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WHY DO THEY KEEP CALLING THIS A RALLY?

Daniel Kahneman, the behavioral psychologist who a dozen years ago won a Nobel Prize in Economics (yes, you read that right), said, "The confidence people have in their beliefs is not a measure of the quality of evidence but of the coherence of the story the mind has managed to construct."

In other words, most people will find it least stressful most of the time not to think long and hard about the economic and financial complexities swirling all about them, but will instead try to fit what is happening in the markets into a relatively simple formula—most often, one with one clear cause and one obvious effect.

Thus, for example, people who fled equity porfolios during and even long after the Great Panic will—while contemplating the S&P 2,000, a level perhaps twice more what it was when they sold—find it painful to conclude, "I panicked, and I know I shouldn't have. I let an extreme emotion override my long-term plan. I can see clearly now, with companies' earning dividends and cash flows making new record highs, that I made a critical mistake, and that I must now deal realistically with repairing it, to the extent that I can."

They are in my experience, far more likely to say, "This stock market bubble has been grotesquely inflated by the Fed's zero interest rate policy; as soon as interest rates start rising again, Cinderella's golden coach will turn back into a pumpkin, and the whole fiction will collapse."

That there is not a scintilla of evidence that Fed policy has had any direct effect on stock prices is not material to this construct. Nor, for that matter, is the fact that record earnings, cash flows, cash positions, dividends and share repurchases are the undeniable fundamental forces bearing equity prices to their current record levels. As the good doctor said, it ain't the quality of the evidence, it's the *coherence of the story.*

Just the other day, on this very subject, I came across a most amusing factoid. From March 2009 (the panic bottom of the equity market) through January 2013, the S&P 500 (with dividends) gained 150%. This is the period most vividly recalled by most investors as **The Great Recession.** The Index gained the exact same amount from 1996 to 2000—a period remembered as **the greatest bull market of all time.**

Thus the frame of reference we use to understand the experience we are having is quite often not the "reality" of the economic/financial/market situation, but ***the one we ourselves have brought to that situation.***

S&P 500 Returns As Of July 31, 2014		
Time Frame	Annual Performance	Historical Rank
5 Year	16.70%	Top 20%
10 Year	8.00%	Bottom 30%
15 Year	4.50%	Bottom 7%

Performance rankings since 1928. Source "A Wealth of Common

Here's another example. When you look at the current equity market, does it strike you as wildly inflated past any acceptable level of valuation, and cruising for a bruising? Or do you see it as simply a continuing reversion to the mean—the long, slow completion of an agonizing period of substandard equity returns, with a great deal further to go in order to rise to their long-term return trendline?

As you see, whichever answer you picked is right, because they both are ***depending entirely on the time horizon over which you chose to frame the question.***

If your time horizon was five years, you will almost certainly have long since concluded that this market is ingesting a controlled substance. At ten years, you most probably thought something along the lines of "Well, not dirt cheap anymore but certainly not historically out of line—or even quite *in* line, for that matter," And at fifteen years, you may have had to be physically restrained from backing up the truck. (That is, unless your pre-packaged conceptual framework is "It's different this time," in which case you have my permission to stop reading this essay, because it's wasting your time, in that it cannot do you any good.) In the end, your conclusion depended entirely on your framing of the question.

Which brings me at long last to the title, if not quite the larger subject, of this essay. To wit: why do they keep calling this a rally?

You see, there is an unindicted co-conspirator in most people's proclivity to process the financial experience they are having through the filter of the least painful (but marginally coherent) story. It is, of course, financial media, which daily serve up an entire menu of cognitive shortcuts which (a) offer an easy simplification of complex and even sinuous causes and effects, and (b) do so largely through the use of code words. One of my favorites is their universal description of the great secular upsurge in equity values as a "rally."

The equity market, with dividends reinvested, has tripled its lows of March 2009, with only one correction worthy of the name—the 19.2% decline of 2011—in the entire five and half years. Inevitable as this probably was—the recovery always mirrors, in trajectory and velocity, the decline preceding it—it has proven deeply offensive to financial media, flouting as it does journalism's negativity narrative.

Thus, the pejorative "rally."

I may be reading too much into this, and/or overreacting to it. (Where journalism is concerned, these are my default positions.) But I'm going to leave this one up to you. For the next five trading days, I invite you to record the number of times financial media use the word "rally" to describe the prevailing equity market environment.

At the same time, record the number of instances in which you read/hear ***any variation whatever*** on the concept "this long-rising powerful, great bull market."

No need to advise me of your findings. I already know.

Some people find it easy to imagine unseen webs of malevolent conspiracy in the world. As we know from the news, they are not always wrong. But there is also an innocence that conspires to hold humanity together and it is made of people who can never fully know the good that they have done....Good teachers are a part of that benevolent conspiracy. Over the years, each good teacher redirects hundreds of lives.

A PERCEPTION OF WEALTH

A man with a very successful career, who'd made a lot of money, took his young son on a trip to the country to visit some family members who lived on a farm. "Now I just want you to know that they are very poor and don't live the way we do," the man told his son before they arrived.

They stayed with the family for several days. The boy seemed to thoroughly enjoy his time on the farm, even pitching in and helping with some of the chores.

After they'd returned to their home in the city, the two were eating dinner on the patio by the pool, and the father asked the son, "so what did you think about life on the farm?"

"I really like it," the boy said, "but why do you say they are poor?"

"Well, they don't have very much money," the father explained. "And they certainly don't have nice things like we do. Just consider these lights as an example," the father said as he pointed to the special outdoor lights that were all around the patio.

The boy frowned in confusion at his father. "They don't have these lights there, but they have the sky full of stars."

"We have this swimming pool," the boy said, "but they have a stream that flows into a lake!"

"We have a wall around our property, but they have so much land that they can't even fence it off."

"We buy the food we eat, but they grow everything they eat and sell the rest."

The boy continued to scan his surroundings for comparison, then he finally asked his father, "How much money do you need to have to be rich?"

The father was left speechless by the wisdom of his son.

Adapted from the Moral Stories website

Two service technicians working for the gas company conducted an ongoing rivalry to break up the monotony of their jobs. One day, as they went around to the back of a house to read the meter, the woman who owned the house idly watched them from her kitchen window.

When they finished their business, the two technicians decided to race back to the truck—and so burst into a run. As they reached their vehicle, they were surprised to see the woman from the house close on their heels. "What's wrong?" one asked.

She panted, "When two gas men run from my house, I figure it's time for me to run, too!"

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