2020 October Market Outlook

Because of the uncertainty of the global health and financial crisis and now the elections make valuing this market difficult. Because of the uncertainty, I suggest readers focus on the technicals, price action of the market section.

Some analysts are calling this a K shaped recovery where certain sectors are growing/improving, but some are struggling. The technical section provides some examples.

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Bullish Case

- The market has had a bullish bias for about the last four years. It tends to rally despite bad economic and business conditions. Some of the reasons for the bullishness is listed below.

- Trillions of dollars in liquidity, relief, financial aid

- Most recessions are exacerbated by a credit crunch. With all the liquidity from the Fed, we may avoid a credit crunch this recession. The bond markets have stabilized.

- The Fed has stated several times that they will do all they can to help the economy. The Fed has the economies and investors back.

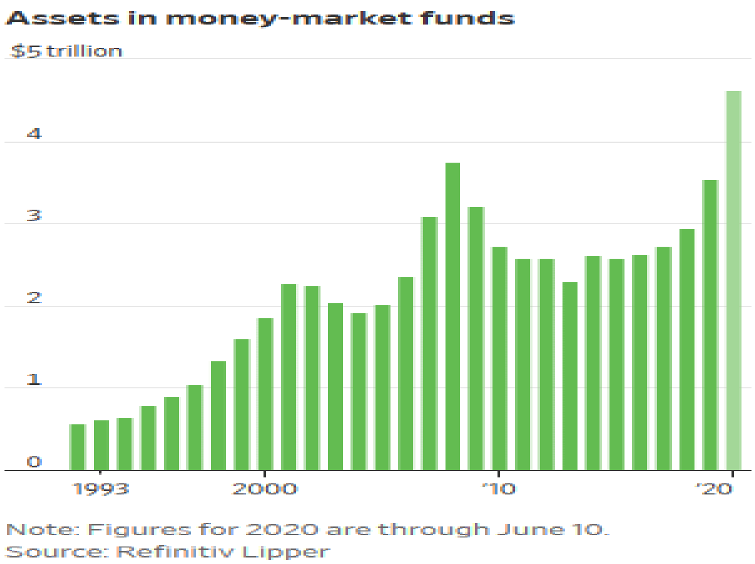
- Low-interest rates have allowed some homeowners to refinance their homes and the extra cash is spurring spending helping the economy.

- Low oil prices and less driving is saving consumers money

- Certain parts of the economy are doing well: housing, autos, online shopping, technology.

- Health experts are confident there will be a vaccine by late this year or the first half of next year. There are many biotechnology, pharmaceutical companies, universities, and countries around the world working on a vaccine, treatments.

- Money market assets are increasing, potential fuel for the markets. Many investors use money markets as a parking place for their money until they find the right investment opportunities.



- For the past 10-years, investors have learned to buy on the dips.

- There are lots of investors like me that need to get invested for the next bull market cycle. There are many sectors in the economy that are in bear markets and are bargains for those willing to take a risk. Investing is about taking intelligent risks. If an investor takes no risk, they can expect little reward.

- There are trillions in 401ks, and these investors will probably not sell because of target funds.

- There is more money managed by financial advisors and they're telling their clients not to sell.

- Investors need to start positioning themselves for the next bull market and economic cycle.

Bearish Case

- The global health crisis must be resolved before a broad, healthy economic recovery can be sustained.

- We have not recovered from the first wave of infections. We are seeing a second wave in Europe and health experts are expecting a second wave here in the U.S. during this cold and flu season making. This could delay sustained economic growth. The market has not factored in a second infection wave. We are starting to see spikes in infections across the country.

- The electoral college could make the election in November close and will come down to a few states. Both Democrats and Republicans have hired dozens of lawyers and thousands of volunteers to challenge the results of the election that could wind up in the courts for months. The markets have not factored in a contentious election.

  Also, President Trump and Republicans have tried all sorts of questionable tactics to win: trying to find dirt on V.P. Biden in Ukraine; because of the fear of the virus many voters plan to vote by mail and Trump installed one of his donors to manage the post office to cause problems with mail-in voting; floated the idea of postponing the election; helping Kayne West become a candidate in certain states to siphon votes from blacks and young people; in Texas, reduce the amount of election ballot boxes; in California, Republicans have installed "unofficial" ballot boxes; the New York Post and Rudy Guilliani are claiming that V.P. Biden and his family are using VP Biden's position to enrich themselves about two weeks before the election. None of these actions aren't working so expect more dirty tricks.

  Determining who the next President could take months, this could do damage to consumer, business, and investor confidence, as well as the economy, and markets.

