HENNESSY FUNDS

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OUTLOOK 2018: A Bull Market with Plenty of Room to Run

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Over the past year, global equity markets have made strong advances, fueled by continued, broad-based economic growth, and in spite of a somewhat unsettling geopolitical backdrop. Over the last 12 months the U.S. economy has continued to grow at a steady rate of almost 2.5% on an annualized basis, as measured by GDP. Companies have added over 170,000 jobs per month on average over the past year, and the current unemployment rate of 4.1% is the lowest in 17 years. Consumer confidence is high and still rising, and corporate profits are at all-time highs. As 2017 comes to a close, with the major indices reaching new highs, I find myself envisioning the Dow Jones Industrial Average building momentum toward 30,000.

Meanwhile, the prospective price to earnings multiples for the Dow Jones Industrial Average and S&P 500 Index are just above long-term averages at 19.5x and 19.9x, respectively. I believe these levels of stock valuation, while higher than a year ago, are still very reasonable. At the peak of the technology/dot-com bubble, U.S. equities sold at much higher multiples across the board than they do today, and bond yields were also much higher. In June of 1999, the Dow Jones Industrial Average sold at 28x earnings and the 10-year bond yield was close to 6%. Today, the Dow is selling at under 20x earnings and is offering a 2.2% dividend yield, on par with the yield of the 10-year government bond at 2.4%.

Equity markets in the U.S. have been rising for almost nine years, and financial media reports have speculated that this bull run will come to an end, but why? I see no substantial reasons or indicators that a major correction is on the horizon. I remain confident that this bull market has room to run. Overall, investment fundamentals are strong. Corporate earnings are growing at a healthy rate, and companies are generating excess cash flow. Cash continues to build on corporate balance sheets, with $5.2 trillion in cash and short term investments among the S&P 500 Index companies*. Tax reform and continued efforts toward regulatory relief could be icing on the cake for equities.

There have been, and will likely continue to be, downturns throughout this extended bull market. Since 2010, there have been 18 downturns in the market, 14 of which were between 5% and 10% and four of which were corrections of between 10% and 20%. Yet the market has bounced back following each pullback and then has moved higher. A correction is not the end of the bull market. What might signal that we are at the end of this bull market? Euphoria. And I still see no signs of euphoria in this market. I am confident in the strength of the market today and believe the economy will continue its slow, but steady growth into the coming year.

**As of October 31, 2017*