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An inverted yield curve, a pig that can fly and the tail end of a bull market:

Three big market themes happening right now, what to make of them and what to do next.

Part 3: **Riding the backside of the U.S. bull market** – It ain't over 'til it's over!

If you haven't already, we suggest you start your reading of this 3-part series with Part 1.

Part 1: **The inverted yield curve** – It happened – the dreaded 'inverted yield curve'.
Late in March, financial media lit up with word the yield curve had 'inverted'.
Market pundits hit the air to issue dire warnings for days ahead.
So, what's the big deal?

Part 2: **China's Year of the Pig** – Is the economy ready to fly again?
Will the U.S. be aligned or at odds with China's economic and market outlook?

All data is current as of April 15, 2019, unless otherwise noted.

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For those who are tempted to take the inverted yield curve as a signal to lighten up or exit their equity exposure, we would be remiss if we didn't outline the cold, hard data around the opportunity cost associated with abandoning equities at the first sign of yield curve inversion. Equities have historically booked above-average returns for many months after the first instance of yield curve inversion (see Exhibit 3.1).

3.1 | S&P 500 Performance Post Yield Curve Inversions

Performance post yield curve inversions tends to be strong for months on end

Curve Inverts	S&P 500 Peak Date*	S&P 500 % Change	# of months past inversion to S&P peak	Recession Start	# of months past inversion to recession start
8/17/1978	1/30/1980	9.6%	17.5	1/31/1980	17.5
9/11/1980	11/28/1980	11.8%	2.6	7/31/1981	10.6
12/14/1988	7/16/1990	34.0%	19.0	7/31/1990	19.5
5/26/1998	3/24/2000	39.6%	22.0	3/31/2001	34.2
12/27/2005	10/9/2007	24.6%	21.4	12/31/2007	24.1
	Average	**23.9%**	**16.5**		**21.2**
	Median	**24.6%**	**19.0**		**19.5**

Source: Bloomberg, March 29, 2019.
*Represents peak in S&P 500 prior to next recession.

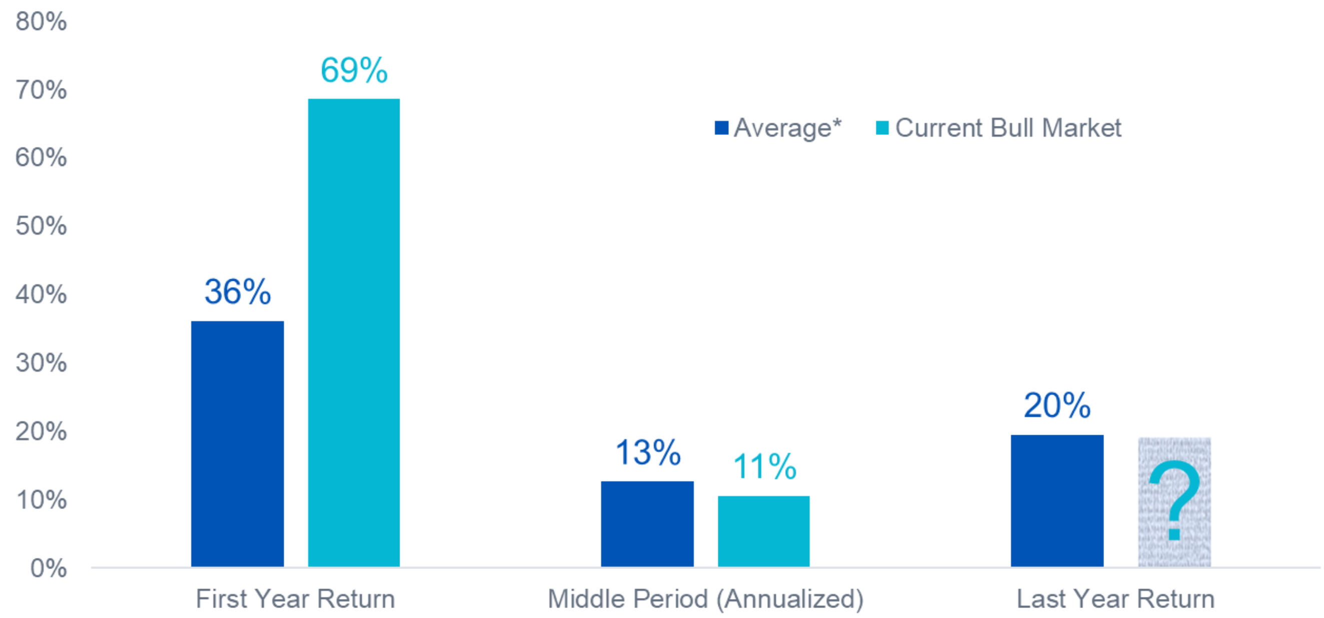
A clinical evaluation of the data in Exhibit 3.1 should really elicit a celebration of yield curve inversions on the part of equity investors.

While we've espoused for more than a year that we feel risks are rising due to the prolonged nature of the current market cycle expansion (i.e. the old age of this bull market), it's also true that, historically, the tail-end of bull markets have been marked by outsized equity market gains (see Exhibit 3.2).

3.2 | Anatomy of a Bull Market

The beginning and end of bull markets have historically brought outsized equity market gains

Post WWII S&P 500 Bull Market Return Distributions



Source: Bloomberg. *Average across 10 S&P 500 bull markets from 1949 to 2007.
Current Bull Market Middle Period = March 9, 2010 to March 29, 2019, annualized.

These historical observations, coupled with the fundamental rationale, are the reason we see the recent yield curve signal as a red herring (as detailed in Part 1 of our 'Three Big Market Themes' series: The Inverted Yield Curve). Furthermore, the evidence laid out in Part 2 of our series: China's Year of the Pig provides rationale for the current global spate of soft economic data and outlines reasons for optimism for both China and the U.S. outlooks.

Bottom line: Added together, we conclude the brief yield curve inversion witnessed in late March is not reason enough to abandon equity markets.

Putting views into action: It's no time to abandon your risk-appropriate equity position. In other words, the less sensitive you are to market volatility and the longer your time horizon before you need to draw income from your investments, typically, the more a higher equity allocation in a portfolio is appropriate. Investors with shorter-term time horizons (less than three to five years) and/or those who have specific capital requirements in the near term (or recurring) should look to have those near-term needs allocated in cash, or cash equivalents. This will allow you to appropriately take into account both the opportunities and risks the current market backdrop presents.