- If the Democrats win, there could be major economic changes. Traditionally Democrats are focused on the consumer, workers, and the environment. Republicans believe in small government and taxes and are pro-business. The markets have not discounted these potential changes if the Democrats win the Presidency, and especially if they win the Senate.

- We don't know how much U.S. and global economic damage will be done because of this pandemic. So far it's been terrible. Parts of the market are reacting as though there is no damage, risk, and uncertainty.

- I keep hearing from commentators on the financial cable channels that all the liquidity will hold up the markets. Some of the money will be loaned to hedge funds, private equity, and venture capital, and I'm sure some of the big money center and investment banks will lend to their investment departments, so some of the Fed's liquidity will flow into the markets. No one knows how much of the Fed's liquidity will wind up in the U.S. equity markets. The liquidity was not meant for stock speculation.

  The liquidity provided by the Fed was meant to shore up the repo market (short-term operations by financial institutions), targeted areas of the bond market, and money to the treasury that could get to the banks and other lenders to loan to small businesses and corporations. Because the bond and money markets have stabilized so have the equity markets.

- The markets have celebrated all the relief, aid, and liquidity released into the economy and financial markets. The reason why there is so much money released into the economy is high unemployment, small businesses, and many low-income consumers are struggling, the economy is in a recession, and there is lots of uncertainty that will take lots of relief, aid to get to the other side of this pandemic.

- There is too much uncertainty:

  If and when, will there be a vaccine and treatment

  When will the recession end (the recession was officially declared in February)

  How bad will unemployment get

  When will the global economy recover

  How bad will earnings be

  When do earnings recover

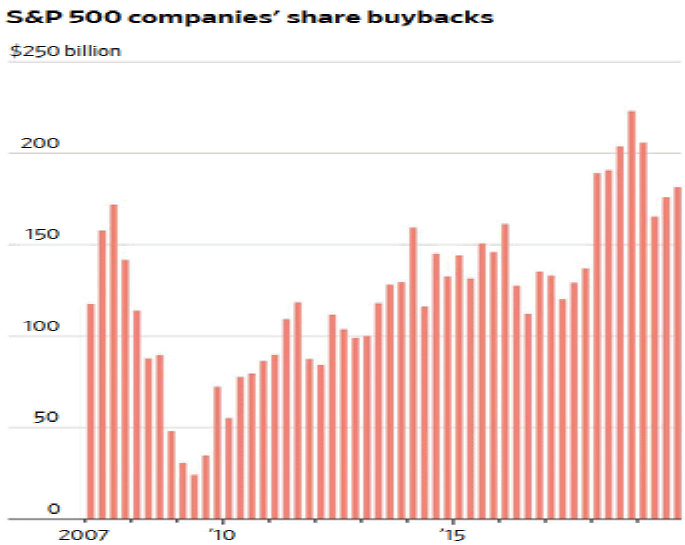
  Will inflation come back or stay low because of all the liquidity unleashed by the Fed and lawmakers. We are starting to see high food inflation. Supply disruptions questions could cause price increases.

  Who will win the election? How much will economic policies change

  How will all the debt that the government businesses and consumers have taken on will impact future growth…

- The S & P, Dow 30, and the NASDAQ are all overvalued

- Fewer buybacks



Source: WSJ

Companies buying back their stock was good for stock market performance for much of the last bull market. This year with a weaker economy and company cash flow, companies are buying back less stock.

- Companies, federal, state, and local governments have too much debt and will probably be headwinds in the future.

Valuations

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Below are the earnings and growth rates for the S & P:

Year	*S&P 500*	*Earnings*	*Earnings Growth*
2015	2043.94	100.48	
2016	2238.83	**106.26**	
2017	2673.61	**124.51**	17.17%
2018	2506.85	148.34	19.14%
2019	3230.78	*162.35*	9.44%
2020	ERN 4CST	130	-19.93%
Cummulative Growth			**25.83%**

The cumulative earnings growth rate from 2017 to 2020 is 25.83%. Normally prices will reflect growth rates. In 2017, the market started at about 2250 and is currently around 3300. This is about a 47% return, more than the 26% increase in earnings. The market has gotten ahead of itself.

Earnings estimates for 2021 is about 165, about the same amount in 2019. If we multiply the historical P/E, 16, times the earnings estimate will give us a value of about 2640. The forward P/E at the current price is about 20, the market is overvalued.

