain became the new and exciting technological developments that many thought would change the way the world operates, driving the price of cryptocurrencies into the stratosphere in 2017.
- The cryptocurrency bubble eventually popped in December 2017, resulting in declines of 60% to 90% for the major cryptocurrencies.

What Does It Mean?

Valuations were not a concern for investors as enthusiasm soared, allowing dot-com stocks to move aggressively higher until they reached a peak in March 2000 before crashing. Cryptocurrency gains in 2017 dwarfed the returns experienced in dot-com stocks of the late 1990s. Fortunately, the cryptocurrency crash has not affected the overall economy or equity markets because the market cap in this space is still relatively small.

#8: Rising Interest Rates

The Federal Reserve implemented rate hikes in the late 1990s. We are currently in another rate hike cycle, although rates are much lower today than in the 1990s.



Source: Cetera Investment Management, Federal Reserve Bank of St. Louis, Board of Governors of the Federal Reserve System. Data as of 10/31/2018.

1990s

- Between June 1999 and May 2000, the Federal Reserve raised interest rates five times, pushing rates from 4.75% to 6.5%.

Today

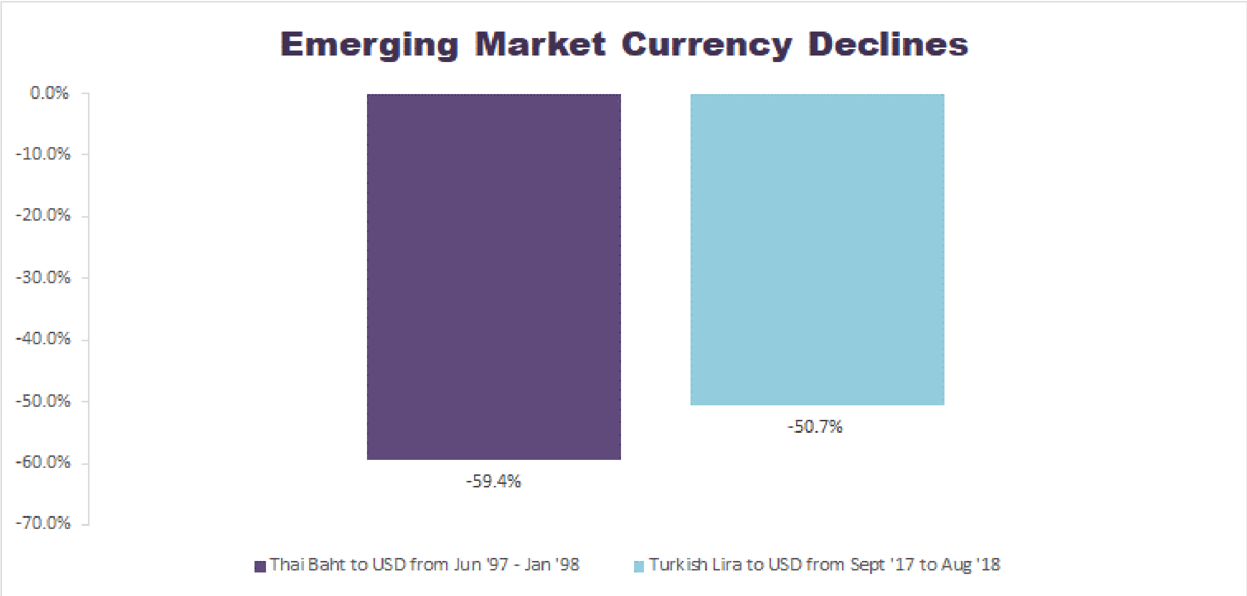
- The Federal Reserve has raised interest rates eight times since December 2015, pushing the Federal Funds rate from near zero to a range of 2.0%-2.25%.
- The Fed might hike interest rates up to three more times by the end of 2019.

What Does It Mean?

The late 1990s rate hike cycle was much shorter and rates were a lot higher than they are in the current cycle. The Federal Reserve still has some room to hike rates before the pace of economic growth is materially impacted. It is expected that interest rate hikes continue into 2019, but it is unlikely that the Federal Funds rate in this cycle reaches levels experienced in the late 1990s. There are parallels here, but the level of interest rates and length of the rate hike cycle are not comparable in these two periods.

#9: Emerging Market Currency Crisis

An emerging market currency crisis made headlines this summer sparking fears of a 1997 Asian financial crisis repeat. The epicenter was in Thailand in 1997 and in Turkey in 2018.



Source: Cetera Investment Management, YCharts, Federal Reserve. Thai Baht decline relative to the US Dollar shown is from June 17, 1997 to January 12, 1998. Turkish Lira decline relative to the US Dollar shown is from September 8, 2017 to August 13, 2018.

1990s

- In 1997, a currency crisis began with the collapse of the Thai baht and eventually spread to several emerging nations in Asia. The Thai baht declined 59.4% relative to the U.S. dollar between June 1997 and January 1998.

