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Investing at market highs

05 April 2024, 10:57 am CEST, written by Daniel Kalt

Even though it may seem counterintuitive, a new record high does not necessarily mean that the market is overvalued or that a correction is on its way. However, it can still be worthwhile for investors to remain disciplined in market phases such as this.

If you are the kind of investor who starts to feel a creeping sense of unease when the stock markets register new record highs week after week, then I can empathize with you. However, looking to get out now out of fear would be the wrong response. Investment decisions made based on a gut feeling very often prove to be less than successful. Firstly, the facts should be considered as objectively as possible, while some basic principles of investment should be taken into consideration.

In the past, equity markets have often risen even further after reaching record highs. This has particularly been the case in phases when global economic growth has been robust or even accelerated further. Even though it may seem counterintuitive, a new record high does not necessarily mean that the market is overvalued or that a correction is in the offing. In fact, over time, markets can often reach further new highs. For instance, data from the S&P 500 index between 1950 and 2023 shows that after reaching a new high, the performance over the next one, three or even five years was not much lower than it was starting from points in time when no new high had been reached. This means that reaching a new record high in itself is by no means an indication that future performance will be poor.

What points toward a continued bull market at present is the fact that the rally, which was originally driven only by the big tech stocks, has become more broadly based over the past few weeks, and the rising market is increasingly also supported by small- and mid-caps as well as value stocks. New highs also often boost investors' confidence, which can bring new investment to the market. This psychological factor, which is often referred to as the momentum effect, can lead to lasting bull markets even after new highs have been reached.

It also goes without saying that during periods in which the markets are racing from one record to the next, considerable volatility may arise as a result of unexpected geopolitical events—which underscores the importance of a broadly diversified

investment strategy. Furthermore, valuation metrics should not be neglected. Even if the market continues to climb after reaching new highs, valuations that are significantly above their historical average may signal a heightened level of risk. A comparison between the current rally and the bull market seen at the turn of the millennium shows that the three US stocks with the highest valuations in 2000 (Cisco Systems, Oracle and Microsoft) showed a price-earnings ratio at the time which was double that of the three stocks that currently show the highest valuations (Ely Lilly, Amazon and Microsoft). At the same time, the return on equity for the three most profitable US stocks at present is three times higher than for the three most profitable stocks in 2000. Current valuations, even for US tech stocks, are a long way from being as excessive as they were at the height of the dotcom bubble. We therefore recommend optimizing the exposure to tech stocks, while at the same time making sure of a sound level of diversification in quality stocks beyond the tech sector. Equally, select small- and mid-caps should be added into the mix, and income-generating strategies as well as capital-preservation structures may also be considered.

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