Below is a table that shows stocks that are overvalued and undervalued:

COMPANY	PRICE/SALES	PRICE/ERN	DIVIDEND	CURRENT PRICE	52 WK LOW	52 WK HIGH	DOWNSIDE	UPSIDE
		OVER VALUED DOWNSIDE RISK UPSIDE POTENTIAL					CURRENT PX VS HIGH	CURRENT PX VS LOW
WAYFAIR	2.43	NOT PROFITABLE	0	$ 297.00	$ 21.70	$ 349.00	92.69%	17.51%
ZOOM	122	172	0	$ 554.00	$ 60.92	$ 588.00	89.00%	6.14%
PELOTON	15.89	344	0	$ 133.00	$ 17.70	$ 139.00	86.69%	4.51%
		UNDER VALUED DOWNSIDE RISK UPSIDE POTENTIAL						
ATT	1.13	8.55	7.55%	$ 27.00	$ 26.08	$ 39.70	3.41%	47.04%
EXXON	0.68	LQDTN VLU	10.38%	$ 33.74	$ 30.11	$ 73.13	10.76%	116.75%
VIACOM CBS	0.65	6.02	3.47%	$ 27.71	$ 10.10	$ 43.04	63.55%	55.32%

Let's review the table:

- The first column is the price to sales ratio, how much are investors willing to pay for a dollar of sales. Investors are paying $122 for a dollar of sales for Zoom and only 65 cents for Viacom CBS, symbol VIAC.

- The second column is the famous P/E, how much are investors paying for a dollar of earnings. Wayfair does not have earnings, so valuations are difficult to determine making Wayfair speculative and overvalued. Investors are only paying $6 for a dollar of earnings for VIAC. The stock is undervalued.

- The third column is the dividend. The first three stocks are called the covid, stay at home stocks, and have become a trader favorite. These stocks don't pay dividends. All three undervalued stocks pay above-average dividends.

- The last column shows how far a stock is from its high. It's possible during the next bull market these stocks could reach their old highs. The undervalued stocks probably have the most upside potential if they can reach their old highs.

- The second to last column shows how far the stock price is from its low. The undervalued stocks are close to their lows, so most of the risk is out of these stocks. The overvalued stocks are the most above their lows and potentially have the most downside risk.

If your involved in stocks that are overvalued, you need to understand the risk you are taking, especially your downside. These are speculative and may be ok for trading, but may not turn out to be good long-term investments. There are many stocks available similar to the second group that are undervalued, pay a high dividend, and have better long-term potential.

Technical/Price Analysis

Below is a year-to-date chart for the S & P:

Here are the important points of the above chart:

- The market had a dramatic fall in March, but the market was able to gain it back in about 5 months despite all the bad news (global recession, contracting earnings, the covid crisis is not improving, millions unemployed) in the past and probably going forward.

- The market has been going sideways for about the last two months.

- Normally, by November the market will start gravitating toward the prospects for the next year, as most things are factored into the current year by November. Next year will probably be much better than 2020, a year that most of us would like to forget and put behind us.

- Because of the current wave of increased infections and elections, at best the markets may go sideways. If things get worse prices could break below 3200 and establish a new lower trading range.

There are about 20 stocks that look like the Zoom chart below:

Zoom has become a favorite among consumers, businesses, and traders. The stock started the year at about $70 and is currently around $520, up about 650%. Growth has been good, but the stock kept accelerating (from a black trendline to the dashed trendlines). Prices did break the upward trend and it looks like it is finally topping. The chart and valuations are risky.

Again, stocks like Zoom are favorites among traders. Investors like me are more interested in investing in companies that: pay an above-average dividend, they grow the dividend at least 3% a year, have a payout ratio less than 60%, are in bear markets but could return to their old highs in a few years. I'm finding many stocks like this to invest in.