- The fallout from the Thai baht collapse was severe and widespread. U.S. stocks almost fell into a bear market over concerns that the Asian financial crisis would cause a collapse in global economic stability.

Today

- This year's emerging currency crisis is in Turkey, where the Turkish lira has experienced a sizeable drop in valuation.

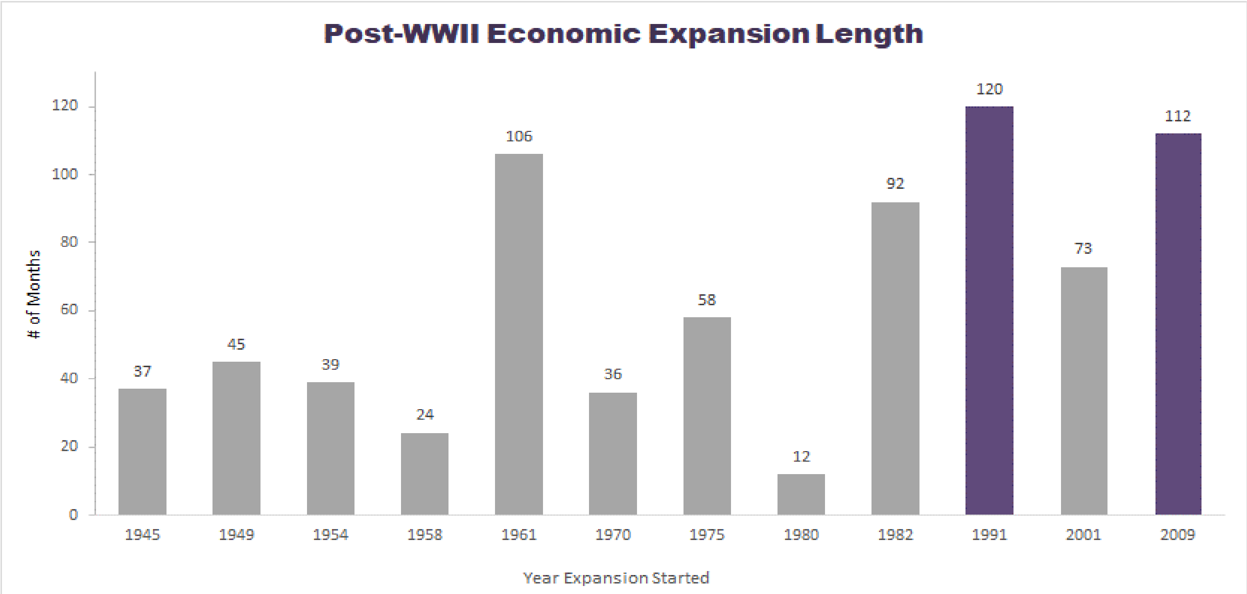
- The value of the Turkish lira fell by 50.7% relative to the U.S. dollar when it reached a bottom in August. The MSCI Turkey Index fell by 60% and the Turkish Central Bank raised interest rates to 24% to prevent further devaluation of the lira.

What Does It Mean?

The current emerging market currency crisis in Turkey is not likely to have severe consequences on global markets. Turkey represents less than 1% of the total global economy, the Turkish stock market is only a fraction of total stock market capitalization, and other emerging nations are in better shape economically and source less debt with foreign currencies than in the 1990s.

#10: Long Economic Expansions

The two longest economic expansions in U.S. history are the 1990s expansion and the current expansion. Both expansions are roughly double the length of the average recovery since WWII.



Source: Cetera Investment Management, National Bureau of Economic Research (NBER). Data as of 10/31/2018.

1990s

- The longest U.S. expansion on record was the 1990s expansion, which lasted 120 months. It began in 1991 and ended in 2001.
- There were seven calendar years in which economic growth exceeded 3% during the 1991-2001 expansion. In fact, GDP growth exceeded 4% every year from 1997 to 2000.
- The unemployment rate fell to as low as 3.8% in 2000.

Today

- The current economic expansion, which began in 2009, is 112 months old and is officially the second longest U.S. recovery on record.
- Economic growth has been stable throughout this expansion, but we have not experienced growth of 3% or more for a calendar year in the current recovery.
- The unemployment rate is currently at a 49-year low of 3.7%.

What Does It Mean?

The pace of economic growth has not been able to keep up with the late 1990s, but there is an opportunity for the current expansion to become the longest on record. This expansion has benefitted from strong monetary support from the Federal Reserve and we are now getting strong fiscal support from the implementation of tax reform for individuals and corporations. Moreover, there has been positive jobs growth for a record 97 consecutive months. All of these factors are having a positive impact on consumer confidence, which is elevated because of the strong labor market, sizeable stock market gains in recent years, and sustained economic growth.

Where the Similarities End

Today's market environment shares many similarities with the late 1990s. The similarities are scary, but we do not think the end of this bull market will be as terrifying as what markets experienced from 2000-2002 with a sharp selloff. The current environment is a less-extreme version of the 1990s. The 10 similarities we discussed earlier are compelling, but not as dramatic. While we are in the longest bull market run now, returns pale in comparison to the '90s.

The 1990s bull market ended with a 31-month bear market that was one of the worst in history based on market losses. However, bull markets do not last forever and there will be another recession at some point in the future. While we are not predicting a recession in the near-term, the economy will eventually fall into a recession. We would expect that the next recession would not be as severe as the financial crisis of 2008-09.

Putting recessions in perspective, since World War II:

- There have been 12 bear markets and the average S&P 500 decline is 32%.
- The last two bear markets (2000-02 and 2007-09) resulted in a S&P 500 decline of roughly 50%, considerably higher than most bear markets in the post-WWII era.
- Excluding the last two bear markets, which were historical outliers, the average S&P 500 bear market decline was 28%.
- Seven out of the 12 bear markets had a market decline of less than 30%.

A drawdown as severe as the last two bear markets does not seem as likely this time around in the absence of a major asset bubble and is even more unlikely if a recession is not in the forecast.

Outlook Remains Strong

Current market and economic fundamentals remain healthy in the U.S.:

- Corporate earnings are growing at a rate of 20% year-over-year in 2018 and the expectation is for low double-digit earnings growth next year.
- At the end of October, the S&P 500 P/E ratio fell to 19.1, a 20% discount from the January peak and a 32% discount from the peak reached in 1999.
- Fortunately, interest rates are still historically low at 2.25% and are unlikely to jump significantly higher from current levels in this cycle.
- The unemployment rate is at a 49-year low of 3.7% and the economy is adding an average of 212,000 new jobs per month in 2018.
- Consumer spending is very strong, growing at its highest rate since 2014 in the third quarter.
- U.S. Manufacturing activity has accelerated this year, propelling the ISM Manufacturing PMI to a 14-year high in August and strong growth in manufacturing employment.

- All 10 of the risk indicators in the Cetera Investment Management Riskometer are signaling a low risk of recession in the near term.

Nevertheless, Risks are Building

Market volatility has picked up this year, resulting in two separate market corrections in 2018 (10% or more drawdowns). Domestic economic growth is the strongest in years, but a few areas of concern are developing, namely a weakening housing market, flattening yield curve, and rising borrowing costs.

Global economic data has also been a concern. The global manufacturing PMI, a proxy for global manufacturing activity and global economic strength, has been trending lower since last December. A rise of inward-looking populist leaders, elevated trade war rhetoric, and geopolitical risk in several global regions provide additional apprehension for the state of the global economy.

Conclusion

The most popular TV show in the late 1990s was *Seinfeld*, notable for being a show about nothing. A few years ago, Jerry Seinfeld made his return as the star of a TV show (*Comedians in Cars Getting Coffee)* for the first time since 1998. The only way to watch *Seinfeld* in 1998 was on a standard analog television broadcast over regular airwaves. Today, you can only watch *Comedians in Cars Getting Coffee* streamed over the internet on a smart TV, smartphone, computer, or tablet.

The euphoria that caused a bubble in internet-related stocks in the late 1990s was largely about the ways in which the internet will change the world forever. The technology available in the late 1990s had not developed to match the mania in equity prices. Technologically, that is definitely not a story about nothing. Smartphones, tablets, and internet connected smart TVs did not even exist when the final episode of *Seinfeld* aired 20 years ago. The internet has transformed other areas of our lives including the way we shop, conduct business, communicate, and socialize.

The sequel to the 1990s has brought the technological capabilities that we all hoped to see 20 years ago when a bubble in dot-com stocks drove U.S. equity valuations to their highest level in history. A side-by-side comparison of Amazon.com in 1998 versus today is a microcosm of the evolution experienced over the last 20 years.

Similarities between now and the 1990s exist, but only up to a point. The 1990s bull market ended with a severe crash and a repeat of a crash that severe is not a likely outcome because valuations are not as extreme as they were in the late 1990s. Market fundamentals remain strong and the economy continues to grow at a solid pace. In this environment, we remain positive on holding risk assets, with the understanding that volatility is likely to pick up as the Fed normalizes rates and the bull market matures. A tilt toward value stocks may be prudent following years of underperformance and because valuations are more reasonable. An allocation to international equities also makes sense to diversify risks and to have exposure to economies that are earlier in their economic cycle than in the U.S. Let us not forget that the lost decade that followed the tech crash. U.S. equities in the 2000s was one of the only asset classes that was negative during that decade. For these reasons, we recommend a balanced allocation lined up with long-term fixed-income targets to dampen portfolio volatility.

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Glossary

The S&P 500 is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

The MSCI EAFE is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East) excluding the U.S. and Canada. The Index is market-capitalization weighted.

MSCI Turkey Index measures the performance of the large and mid cap segments of the Turkish stock market. It is composed of 24 constituents and covers approximately 85% of the Turkey equity universe.

Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values.

Russell 1000 Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

NASDAQ composite is an index that tracks more than 3,000 domestic and international based companies that trade on the NASDAQ Stock Market. This index has a high weight of information technology stocks.