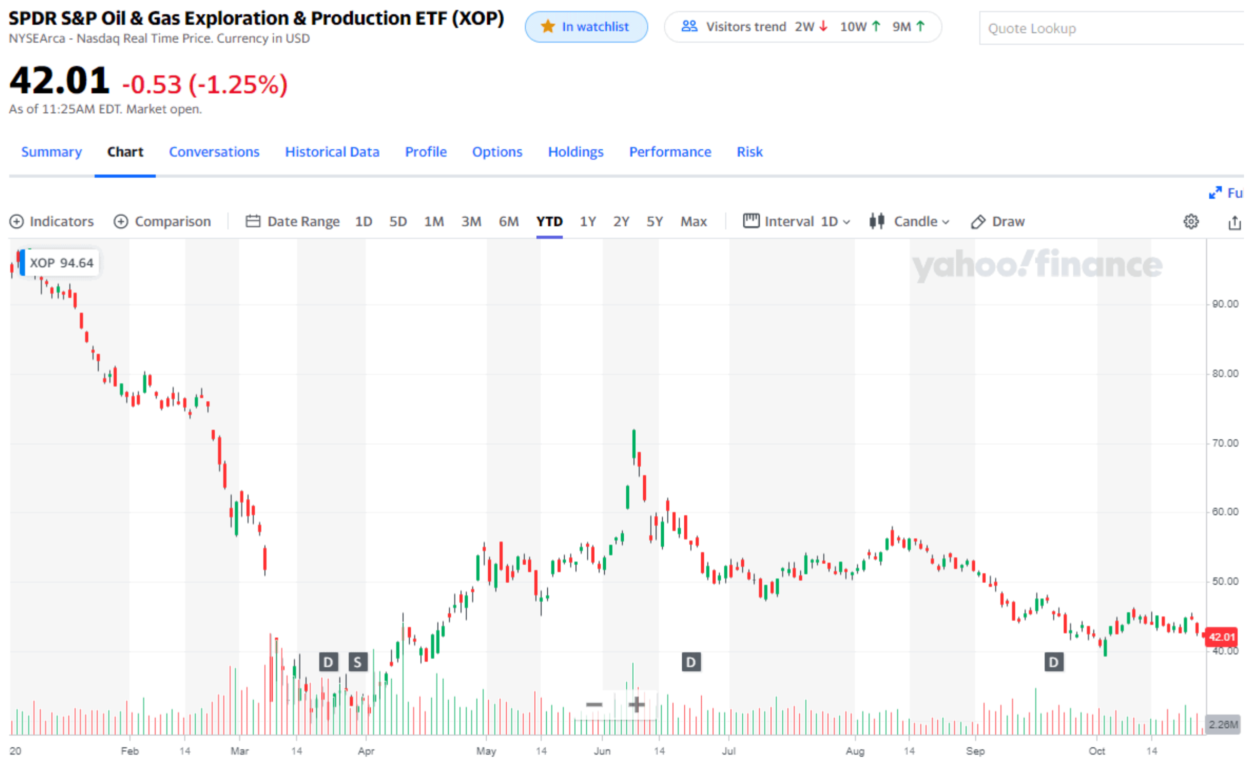
We can not have a full recovery without banking and energy and they reflect the problems in our economy.

Below is a chart of the banking ETF:

The banking index and most banking stocks look like a traditional bear market that are basing (have bottomed and are trading sideways, waiting for improvements in the economy). As I've written before basing periods are like diving boards, the longer the board the better the bounce. Most banking stocks are building long bases.

Energy also reflects an economy that has not recovered. At low oil prices, most energy companies will not be looking for oil. The low capital spending looking for and producing oil could cause energy shortages causing oil prices to move back up. For patient investors, this could be profitable long-term. Also, many energy companies pay more than a 5% dividend.

Below is a chart for the oil exploration and production ETF:



XOP is basically basing. Because of the weak global and domestic economies and other factors oil prices have fallen, this is causing energy companies to have another leg down with the potential to test the March lows.

I'm more interested in these investments and others that are undervalued have found their bottoms and are basing, pay a good dividend, and over time have the potential to go back to their old highs.

Psychology of the Market

As mentioned in the bullish section, the market has a bullish bias.

Until recently the market believed: the President would be reelected, the economy would reopen and we would have a v-shaped recovery, we would have a vaccine by the end of the year.

Currently, a Biden win is expected and this could mean: a plan to beat covid, have more aid/support for the unemployed, small business, state, and local governments, and infrastructure spending. A vaccine may be approved for front line workers and the elderly by the end of the year. A vaccine for the public may be available by the first or second quarter of 2021.

For now, the market is volatile and cautious as we approach election day. It's understood that the winner of the election could take weeks to determine because of the increase in mail-in voting, and lawsuits.

Summary and Conclusion

For about the last four years, the market continues to have a bullish bias despite:

- We're in a recession
- Millions are unemployed
- Lawmakers have not passed a much-needed support/aid bill
- Uncertainty regarding earnings
- Uncertainty regarding if and when there may be an effective safe vaccine
- Elections could be very disruptive, mayors and governors are preparing for riots, demonstrations, the courts have been busy with lawsuits
- We are currently experiencing another surge of infections. This new wave of infections could continue to delay a sustained full recovery.

We will probably have an eventual, full, sustained recovery once we get past the health crisis.

- Some analysts are calling this a K economy. Certain sectors are fine and growing and some sectors are struggling.

Certain stocks are crowded, overvalued, and are risky. The risk-reward potential is not favorable.

Certain stocks look like typical bear markets: they have found a bottom, are basing. This is the area of investments that I'm interested in, especially if these stocks pay an above-average dividend that grows. As in most bear markets, these stocks do go back to their old highs and many go higher. The risk-reward potential is attractive.

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If you need help adjusting your portfolio to new bull market and economic cycle, you can contact me at danhassey@yahoo.com.